

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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**REPLY COMMENTS OF THE  
OFFICE OF CONSUMER ADVOCATE**

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Tanya J. McCloskey  
Senior Assistant Consumer Advocate  
David T. Evrard  
Assistant Consumer Advocate

For:  
Irwin A. Popowsky  
Consumer Advocate

Office of Attorney General  
Office of Consumer Advocate  
555 Walnut Street 5<sup>th</sup> Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048

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## **I. INTRODUCTION**

The Office of Consumer Advocate (“OCA”) offers these Reply Comments in response to the Comments submitted to the Pennsylvania Public Utility Commission (“Commission”) by interested parties in the Commission’s Proposed Rulemaking on Electric Distribution Companies’ Obligation to Serve Retail Customers at the Conclusion of the Transition Period. The Comments of the interested parties were submitted April 27, 2005, pursuant to the terms of the Commission’s Proposed Rulemaking Order, published February 26, 2005 in the Pennsylvania Bulletin. The OCA reviewed comments submitted by PECO Energy Company (“PECO”); PPL Electric Utilities (“PPL”); Allegheny Power (“Allegheny”); UGI Utilities, Inc. - Electric Division (“UGI”); Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (“Met-Ed/Penelec/Penn Power, collectively, The FirstEnergy Companies”); Duquesne Light Company (“Duquesne”); Citizens’ Electric Company and Wellsboro Electric Company (“Citizens’/Wellsboro”); Pike County Light & Power Company (“Pike”); Direct Energy Services, LLC (“Direct Energy”); Dominion Retail Inc. (“Dominion Retail”); Strategic Energy, LLC (“Strategic Energy”), Reliant Energy, Inc. (“Reliant”), National Energy Marketer Association (“NEMA”); Mid-Atlantic Power Supply Association (“MAPSA”); Morgan Stanley Capital Group, Inc. (“Morgan Stanley”); Amerada Hess Corporation (“Hess”); Office of Small Business Advocate (“OSBA”); Industrial Energy Consumers of Pennsylvania (“IECPA”); PJM Interconnection, LLC (“PJM”); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc (“Constellation Energy”); First Energy Solution Corporation (“FES”); Richards Energy Group, Inc (“Richards”); Department of Environmental Protection (“DEP”); Energy Association of Pennsylvania (“EAPA”); David M. Boonin (“Boonin”), and Allegheny Conference on Community

Development (“Allegheny Conference”). In these Reply Comments, the OCA will not respond to all individual arguments of the parties, but will address general issues raised by the parties.

As an initial matter, the OCA would note that the Commission’s proposed Rulemaking Order, because it is establishing policy in a brand new area of law, contained many issues deserving of comment and indeed, the parties diligently and thoughtfully offered their views on this broad range of issues. What the OCA finds noteworthy, and what it urges the Commission to take special notice of, is that despite the array of issues raised by the rulemaking and the significant number of parties who commented on it, there exists substantial agreement on several of the most fundamental issues between the parties representing those who will pay for default service (OCA, OSBA and IECPA) and those who will provide that service, the electric distribution companies (“EDCs”). This convergence of interests between two of the primary groups affected by this rulemaking should be of considerable significance to the Commission as it deliberates on the design of its final-form rules.

Among the areas on which there is substantial agreement between the “payors” and “providers” of default service are the following:

- Default service should be provided by the EDCs.
- Procurement of default service supply should be accomplished through a competitive process in the wholesale market.
- Default service rates for residential customers should be characterized by stability, not volatility.

The EDCs and OCA are also in agreement regarding the following:

- That the proposed Generation Supply Charge should be made a reconcilable per kilowatt-hour charge to, among other things, facilitate compliance with the requirements of the Alternative Energy Portfolio Standards Act.

- That the proposed Generation Customer Charge should be eliminated as unnecessary, complicated and potentially confusing to customers, and that the cost items to be recovered by that charge should generally remain a part of distribution rates.

The OCA urges the Commission not to underestimate the significance of agreement in this proceeding. The issues in this rulemaking are controversial and potentially divisive. To find substantial accord on a number of critical points between those who will pay for default service and those who will provide it should, at the very least, be instructive to the Commission as it contemplates how to proceed in its final-form rules on default service. The OCA would also note that with respect to residential customers, other commenters also supported stable default service pricing as appropriate and that the prices should be understandable and easy to compare with those of competitive suppliers. See, e.g., DEP Comments at p. 1.

Where the OCA differs from a number of other commenters is in their call to expose residential customers to excessive, volatile and unreasonable prices for default service. The OCA urges rejection of all such proposals. In its Comments, the OCA proposed a method by which residential customers would be able to obtain reasonable and stably priced default service. Specifically, OCA proposed that EDCs meet their default service supply obligation by competitively procuring a portfolio of short and long term supply contracts such that only a portion of the portfolio would have to be replaced in any given year and price changes to customers (which would occur on an annual basis) would be correspondingly modest. A number of parties have argued, however, that default service prices, even for residential customers, should be tied to prices in the short-term wholesale energy market and should be adjusted on a monthly or quarterly basis. See, NEMA Comments at p.7; Direct Energy Comments at pp. 12-

13. These are the very types of proposals the OCA urges the Commission to reject. Such proposals will introduce unnecessary and unwelcome volatility into the pricing for residential customers. As the OCA has consistently maintained, use of the phrase “prevailing market prices” in the Competition Act does not demand or even suggest exclusive focus on the spot or short-term wholesale energy markets. The wholesale market provides a variety of products, both long and short term, and it is important to consider all aspects of that market, as the OCA does with its competitive portfolio approach and resultant pricing, rather than focus exclusively on the short-term energy market and use it as the sole basis for determining the price of default service.

The OCA also urges the Commission to reject all proposals that would limit or eliminate the EDCs’ role as the default service provider. Several commenters have proposed a “retail default model” under which the entire default service provider function is auctioned to one or more electric generation suppliers (“EGSs”). See, Direct Energy Comments at pp.3-9; Dominion Retail Comments at p. 10; Strategic Energy Comments at p. 2; NEMA Comments at pp. 3-5; Reliant Comments at pp. 17-19. One commenter has proposed that a date be set by which EDCs will no longer provide default service and at which point such service would be provided by EGSs. NEMA Comments at pp. 3-4. In response to these proposals the OCA first notes that under the Electric Competition Act, a customer does not have to leave his or her EDC in order to get access to competitive generation. A customer can receive such benefit when the EDC purchases generation on the customer’s behalf in the competitive wholesale market. The purpose of the Act was not to force customers to switch retail providers for the sake of switching, but to bring lower rates to customers as competitive forces lower the cost of generating electricity. The OCA would further note that no other state in the PJM region has adopted the “retail default model” proposed by the commenters. Indeed, the “wholesale default model”

advocated by all of the consumer and EDC commenters in this proceeding has now been adopted in New Jersey, Maryland, Delaware, and the District of Columbia. Finally, it should be recognized that Pennsylvania's previous attempt at pursuing this type of approach (the assignment of a portion of PECO Energy's customers to a competitive default supplier) was a decided failure.

The arguments advanced in favor of the "retail default model" – that it will bring greater value to consumers, promote reliability, and promote greater energy diversity and economic development – could all be equally true of a system that uses incumbent EDCs acquiring power in the competitive wholesale markets as the default suppliers. As noted above, the Commonwealth's EDCs have unanimously indicated their willingness to provide this service.

It is simply a reality that EDCs will continue to be called upon to step in as the "last resort" when other entities fail. Indeed, one of the proponents of the "retail default model" essentially acknowledges this in its comments when describing the continuing role of the EDC as "to meter the service and be responsible for physically terminating a customer's service, as well as retail back-up service for short-term energy replacement." See, Direct Energy Comments at p. 7 (emphasis added). The Commission has appropriately assigned the default supply responsibility to the EDCs. It is an arrangement customers are used to. It will require no significant investment in further customer education. If done in accordance with the OCA's recommended portfolio approach, EDCs will be able to supply reliable, reasonable, and stably priced electricity to residential customers. In short, there is no compelling reason for the Commission to deviate from the path it has chosen. The EDCs should serve in the role of default suppliers.

The Commission should also reject any proposal to implement a “Texas-style” default service model in Pennsylvania. Given recent experience in Texas, this is no model to be emulated. A May 20, 2005 article in the Wall Street Journal<sup>1</sup> reported on a study which found that the default prices of Texas’ residential customers have jumped, on average, some 43% between January 2002 and October 2004. This is in contrast to a 17% increase (over the same time span) for customers of Texas utilities that have not undergone restructuring and are still charging traditional cost-based rates, and a 9% increase for customers of the state’s rural electric cooperatives.

According to the article, the state’s largest default supplier, TXU Energy Retail Co., has increased its regulated default service rate six times since early 2002, with the most recent increase equaling 9.9%, its second largest increase ever. Rates of the second largest default supplier, Reliant Energy Inc., have increased 41% since 2002 and are now set at 12.8 cents per kilowatt hour. Under Texas’ system, default service providers can ask for price increases twice per year based on the wholesale short term price of natural gas without any obligation to demonstrate the impact of that wholesale market index on the actual generation portfolio of the service provider. As natural gas prices have climbed steadily, so too have the default service rates, reaching today’s very high levels. Additionally, while Texas has seen extensive shopping for competitive supply among large electricity users, there has been a far lower level of switching activity for residential customers. Only one in five residential customers has switched away from their default supplier. Given such facts, there is every reason to be cautious about adopting any form of the Texas default service model in Pennsylvania. Indeed, no other PJM state has adopted the Texas model. The OCA firmly believes that the

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<sup>1</sup> Rebecca Smith, “Texas Electricity Deregulation Hasn’t Aided Small Power Users”, Wall Street Journal, May 20, 2005, at A2.



process the Commission laid out in its proposed rulemaking holds much greater promise of delivering reasonable and affordable electricity supply to the Commonwealth's households. The OCA strongly encourages the Commission to adhere to its current path.

The OCA urges the Commission to adopt default service regulations that will provide residential customers with the continuation of stably priced and affordable electric generation service. Many of the elements for achieving this already exist in the Commission's proposal and the OCA has offered modifications in its Comments to assist in achieving this goal. If in formulating its final-form regulations the Commission is guided by those areas in which the providers and payors of default service are in agreement, and if it rejects those ideas that would radically alter what it has previously proposed to the detriment of consumers, the Commission will be well on the way to adopting workable default service regulations that will achieve the goals of the Competition Act.

These reply comments will now individually address a number of key issues.

## **II. SPECIFIC REPLIES TO ISSUES RAISED BY THE COMMENTS**

### **A. Role of the EDC: Retail vs. Wholesale Default Service Function**

As discussed in detail in the OCA's Comments, the OCA strongly supports the Commission's proposed regulations that require the EDC to serve as the default service provider. The OCA just as strongly urges the Commission to reject recommendations that the "retail default model" be adopted. The adoption of such a model introduces no efficiencies and provides no competitive benefits. If anything, it introduces additional costs and concerns. For example, when considering whether to adopt a "retail default model," one must determine the EGSs' capacity to perform the entire range of retail functions – customer care, billing, collection and metering – in a cost-effective manner. It is very likely that the EGSs' costs to perform these functions will be higher than (or duplicative of) the costs of the EDC systems that are already in place. The EDCs are currently performing the billing and collection function for all residential and small commercial customers for both distribution and generation service. While several EDCs have given the option to EGSs to provide consolidated billing and collection functions for residential customers, no EGS is doing so at this time. The same is true in other PJM states where EGSs either do not market to residential customers or, where they do, they have elected to have the EDC handle billing and collection for both generation and distribution service.

Additionally, the EDC will always be required to step in as the "last resort" if the EGS fails or the term they agreed to ends. EDCs cannot simply eliminate such functions since the EDC must always be ready to serve. This results in a duplication of functions and costs. As the OCA recommended in its Comments, the "retail default model" should be rejected.

In their Comments, several retail marketers or marketer organizations supported adoption of the "retail default model." See, Direct Energy Comments at pp.4-9; NEMA

Comments at pp.3-4; Reliant Comments at pp. 17-19; Strategic Energy Comments at p. 2; Dominion Retail Comments at p. 10. NEMA suggested that the Commission set a date certain by which EDCs must exit the merchant function, changing their responsibility from that of an obligation to serve to an obligation to deliver. NEMA Comments at pp. 3-5. Reliant Energy suggests something similar, calling for the default provider role to be assumed by a competitive affiliate EGS of the EDC. Reliant Comments at pp. 17-19. Direct Energy proposes that the Commission bid out the default service function to one or more EGSs. Direct Energy Comments at pp. 4-9. All three approaches appear to require a Texas-type market structure for Pennsylvania. The Texas model, however, is unique. No other state has approached electric restructuring in the same way. Pennsylvania, for example, did not mandate the divestiture of generation or the structural separation of current EDC functions, as Texas has done. Superimposing the Texas model on Pennsylvania's structure is not a workable solution. As noted earlier, Texas' residential customers have seen substantial increases in their default service rates since the advent of restructuring in January 2002. This is directly contrary to the type of default service rate stability the OCA recommends for the Commonwealth's residential customers. In addition, the OCA notes that the "retail default model" has been considered and rejected in all of our neighboring PJM jurisdictions, notably Maryland, New Jersey, the District of Columbia, and most recently, Delaware.<sup>2</sup>

The commenters supporting the "retail default model" also urge the Commission to adopt a default service pricing approach that will lead to volatile, unpredictable prices for residential customers. For example, Direct Energy wants to provide consumers "with prevailing

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<sup>2</sup> Delaware PSC, Re: Provision of Standard Offer Supply to Retail Consumer in the Service Territory of Delmarva Power and Light Co., Docket No. 04-391, Order No. 6598, March 22, 2005. The PSC rejected the "retail model" which would have chosen the standard offer supplier pursuant to a competitive solicitation, but instead approved an approach that will rely on the wholesale market for the competitive acquisition of standard offer supply by the utility.

market prices through monthly pricing.” Direct Energy Comments at p. 11. NEMA proposes a “monthly adjusted, market-based rate.” NEMA Comments at p.7. Reliant Energy’s approach is its “Market Responsive Price Model” in which prices for residential customers would change 2-3 times per year based on an external wholesale market index, similar to the Texas model. Reliant Comments at p. 10. All of these proposals have the potential for significantly degrading the provision of essential electric service to residential consumers as well as the potential to create a backlash that will threaten the public’s acceptance of industry restructuring.<sup>3</sup> Furthermore, such an approach is likely to result in higher prices due to the significant transition costs associated with such radical change.<sup>4</sup> One can also anticipate the dissatisfaction that would result among residential customers as they face volatile price changes with little ability to significantly change their consumption in response to those prices.<sup>5</sup>

For the reasons set forth above, and for the reasons set forth in the OCA’s Comments at pp. 30-31, the OCA urges the Commission to reject recommendations to move to a

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<sup>3</sup> The EGSs argue that the competitive marketers will provide rate stability to residential customers if there is volatile default service pricing. This argument has not been borne out by the experience in Texas where residential switching has only been about 1 in 5 customers. More importantly, this would require the Commission to find that EGSs who have no obligation to serve should be relied upon to provide an essential service to residential customers under terms that are reasonable and affordable. The Act calls for reasonable service for all customers, not just those customers who may choose to, or be able to, switch. 66 Pa.C.S. §2802(9). Default service is the means by which the Commission must ensure that this essential service is available on reasonable terms and conditions.

<sup>4</sup> These transition costs include the costs of the regulatory proceedings to consider and finalize such an approach, the additional consumer education programs that would be required to implement such a dramatic change in the provision of basic electricity services to residential customers, and the likely result that an EGS would need to replicate and charge prices for customer care, billing, and collection, that are higher than those currently reflected in the EDC rates. While the EDC prices purportedly would reflect the removal of embedded costs for such services in a retail POLR model, the assumption of these services by an EGS without the current capacity to perform those functions is likely to raise prices or result in significantly degraded customer service and service quality.

<sup>5</sup> The OCA does not suggest that customers cannot make consumption changes in response to prices. Rather, our point is that most residential customers use a modest amount of electricity for basic necessities that is not subject to significant usage discretion. This is particularly true for low income customers who, on average, use less electricity than higher income customers and whose household income is already severely strained to pay for electricity and other energy services.

“retail default model.” The Commission should continue EDCs as the default service providers and eliminate proposed §§ 54.183 (b) and (c) in their entirety.

**B. Prevailing Market Price: Definition and Policy**

The OCA supports the Commission’s overall approach to the definition of “prevailing market price” as contained in the proposed rulemaking. The definition reflects the fact that prevailing market price is realized through the procurement process included in default service implementation plans. Most commenters agreed that the statutory directive to acquire electric energy at prevailing market price can be met by pricing default service through a variety of competitive acquisition methods. 66 Pa.C.S. § 2807(e)(3). The price that results from one, or a combination, of these methods would be the “prevailing market price.” In particular, the OCA urges the Commission to consider the statement by PPL:

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

PPL Comments p. 14.

Strategic Energy, however, argues that the Commission’s proposed definition is contrary to the Electric Competition Act. Strategic Energy Comments at p. 22. Strategic’s argument is flawed. Like the other marketers, Strategic insists there is only one way to measure “prevailing market price” – by looking toward short-term or spot wholesale market indices. This

is simply incorrect. The term “prevailing” does not refer to only one type of product or service in the market. Rather, such a term must logically refer to any or all products or services available in the market. There are long-term bilateral transactions that occur in the current wholesale market. There are contract terms for service that reflect multiple years (as clearly indicated by the results of the New Jersey and Maryland wholesale market solicitations and resulting contracts for default service in those states). Indeed, there are thousands of real-time prices established every hour in PJM, as well as day-ahead, month-ahead, year-ahead and multi-year-ahead prices. The critical point is that the default service provider should build an appropriate portfolio of resources. The cost of this portfolio is the prevailing market price for providing reliable default service. Put another way, the wholesale market will deliver the products and services that the retail market demands, and the resulting prices for those services will be the “prevailing” price of the necessary products.

The OCA would reiterate its earlier concern about the suggestion that “prevailing market price” must be interpreted to mean reliance on short-term or spot wholesale market prices. Such an interpretation would doubtlessly lead to unstable and volatile rates for residential customers. As an example, Reliant Energy proposes using a Texas-style “market responsive pricing model” which, for residential customers, will permit default service prices to adjust several times a year in step with an index of wholesale market prices. Reliant Comments at p. 10. As noted earlier, this structure has resulted in Texas’ households seeing price increases on average of 43% since the advent of restructuring in January 2002, a direct result of pegging the default service price to increases in the price of natural gas, regardless of the impact of that increase on the cost to the provider. Prices for customers of Reliant Energy Inc. in Texas have jumped 41% since 2002. This contrasts to a 17% increase for customers of Texas utilities that

still charge traditional cost-based rates and 9% for customers of rural electric cooperatives.<sup>6</sup> The general approach taken by the Commission in its proposed rulemaking holds out the potential to prevent such a harmful result for residential customers in Pennsylvania. Utilizing the OCA's recommended portfolio approach for procuring default service supply, extreme price volatility can be eliminated or substantially moderated, and residential customers can realize price stability and predictability.

As set forth in the OCA Comments, prevailing market price should be the blended price of the various components of the portfolio of resources acquired by the default service provider to meet its load. See, OCA Comments pp.4-6, 29-30, 34. The price will be adjusted annually as new components are phased in, but the changes should be modest, and overall, prices should be somewhat stable. This result would clearly be preferable to models that utilize short-term pricing and result in volatile default service rates for residential customers.<sup>7</sup> The Commission should reject any proposals that try to tie prevailing market price to short-term or spot market pricing.<sup>8</sup>

### **C. Default Service Implementation Plans**

Most EDC comments, and those of the EAPA, support the Commission's position that EDCs should be permitted to develop company-specific default service implementation plans. The OCA also supported such plans given that the Commonwealth's EDCs are of distinctly different sizes, belong to different RTOs, have different service territory characteristics

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<sup>6</sup> See *supra* note 1.

<sup>7</sup> Direct Energy argues that short term pricing may not necessarily result in price volatility. Direct Energy references an "internal analysis" of the New Jersey auction results in 2004. Direct Energy Comments at 12. Direct Energy claims that there would have been a range of default service prices from 4.33¢/kwh to 6.45¢/kwh, a differential of almost 50% during the year.

<sup>8</sup> As noted by the OCA in its Comments, other states such as Maine and New Jersey that have had to address this issue sooner than Pennsylvania have moved toward multi-year "laddered" approaches to default service procurements for residential customers.

and have staggered termination dates for their transition periods. In short, what is appropriate for PECO may not be appropriate for Citizens' Electric. That said however, the OCA submits that each default service implementation plan should have the same goal with regard to residential customers – to provide reliable service at stable and reasonable rates over the long-term.

Three commenters -- PPL, OSBA and Morgan Stanley -- suggested the Commission adopt a statewide procurement process modeled after New Jersey's descending clock auction. Direct Energy also recommended that the Commission implement a "one size fits all" approach or a statewide procurement method. Direct Energy Comments at p.12. The OCA is concerned that a one size fits all approach would not be conducive to the type of portfolio management for default supply strategy that the OCA has advocated in its Comments. The OCA continues to recommend that an EDC serve the role of a portfolio manager that acquires a portfolio of resources in the competitive wholesale market to meet its load obligations. The portfolio or procurement process should be designed to provide reliable service at stable rates. It should also emphasize diversity of resources, a variety of contract terms and it should incorporate any state-mandated public policy requirements. This would include, of course, compliance with the Alternative Energy Portfolio Standards Act. Through this portfolio approach, the EDC should be able to procure reliable supply at the lowest reasonable cost.

The OCA submits that for residential customers, reliable service at stable, reasonable prices, on reasonable terms and conditions, should be the goal of default service. In Pennsylvania, where there are a number of diverse electric service territories, a procurement strategy that meets the unique needs of each particular service territory may be the best way to serve Pennsylvania consumers.



For the reasons set forth here, and in the OCA's Comments, the OCA supports the proposed regulations at § 54.185, calling for EDC-specific default service implementation plans.

**D. Cost Recovery, Rate Design and Rate Unbundling**

1. Introduction

As a general matter, the OCA submits that the cost recovery and pricing associated with default service must reflect the fact that electricity is an essential service, must only include the reasonable costs of default service, and must be understandable in order to facilitate price comparisons with products offered by competitive suppliers. The OCA is concerned that the Commission's proposed regulations would not achieve this objective. The Commission proposed three separate rates for default service – a customer charge, a non-reconcilable Generation Supply Charge, and a reconcilable charge for recovering the cost of purchases made to comply with the Alternative Energy Portfolio Standards Act. Through the customer charge the Commission proposes to collect such things as the costs for customer billing, collections, customer service, meter reading, as well as uncollectible expense, administrative or regulatory expenses, taxes and a return component. In its Comments the OCA opposed creation of the customer charge on the grounds that it was unnecessarily complicated and included costs that were not properly part of a default service rate. The OCA also opposed two separate supply charges, one reconcilable and one non-reconcilable. The OCA noted that the Alternative Energy Portfolio Standards Act, which calls for reconcilable cost recovery of complying with the Act, leads the OCA to the conclusion that a reconcilable charge must be used for default service.

Most of the EDCs were also critical of all or part of the proposed customer charge. See, PPL Comments at pp. 9-10; Allegheny Comments at pp.8-9; Duquesne Comments

at pp. 26-31; UGI Comments at pp. 9-12; Met-Ed/Penelec/Penn Power Comments at pp. 6-7; Citizens'/Wellsboro Comments at pp. 17-19. Additionally, many EDCs recommended a move to a reconcilable charge for default service. PPL Comments at pp. 6-7, 9-10; PECO Comments at pp. 5, 16; Met-Ed/Penelec/Penn Power Comments at pp. 2-5; UGI Comments at pp. 12-13; Allegheny Comments at p. 7; Citizens'/Wellsboro Comments at pp. 16-17. This approach supports the OCA's overall recommendation that EDCs be required to manage their default service portfolio, including the obligation to comply with the Alternative Energy Portfolio Standards Act, in an integrated fashion.

The Comments of the various parties raised two other issues to which the OCA wishes to respond. First, NEMA sought to require embedded cost studies and revenue requirement cases to unbundle many distribution costs that they allege should be transferred to and reflected in the default service price. See, NEMA Comments at pp. 5-6. See also, Strategic Energy Comments at p.23 and MAPSA Comments at p. 4. The EGSs seek to include in the default service rates the cost of such things as the customer call center, customer information and recordkeeping, customer agreement initiation and maintenance, customer enrollment and switching support, billing, credit and collection, revenue accounting and disbursement, uncollectibles, and EDI capability, among others. See, e.g., Strategic Energy Comments at p. 24. The EGSs seek policies that would result in higher default service prices, thus allowing them "head room" to market their services to residential customers. The OCA does not support the inclusion of costs in the default service rates that unreasonably and unnecessarily increase the price of default service.

The second issue arises from the joint Comments of Met-Ed, Penelec and Penn Power and concerns certain aspects of the reconcilable Generation Supply Charge they recommend. Of specific concern is the proposal for quarterly (as opposed to annual) adjustments to the charge and their suggested inclusion of a "risk adder" as part of the charge. Met-Ed/Penelec/Penn Power Comments at pp. 2-6. The OCA submits that adjustments to default service rates should occur no more than once per year. Additionally, there is no basis for a risk adder to a fully reconcilable, dollar for dollar, recovery mechanism.

2. Costs Included In The Default Service Rate Should Be The Reasonable Costs Of Providing Default Service.

As the OCA set forth in its Comments, the costs that the regulations, and the EGSs, propose to allocate to default service rates are not costs that are necessarily avoided by an EDC when a customer switches to an alternate supplier. For example, even if a particular customer chooses to receive a bill from the alternate supplier, that does not mean that the EDC can reduce its overall billing costs by an appreciable amount. The EDC still has to bill customers and maintain its overall billing system. It must also maintain the capacity to resume all billing functions if the customer returns or the supplier determines it will no longer offer billing services.

Metering is an even clearer example. When a meter is read, the same kilowatthour usage is used to bill the customer for distribution service and generation service. It is clear that there will not be two meters or two meter readings to read the same usage off the same meter. Meter reading is not a cost that is avoided by the EDC when a customer shops for generation.

NEMA suggests, however, that the Commission should engage in an unbundling proceeding to allocate costs such as billing and metering, to the generation function. NEMA Comments at p.6. While the OCA agrees that default service rates should include reasonable costs of providing default service, the costs must be those associated with providing the service and should only be costs that are avoidable when a customer shops for generation. If the costs are not avoidable, remaining customers will end up paying twice for these costs.

Any costs included in the default service rate should also be the necessary costs for providing default service, and not merely an attempt to create “headroom” for EGSs. For example, including the costs of metering and billing in default service rates seems unnecessary at this time. All EGSs in Pennsylvania currently choose to bill through the EDC for their residential customers. At this time, there is little or no evidence to show that EGSs can provide customer care, billing and collection services to mass market residential customers more efficiently than the EDCs. There is no record of EGS billing and collection of a consolidated bill from residential customers in large numbers outside of Texas, a market that is unique in its structure and implementation.

The OCA submits that the Commission should ensure that default rates are not increased to include costs that properly belong in distribution rates. The Commission must also ensure that default service customers are not charged twice for the same service.

3. Generation Supply Charge – Quarterly Adjustment and Risk Adder

The FirstEnergy Companies proposed that the Generation Supply Charge be reconcilable, subject to quarterly adjustment, and include an adder to compensate for risk. With respect to quarterly adjustment, the OCA would note that the purchased gas cost (“PGC”) rates of natural gas distribution companies are currently adjusted quarterly and the frequent changes to

the PGC rate make it difficult for customers to compare prices and shop for alternative suppliers. So, too, would quarterly changes to electric default service rates make offer comparisons difficult. Among other things, the FirstEnergy Companies argue that quarterly, as opposed to annual, adjustments would minimize the level of rate changes from one twelve month procurement period to the next. However, if the OCA's multi-year portfolio management approach to default supply procurement were utilized, price adjustments from year to year would, by the very nature of the process, be moderated. The FirstEnergy Companies also argue that quarterly adjustments to the Generation Supply Charge would keep it "in sync" with the prevailing market price. Here the Companies fall into the fallacy that prevailing market price is defined exclusively by the short-term energy market. As the OCA discussed above, reliance on short-term energy markets for setting default service rates will inevitably lead to unstable and volatile pricing. The prevailing market price should reflect the price of the variety of products sold in the wholesale market, including contracts of varying length.

Regarding the FirstEnergy Companies' suggestion that a risk adder be included in the Generation Supply Charge, the OCA would note that there is no reason whatsoever to include such an adder if the charge is reconcilable. As the OCA stated in its Comments: "the risk of resources needed to support default service should be reflected in the cost of the portfolio of resources that the default service provider procures to meet its obligation and should be based on the recovery mechanism adopted. For example, if the default service provider is using a dollar for dollar fully reconcilable recovery mechanism, there is no risk and no need for any risk adjustment." OCA Comments at p. 45. The OCA continues to hold that inclusion of a risk adder for an EDC with dollar for dollar, reconcilable recovery would be entirely inappropriate and unnecessary.

For the reasons stated, the OCA urges the Commission to reject any suggestion that the Generation Supply Charge be adjusted more frequently than annually or that the charge include any form of “risk adder” if the charge is to be reconcilable.

**E. Deployment of Interval Metering**

Several marketers emphasized the importance of moving to interval metering for all customers, not just the largest commercial and industrial customers who elect hourly pricing for default service. See, Direct Energy Comments at p. 14; Strategic Energy Comments at pp. 8-9. While the OCA supports the continuing evaluation of new technologies and is supportive of the voluntary selection of alternative pricing methods and meters to support those methods, the suggestion that default service should be accompanied by a move to “real time” pricing or the mass installation of interval meters to provide hourly pricing for all customers is without merit. The cost of installation of such meters, the billing changes that would be required to implement such alternative pricing proposals, and the costs associated with customer education to move toward such price options would be substantial for most residential customers. As the OCA set forth in its Comments, the basic default service rate for residential customers should be a fixed rate. Residential customers could be offered other options such as time-of-day rates, but these should be voluntarily chosen by the customer.

**F. Customer Switching**

Dominion Retail offers a proposal to link the level of customer switching to the right of the EDC to continue to serve as the default service provider. Dominion proposes that the Commission “incentivize EDCs to be promoters of customer choice” and “specifically link the EDC’s privileged and incumbent position as the default service provider to the degree of customer switching.” Dominion Retail Comments at p. 9. This proposal is accompanied by an

auction or allocation of a percentage of default service customers to an EGS who seeks to provide this service if the EDC fails to stimulate customer switching of a set amount. Dominion Retail pp.9-10. The OCA submits that this proposal should be rejected.

The underlying premise of the Electric Competition Act was that when competitive market forces were brought to bear on the generation of electricity, those forces would reduce the cost of generating that electricity and in turn, reduce the price of the generation service to retail customers. Significantly, under the Act, a customer does not have to leave his or her retail electric distribution company to gain access to competitive market generation. Rather, once the transition period is over, the customer can choose between purchasing generation from an EGS or purchasing unbundled generation from an EDC at a price that is designed to reflect the costs to the EDC of acquiring generation in the competitive wholesale market at prevailing market prices.

The Commission's policies should not be geared toward incentives for customer switching. The goal of the Electric Competition Act was to lower costs to customers, not to achieve any particular level of retail customer switching. The OCA urges the Commission to resist any suggestion to the contrary. The OCA would also note that previous attempts to pursue this method in the PECO Energy service territory were not very successful and should not be repeated.<sup>9</sup> For these reasons, Dominion Retail's proposal should be rejected.

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<sup>9</sup> As the Commission is aware, NewPower was selected to be the competitive default service provider for approximately 20% of PECO's residential customers. Before the end of the first year of the CDS term, NewPower left the market and returned all customers to PECO. In the PECO Market Share Threshold program, Dominion Retail was selected to provide service at a discount to a percentage of PECO Rate R customers for a one year term, but Dominion did not elect to continue to serve the customers at that price at the conclusion of the term and returned the customers to PECO. In the MST program, no bids were received to serve PECO Rate RH customers.

**G. Access to Customer Information**

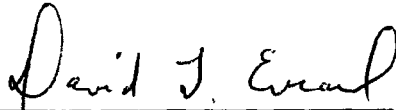
A number of marketers proposed that the Commission impose more uniformity on the rules and procedures in place among the EDCs with respect to access to customer information and the use of EDI protocols to exchange metering and billing data. See, Strategic Energy Comments at pp.27-28; MAPSA Comments at pp. 7-8. The OCA agrees that such an approach should be explored and has participated in the Commission's Electronic Data Exchange Working Group, as well as in the development of voluntary business practices by the Retail Electric Quadrant at the North American Energy Standards Board. It is appropriate to adopt uniformity in such transactions and methods of exchanging electronic data between EGSs and EDCs.



### III. CONCLUSION

The OCA appreciates the opportunity to file Reply Comments on some of the critical issues regarding the provision of default service in the post-transition period. The OCA will continue to work with the Commission and the stakeholders to develop default service regulations that provide residential ratepayers with reliable electric service at reasonable and stable rates.

Respectfully Submitted,



Tanya J. McCloskey  
Senior Assistant Consumer Advocate  
David T. Evrard  
Assistant Consumer Advocate

Counsel for:  
Irwin A. Popowsky  
Consumer Advocate

Office of Consumer Advocate  
555 Walnut Street 5th Floor, Forum Place  
Harrisburg, PA 17101-1923  
(717) 783-5048

DATED: June 27, 2005  
84575



Original: 2463

McNees Wallace & Nurick LLC  
attorneys at law

COPY

CHARIS MINCAVAGE  
DIRECT DIAL: (717) 237-5437  
E-MAIL ADDRESS: CMINCAVAGE@MWN.COM

June 27, 2005

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

VIA HAND DELIVERY

**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 please find the original and fifteen (15) copies of the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance ("IECPA, et al."), Reply Comments in the above-referenced proceeding.

If you have any questions regarding IECPA, et al.'s Reply Comments, please contact the undersigned at your earliest convenience. We ask that you please date-stamp the extra copy of this letter and return it to our messenger for our files. Thank you.

Very truly yours,

MCNEES WALLACE & NURICK LLC

By

Charis Mincavage

Counsel to the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance

CM/lhe  
Enclosures

- c: Mr. Robert Bennett, Bureau of Fixed Utility Services (via hand delivery)
- Shane Rooney, Esq., Office of Law Bureau (via e-mail and hand delivery)
- Ms. Cynthia Page, Communications (via e-mail and hand delivery)
- Certificate of Service

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**CERTIFICATE OF SERVICE**

I hereby certify that I am this day serving a true copy of the foregoing document upon the participants listed below in accordance with the requirements of Section 1.54 (relating to service by a participant).

**VIA FIRST-CLASS MAIL**

Robert F. Young, Esq.  
Deputy Chief Counsel  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
Office of Law Bureau – 3<sup>rd</sup> Floor West  
400 North Street  
Harrisburg, PA 17120

Tanya J. McCloskey, Esq.  
Irwin A. Popowsky, Esq.  
Office of Consumer Advocate  
Forum Place, 5<sup>th</sup> Floor  
555 Walnut Street  
Harrisburg, PA 17101-1923

William R. Lloyd, Esq.  
Office of Small Business Advocate  
300 North Second Street, Suite 1102  
Harrisburg, PA 17101

John F. Povilaitis, Esq.  
Ryan, Russel, Ogden and Seltzer LLP  
800 North Third Street, Suite 101  
Harrisburg, PA 17102-2025

Tracy McCormick  
Executive Director  
MAPSA  
P.O. Box 6089  
Harrisburg, PA 17112

Dennis Buckley, Esq.  
Brian J. Knipe, Esq.  
Klett, Rooney, Lieber and Schorling  
240 North Third Street – Suite 700  
Harrisburg, PA 17101-1503

Harry S. Geller, Esq.  
Pennsylvania Utility Law Project  
118 Locust Street  
Harrisburg, PA 17101-1414

Eric J. Epstein  
4100 Hillsdale Road  
Harrisburg, PA 17112

John Hanger  
Penn Future  
610 North Third Street  
Harrisburg, PA 17101

Frank M. Betley  
212 Locust Street  
P.O. Box 1266  
Harrisburg, PA 17108-1266

Kevin J. Moody, Esq.  
Wolf, Block, Schoor and Solis-Cohen LLP  
212 Locust Street , Suite 300  
Harrisburg, PA 17101

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Todd S. Stewart, Esq.  
Hawke, McKeon, Sniscak and Kennard LLP  
100 North Tenth Street  
Harrisburg, PA 17101

David P. Zambito, Esq.  
Saul Ewing  
2 North Second Street, 7<sup>th</sup> Floor  
Harrisburg, PA 17101-1604

Douglas L. Biden  
Electric Power Generation Association  
800 North Third Street, Suite 303  
Harrisburg, PA 17102

Michael J. Love  
Energy Association of Pennsylvania  
800 North 3<sup>rd</sup> Street, Suite 301  
Harrisburg, PA 17102

James Steffes  
263 Tresser Boulevard  
One Stamford Plaza, 8<sup>th</sup> Floor  
Stamford, CT 06901

Richard Rathvon  
MAPSA, c/o Reliant Energy Solutions  
379 Thornall Street, 5<sup>th</sup> Floor  
Edison (Metro Park), NJ 08837

Julie Coletti, Esq.  
Two Gateway Center, 9<sup>th</sup> Floor  
Pittsburgh, PA 15222

Frank Lacey  
Market Development and Regulatory Affairs  
Two Gateway Center, 9<sup>th</sup> Floor  
Pittsburgh, PA 15222

James McCormick  
Market Development for Mid-Atlantic Region  
1940 Robert Road  
Meadowbrook, PA 19046

Nancy J. D. Krajovic, Esq.  
Richard S. Herskovitz, Esq.  
411 Seventh Avenue  
Mail Drop 8-2  
Pittsburgh, PA 15219

Dave McMillan, Esq.  
Thane Thomas Twiggs  
3815 Capital of Texas Highway S.  
Suite 100  
Austin, TX 78704

John Holtz  
300 Atrium Way  
Mailbox #275  
Mt. Laurel, NJ 08054

Debra Hart  
Morgan Stanley Capital Group, Inc.  
1585 Broadway, 4<sup>th</sup> Floor  
New York, NY 10036

Gregory K. Lawrence, Esq.  
McDermott Will & Emery LLP  
28 State Street  
Boston, MA 02109-1775

Scott Rubin, Esq.  
3 Lost Creek Drive  
Selinsgrove, PA 17870-9357

Alyssa Weinberger  
One Hess Plaza  
Woodbridge, NJ 07095

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Page 3

Lisa Ferguson  
State Regulatory Affairs  
5400 Westheimer Court  
Houston, TX 77056

Craig Goodman  
Stacey Rantala  
National Energy Marketers Association  
333 K. Street – NW, Suite 110  
Washington, D.C. 20007

David W. Trego  
UGI Utilities, Inc.  
400 Stewart Road  
P.O. Box 3200  
Wilkes Barre, PA 18773-3200

Craig Eccher  
Wellsboro Electric Company  
33 Austin Street  
Wellsboro, PA 16901

Eric Winslow  
Bonnie Shadle  
Citizens Electric Company  
P.O. Box 551  
Lewisburg, PA 17837

Eric W. Matheson  
Constellation NewEnergy, Inc.  
111 Market Place, 7<sup>th</sup> Floor  
Baltimore, MD 21202

Mary M. Lynch  
Constellation Power Source, Inc.  
111 Market Place, Suite 500  
Baltimore, MD 21202

Thomas J. Butler  
Dominion Retail, Inc.  
1201 Pitt Street  
Pittsburgh, PA 15221

Gregory Pakela  
414 South Main Street, Suite 200  
Ann Arbor, MI 48104

Mark T. Clark  
FirstEnergy Solutions Corporation  
76 South Main Street  
Akron, OH 44308

William Byrd  
FirstEnergy Solutions Corporation  
395 Ghent Road  
Akron, OH 44333

Linda R. Evers, Esq.  
Richard A. D'Angelo, Esq.  
FirstEnergy Corporation  
2800 Pottsville Pike  
P.O. Box 16001  
Reading, PA 19612-6001

David M. Blank  
FirstEnergy Service Company  
76 South Main Street  
Akron, OH 44308

T.W. Merrill  
NRG Energy Center Pittsburgh  
111 South Commons  
Pittsburgh, PA 15212

Brain D. Crowe  
2301 Market Street S15-2  
Philadelphia, PA 19103

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Page 4

John F. Sipics  
PPL Electric Utilities Corp.  
Two North Ninth Street  
Allentown, PA 18101

Ike Gibbs  
Reliant Resources, Inc.  
1000 Main  
Houston, TX 77002

Charles J. Kruff  
Allegheny Power  
10435 Downsview Pike  
Hagerstown, MD 21740-1766

John L. Munsch, Esq.  
Allegheny Power  
800 Cabin Hill Drive  
Greensburg, PA 15601

Sara M. Stashak  
Mirant Corporation  
1155 Perimeter Center West  
Atlanta, GA 30338

Bruce Campbell  
Mirant Corporation  
8711 WestPhalia Road  
Upper Marlboro, MD 20772

Shawn Leyden  
George Henderson  
80 Park Plaza T-19  
Newark, NJ 07102

Jan Freeman  
Exelon Generation Company LLC  
200 Exelon Way, Suite 340  
Kennett Square, PA 19348

Matthew J. Picardi, Esq.  
Shell Trading Gas & Power Company  
111 Washington Avenue, Suite 750  
Albany, NY 12210

John Hartnett  
Shell Trading Gas & Power Company  
Two Clinton Square, Suite 305  
Syracuse, NY 13202

Lindsay Johnston, Esq.  
Denise Foster, Esq.  
Jeffery Bladen  
95f5 Jefferson Avenue  
Norristown, PA 19403-2497

Michael D'Angelo  
750 Highway 34  
Matawan, NJ 07747

David Magnus Boonin  
TBG Consulting  
1210 Pine Street  
Philadelphia, PA 19107

Lisa Yoho  
Calpine Corporation  
13501 I Street NW, Suite 1270  
Washington, D.C. 20005

Richard Kanoff, Esq.  
Calpine Eastern Corporation  
Two Atlantic Avenue, Third Floor  
Boston, MA 02110

Peter Adels, Esq.  
PennFuture  
117 South 17<sup>th</sup> Street, Suite 1801  
Philadelphia, PA 19103

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Page 5

Leonard E. Navitsky  
Select Energy, Inc.  
3301 Cherokee Street  
Emmaus, PA 18049

Cindy Datig  
Dollar Energy Fund  
Box 42329  
Pittsburgh, PA 15203-0329

Jesse A. Dillon, Esq.  
Paul Champagne, Esq.  
Two North Ninth Street  
Allentown, PA 18101-1179

Stan Garnett  
1750 Pennsylvania Avenue NW, Suite 1000  
Washington, D.C. 20006

Dr. Ransom E. Owan  
Washington Gas Energy Services, Inc.  
13865 Sunrise Valley Drive, Suite 200  
Herndon, VA 20171-3401

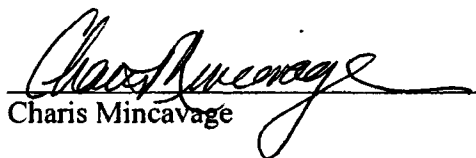
Mark C. Morrow, Esq.  
UGI Utilities, Inc., - Electric Division  
460 North Gulph Road  
King of Prussia, PA 19406

John L. Carley  
Consolidated Edison Co. of New York, Inc.  
4 Irving Place  
New York, NY 10003

Eric W. Matheson  
Constellation NewEnergy, Inc.  
855 Williamsburg Blvd.  
Downingtown, PA 19335

Paul R. Bonney, Esq.  
PECO Energy Company  
2301 Market Street  
P.O. Box 8699  
Philadelphia, PA 19101-8699

Steven M. Bunkin  
Goldman Sachs and Company  
One New York Plaza  
New York, NY 10004

  
Charis Mincavage

Dated this 27<sup>th</sup> day of June, 2005 in Harrisburg, Pennsylvania.

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**RULEMAKING RE ELECTRIC :  
DISTRIBUTION COMPANIES' :  
OBLIGATION TO SERVE RETAIL : DOCKET NO. L-00040169  
CUSTOMERS AT THE CONCLUSION :  
OF THE TRANSITION PERIOD PURSUANT :  
TO 66 PA C.S. § 2807(e)(2) :**

---

**REPLY COMMENTS OF THE INDUSTRIAL ENERGY CONSUMERS OF  
PENNSYLVANIA, THE MET-ED INDUSTRIAL USERS GROUP, THE PENELEC  
INDUSTRIAL CUSTOMER ALLIANCE, THE PHILADELPHIA AREA INDUSTRIAL  
ENERGY USERS GROUP, AND THE PP&L INDUSTRIAL CUSTOMER ALLIANCE**

---

David M. Kleppinger, Pa. Bar No. 32091  
Charis Mincavage, Pa. Bar No. 82309  
MCNEES WALLACE & NURICK LLC  
100 Pine Street  
P.O. Box 1166  
Harrisburg, PA 17108-1166  
(717) 232-8000  
(717) 237-5300 (fax)

Counsel to the Industrial Energy Consumers  
Of Pennsylvania, the Met-Ed Industrial Users  
Group, the Penelec Industrial Customer  
Alliance, the Philadelphia Area Industrial  
Energy Users Group, and the PP&L Industrial  
Customer Alliance

Dated: June 27, 2005



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## I. INTRODUCTION

On December 16, 2004, the Pennsylvania Public Utility Commission ("PUC" or "Commission") entered a Proposed Rulemaking Order formally commencing the Commission's process to define the obligations of a Provider of Last Resort ("POLR") to serve retail customers at the conclusion of an Electric Distribution Company's ("EDC") transition period. Pursuant to the passage of the Electricity Generation Customer Choice and Competition Act ("Competition Act"), an EDC, or an alternative Default Service Provider ("DSP") approved by the Commission, has a duty as a provider of last resort for customers who have either not chosen an Electric Generation Supplier ("EGS") or have contracted for electric energy that was not delivered. To that end, the Commission entered an Order establishing interim guidelines to define a DSP's obligation to serve retail customers.

The Commission's December 16 Order proposed permanent regulations to meet the requirements of the Competition Act and to provide for a robust retail market for electricity that serves the public interest. The December 16 Order also requested interested parties to submit comments on the proposed regulations. To that end, the Industrial Energy Consumers of Pennsylvania ("IECPA"), the Met-Ed Industrial Users Group ("MEIUG"), the Penelec Industrial Customer Alliance ("PICA"), the Philadelphia Area Industrial Energy Users Group ("PAIEUG"), and the PP&L Industrial Customer Alliance ("PPLICA") (hereinafter, "IECPA, et al.") submitted Comments (hereinafter, "IECPA Com.") to the Commission in order to highlight particular areas of concern to large commercial and industrial customers. See IECPA Com., p. 2.

IECPA, et al. obtained Comments submitted by the following parties: National Energy Marketers Association ("NEMA"), Allegheny Conference on Community Development ("ACCD"), Richards Energy Group, Inc. ("REG"), Strategic Energy LLC ("Strategic"), David

Magnus Boonin ("Boonin"), Department of Environmental Protection ("DEP"), PPL Electric Utilities Corporation and PPL EnergyPlus, LLC ("PPL"), UGI Utilities, Inc. - Electric Division ("UGI"), FirstEnergy Solutions Corporation ("FES"), Allegheny Power ("Allegheny"), Constellation Energy Group, Inc. ("Constellation"), Dominion Retail, Inc. ("Dominion"), Direct Energy Services, LLC ("Direct"), Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company ("Met-Ed/Penelec"), Mid-Atlantic Power Supply Association ("MAPSA"), Amerada Hess Corporation ("Amerada Hess"), Reliant Energy, Inc. ("Reliant"), Morgan Stanley Capital Group, Inc. ("Morgan Stanley"), Duquesne Light Company ("Duquesne"), Pike County Light & Power Company ("Pike"), PJM Interconnection, LLC ("PJM"), Office of Consumer Advocate ("OCA"), Office of Small Business Advocate ("OSBA"), PECO Energy Company and Exelon Generating Company, LLC ("Exelon Companies"), Energy Association of Pennsylvania ("EAP"), and Citizens' Electric Company and Wellsboro Electric Company ("Citizens'/Wellsboro").

IECPA, et al. submits these Reply Comments to respond to specific issues raised in the Comments of other parties.<sup>1</sup> As discussed more fully herein, IECPA, et al.: (1) disagrees with any process that would modify the Commission's proposal to allow each DSP to implement its own procurement process; (2) opposes the combination of a customer charge to account for both distribution and generation charges, especially if the DSP does not perform a Cost of Service Study ("COSS") to support such a charge; (3) disagrees with several EGSs' proposals to prohibit a fixed-priced option for large commercial and industrial customers, as such a proposal would

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<sup>1</sup> IECPA, et al.'s Reply Comments will not respond to every argument contained in all of the parties' Comments, but only those issues necessitating additional response. IECPA, et al.'s decision not to respond to all arguments should not be construed as agreement with any party's position on any of the issues currently outstanding in this proceeding.

result in an unreasonable discrimination to this class of customers; and (4) contests any notion that the DSP is not a competitive alternative in the marketplace. Each of these issues is discussed more fully herein.

## II. ARGUMENT

### A. **The Commission Correctly Proposes to Allow DSPs to Obtain POLR Supply Via an Individual Procurement Process.**

As proposed, the POLR regulations would allow DSPs to obtain generation supply via their own individual procurement processes, rather than via other measures, such as a statewide process. Because individual procurement accounts for the different needs and characteristics of each DSP, the Commission's decision to utilize an individual procurement process is appropriate. See IECPA Com., p. 5. Similarly, the Commission proposes procurement via a wholesale auction process, with DSPs flowing through the resulting costs to customers via a generation customer charge and a generation supply charge. Because this process would ensure that the DSP acquires electric energy at prevailing market prices, while also recovering all reasonable costs, the Commission's proposal adheres to the terms of the Competition Act. See id. at 11-21.

While the PUC's proposal to allow DSPs to obtain POLR supply on an individual basis appropriately addresses the different characteristics of the various EDCs' service territories, several parties propose the use of a statewide auction process. See, e.g., OSBA Com., p. 6; Exelon Companies Com., p. 3; Direct Energy Com., p. 12. For example, Direct Energy claims that a statewide process would allow for a single set of rules, thereby lessening any chance of confusion by customers switching between EDC service territories. Direct Energy Com., p. 12.

Although the basis of the statewide proposal seems to be that POLR regulation would be "easier," the proponents of this method fail to recognize that the service territories and customer bases of the various EDCs in Pennsylvania are extremely different. While the OSBA (incorrectly) believes that a statewide process would avoid litigation, the OSBA fails to recognize that the purported "benefit" of creating one set of rules would be outweighed by the resulting harm to customers. If DSPs were required to obtain electricity via a statewide procurement process, the DSPs could not necessarily ensure that all of their customers were being treated equitably. For example, a statewide auction may ignore local price differentials due to congestion and ultimately have customers not located in congested areas subsidize customers in congested areas through a socialization of congestion costs. Moreover, individual procurement would enable DSPs to use a process that is optimum for the individual DSP, thereby potentially lowering POLR rates for customers.

Accordingly, while utilizing an individual procurement process could mean separate rules and regulations for each DSP, any nuisance resulting from these separate rules is outweighed by the benefit to individual customers. By tailoring each program to the individual DSP's needs, the Commission is ensuring just, reasonable, and non-discriminatory POLR rates for the customers located in each of the various (and diverse) EDC territories.

In addition, several entities oppose the Commission's proposal to implement a bidding process, instead proposing different methodologies, such as a Market Response Pricing Model ("MRPM") or a Spot Market Based Pricing model. See Reliant Com., p. 3; Boonin Com., p. 1. Unfortunately, such models would not adhere to the terms of the Competition Act. For example, the MRPM would provide only hourly-priced options for large customers, with an additional

administrative fee, in an attempt to restrict the DSP's ability to provide competitive default service. Reliant Com., p. 9.

The Competition Act also requires that a DSP "acquire electric energy at prevailing market prices" to serve its customers, while also allowing a DSP to be a competitive alternative in the market. 66 Pa. C.S. § 2807(e)(3); Id. at § 2806(h). The MRPM would not necessarily allow energy to be acquired at the prevailing market price, but rather, would result in customers potentially paying an "ugly" POLR rate. Similarly, the Competition Act provides that the DSP can "recover fully all reasonable costs;" however, the MRPM provides for an administrative fee without providing the basis for this fee. Id. at § 2807(e)(3). Unlike Reliant's proposal, the Commission's POLR regulations address the costs to be recovered in the DSP's customer charges to ensure a reasonable basis for these fees.

Finally, the Competition Act requires that restructuring not be implemented in a manner that would result in unreasonable discrimination among the customer classes. Id. at § 2804(7). Conversely, Reliant's proposal would implement the MRPM for large customers, while delaying development of market rules for smaller customers until 2006. Reliant Com., p. 13. In addition, Reliant would implement an hourly priced mechanism for large customers, while smaller customers would have a more "fixed" price option. Id. at 9-10. Because this methodology would detrimentally impact large customers, implementation would result in unreasonable discrimination, thereby contravening the intent of the Competition Act.

In order to ensure that the goals of the Competition Act are met within the realm of POLR regulation, the Commission must implement a procurement methodology that accounts for the individual differences of the EDCs' service territories, ensures that DSPs are acquiring energy at prevailing market prices, provides for the recovery of only reasonable costs, and

prohibits any unreasonable discrimination among the customer classes. Any POLR methodology that does not account for these issues must be rejected.

**B. The POLR Customer Charge Must Include Only Generation-Related Charges and Be Based on Cost Causation Principles.**

In developing the generation customer charge, the Commission must ensure a cost causative basis and include only those charges that are appropriately allocated to generation rates. By utilizing this methodology, the Commission can ensure just, reasonable, and non-discriminatory POLR rates. To do otherwise, however, would inappropriately create an "ugly" generation customer charge, which would defeat the purpose of POLR principles.

Under the proposed POLR regulations, the Commission provides for a generation supply charge and a generation customer charge. Conversely, several parties suggest that the Commission should not establish a separate generation customer charge, but rather, combine the generation and distribution customer charges into one customer charge. See EAP Com., pp. 7-9; Met-Ed/Penelec, pp. 6-7. For example, EAP claims that supply-related customer services are fully bundled with distribution-related customer services, and these costs cannot be segregated. EAP Com., p. 8. Similarly, Met-Ed/Penelec argue that the customer service functions are not easily allocated between supply services and transmission and distribution services, thereby prohibiting any unbundling. Met-Ed/Penelec Com., p. 6.

As discussed more fully in IECPA et al.'s Comments, the Competition Act requires the DSP to act as a competitive alternative under Section 2806(h), thereby ensuring that a customer is not forced into the market because of an artificially high POLR rate. IECPA Com., pp. 19-20; 66 Pa. C.S. § 2806(h). Thus, in order to ensure that a customer can choose between an EGS or a DSP, the Commission cannot permit a generation customer charge that could indirectly result in a higher than appropriate POLR rate. Id. In order to ensure that POLR rates do not contain

inappropriate costs, the proposed regulations must ensure that only costs related to generation are permitted in the generation customer charge. See IECPA Com., pp. 20-21.

In the event, however, the Commission determines that these customer charges should be combined, it is imperative that the customer charge be set on a cost causative basis. The currently proposed POLR regulations do not require a DSP perform a COSS; however, the only way to ensure that these charges account for cost-causation principles is for the DSP to perform a COSS to support any such allocation.<sup>2</sup> See IECPA, et al. Com., p. 21. The need for a COSS is further highlighted if the generation and distribution customer charges are combined. Many EDCs, which will be acting as the DSP, have not filed for base rate increases in over ten years. As a result, the current distribution customer charge is based upon outdated and inappropriate information. In order to ensure that this problem is not compounded, a COSS must be performed by the DSP in order to address appropriate cost-causation relationships with respect to the customer charge. To set charges without such a basis could result in a POLR rate that does allow a DSP to act as a competitive alternative in the market.

The Competition Act allows a DSP to recover all reasonable costs related to the procurement of generation. 66 Pa. C.S. § 2807(e)(3). This intent cannot be achieved, however, if the generation customer charge contains costs related to other functions or is not based upon cost-causation principles. In order to ensure that the requirements of the Competition Act are

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<sup>2</sup> Strategic attempts to avoid the use of a COSS by suggesting that the Commission should instead develop a retail charge as a proxy for costs that are embedded within retail supply service, and this charge should be applicable to large commercial and industrial customers. See Strategic Com., pp. 23-24. Strategic also implies that these charges may result in overcollections, the proceeds of which should be used in part for customer education programs, sustainable development funds, or advanced metering technology. Id. Strategic's proposal would contravene the requirements of the Competition Act and compromise any cost-causation policies. Accordingly, Strategic's proposal must be dismissed out of hand.



met, the Commission must allow for a separate generation customer charge that is based upon a COSS performed by the DSP.

**C. POLR Regulations Must Require One Fixed Priced Option and One Hourly Priced Option for Large Commercial and Industrial Customers.**

As proposed, the Commission's POLR regulations would implement at least one fixed priced option for residential and small commercial customers and at least one hourly priced option for large commercial and industrial customers with a registered peak demand of 500 KW or less. In addition, a DSP would have the option, but would not be required, to offer a fixed price option to large commercial and industrial customers. Because many large commercial and industrial customers would have inadequate resources to cope with an hourly priced mechanism, the DSP must be required to offer at least one fixed price option to these customers, with an hourly pricing mechanism offered as a second option for customers with a registered peak demand of 1 MW or more. Because some larger industrial customers may choose an hourly priced mechanism, the implementation of this option should not be eliminated, but rather, supplemented with a fixed priced option to account for the numerous large commercial and industrial customers for whom an hourly priced option would be unmanageable. Allowing for only an hourly priced mechanism, however, would result in large commercial and industrial customers being subject to unreasonable discrimination contrary to the intent of the Competition Act. See IECPA Com., pp. 22-26.

Conversely, several EGSs suggest that DSPs should be prohibited from offering a fixed priced mechanism altogether to large commercial and industrial customers, thereby further limiting the options available for these customers. See Reliant Com., p. 17; NEMA Com., pp. 6-8; MAPSA Com., pp. 5-6. According to NEMA, "[c]onsumers interested in obtaining fixed price options should be required to obtain such services from the marketplace...[c]onversely,

Default Service should be no-notice, 365 day/7 days a week/24 hours a day commodity service for any customer that is in need of emergency last resort service." NEMA Com., p. 7. In other words, NEMA suggests that the large commercial and industrial customers be essentially foreclosed from taking service from the DSP because the DSP is unduly constrained in their service offerings.

NEMA fails to recognize that the intent of the Legislature was not to make POLR service that of a "last resort" but rather to allow a DSP to be a competitive alternative to the marketplace. See 66 Pa. C.S. § 2806(h). Specifically, the Competition Act provides the Commission with the authority to approve for DSPs flexible pricing and flexible rates, including negotiated, contract-based tariffs designed to meet the specific needs of a customer and to address competitive alternatives. Id. Thus, the Commission cannot treat DSP service as an emergency service, but rather, must allow the DSP to provide competitive generation services similar to that of an EGS. See IECPA Com., pp. 22-24.

MAPSA also suggests that a fixed priced option should be eliminated in order to ensure responsive pricing and effective market based price signals. MAPSA Com., pp. 5-6. MAPSA fails to recognize, however, that the elimination of a fixed priced option could result in inflated market prices. If large commercial and industrial customers are not provided with both fixed and hourly priced mechanisms under DSP service, EGSs only need to "beat" an hourly priced service – the volatility of which the customer cannot tolerate in the first instance. As a result, EGSs will have the opportunity to significantly raise their fixed prices above what the DSP may otherwise offer on a fixed price basis.

As correctly noted by DEP, requiring large commercial and industrial customers "to submit to hourly pricing based on the RTO's or ISO's location marginal price will create undue

economic hardship on these customers." DEP Com., p. 2. Accordingly, large customers would be subject to unjust and unreasonable rates, resulting in unreasonably discriminatory hardship, stemming directly from the lack of a fixed price option for POLR rates. IECPA Com., pp. 23-24. Thus, while elimination of a fixed price option may prove a boon for EGSs seeking to serve these customers at higher rates, such elimination would detrimentally impact large commercial and industrial customers.

Moreover, elimination of a fixed priced option could negatively affect the implementation of the Alternative Energy Portfolio Standards Act ("AEPS"). Hourly pricing options would severely hinder a DSP's flexibility in meeting the requirements of AEPS. DEP Com., p. 3; IECPA Com., pp. 25-26. As noted by the OCA, hourly priced rate service is purchased from the spot energy market, which then flows through the locational marginal price from the energy market to the customer. As a result, it is unclear how hourly spot market purchases could meet the requirements of AEPS, as these spot purchases will almost certainly not have alternative energy attributes. OCA Com., p. 24. Accordingly, eliminating a fixed priced mechanism for large commercial and industrial customers could have further reaching implications beyond just the implementation of POLR regulations.

Further compounding this problem, Amerada Hess incorrectly proposes that the threshold level for offering hourly pricing mechanisms should be lowered to 200 KW. Amerada Hess Com, p. 3. The more appropriate approach, however, would be that posited by both EAP and UGI, both of which propose to increase this threshold to 1 MW. See EAP Com., p. 9; UGI Com., pp. 15-16. As previously noted, however, the preferred option would be to provide large commercial and industrial customers with both a fixed priced and an hourly priced mechanism, thereby negating the need for any threshold.

Hourly pricing subjects a customer to arbitrary price increases, which can detrimentally affect load usage. Because large customers utilize significant amounts of electricity, unstable prices can result in significant unplanned budget expenditures. Moreover, if larger customers cannot determine and plan for these budgetary expenses, the overall production process can be hindered. Similarly, as EAP concurs, the hourly pricing market is extremely complex, and many customers have insufficient resources to gain the familiarity necessary to understand this market. IECPA Com., pp. 23-24; EAP Com., p. 9. Accordingly, if anything, the Commission's threshold for hourly priced mechanisms must increase, not decrease, from the 500 KW set forth in the proposed POLR regulations.

The Competition Act requires that restructuring be implemented in a manner that does not unreasonably discriminate against one customer class. See 66 Pa. C.S. § 2804(7). By failing to provide a fixed rate option to large commercial and industrial customers, while requiring such an option be provided to small commercial and residential customers, the POLR regulations are effectively discriminating against large commercial and industrial customers. While some larger industrial customers may seek an hourly priced mechanism under DSP service, the POLR regulations must be modified to ensure that DSPs provide at least one fixed priced and one hourly priced rate option for large commercial and industrial customers. Without such a provision, the POLR regulations would inappropriately contravene the intent of the Legislature, the Competition Act, and the Alternative Energy Portfolio Standards Act.

**D. The Competition Act Requires a DSP to Be a Competitive Alternative in the Marketplace.**

The goal of POLR service is to provide just, reasonable, and non-discriminatory rates to customers that have either not chosen an EGS or have had an EGS default on the system. As part of this goal, the Competition Act allows a DSP to be a competitive alternative to the

marketplace. Specifically, the Competition Act allows a DSP to offer flexible pricing and rates, as well as negotiated contract-based tariffs designed to meet the specific needs of a utility customer. 66 Pa. C.S. § 2806(h). Accordingly, any proposal that would prohibit a DSP from providing competitive generation supply service must be rejected.

Conversely, several EGSs' Comments attempt to rewrite the legislation and propose numerous modifications to the POLR regulations that would result in an "ugly" POLR service. For example, Strategic suggests that POLR should be a "temporary" mechanism, with redefined customer classes and modified codes of conduct. Strategic Com., pp. 25-36. Similarly, NEMA requests that the Commission set a date certain by which EDCs must exist the merchant function. NEMA Com., p. 2.

As correctly noted by ACCD, the purpose of the Competition Act is to provide a default service that addresses the best interest of all customers. ACCD Com., p. 2. By allowing a DSP to be a competitive alternative in the electric marketplace, the Commission ensures that customers are not forced into the marketplace due to an "ugly" POLR rate, but rather, provides customers the opportunity to receive just, reasonable, and non-discriminatory rates.

In addition, several parties suggest that retail functions should be bid out to EGSs, rather than DSPs retaining these functions. See Direct Energy Com., p. 6. As correctly determined by the Commission, in the beginning stages of the marketplace, the EDC should act as the DSP and provide the accompanying retail functions. See IECPA Com., pp. 7-10. In order to ensure that customers continue to receive safe and reliable service, POLR regulations must be implemented on a step-by-step basis, rather than resulting in all of the functions being modified immediately.

If, however, the Commission determines that these retail functions can be provided by an EGS at a later point in time, the Commission must establish rules and regulations to ensure that

any EGS providing these functions is able to do so in a safe, reasonable, and just manner.

Accordingly, before allowing EGSs to provide retail functions, the Commission must ensure that the marketplace is able to manage with such functions being removed from the DSP without causing any harm to customers.

In addition, several parties suggest that switching rules must be implemented as part of the POLR regulations. See, e.g., EAP Com., pp. 10-11. For example, EAP argues that DSPs cannot effectively address the supply risks associated with customer migrations without any switching restrictions. As a result, EAP suggests that DSPs in Pennsylvania would be forced to manage these risks through higher POLR rates than would otherwise occur with fair and appropriate switching rules. Id. at 10.

The Commission must ensure that an "ugly" POLR rate does not result from the implementation of POLR regulations. To that end, switching rules may be a necessity; however, any implementation of such rules must provide flexibility in order to ensure fairness and reasonableness for all customers. For example, the switching rules should be flexible enough to account for the procurement process used by the DSP, as well as the duration of any contracts entered into by the DSP. Only by providing such flexibility can the Commission ensure that the switching rules themselves will not hinder the ability of customers to both freely shop the competitive market, as well as maintain the safety net of POLR service.

The Competition Act requires a DSP to be a competitive supplier among EGSs. In order to ensure that the intent of the Competition Act is adhered to, the POLR regulations must allow the DSP to implement competitive rates, provide long-term service to customers, and implement flexible, fair, and just switching rules. By meeting all of these elements, the Commission can ensure just, reasonable, and non-discriminatory POLR service.


### III. CONCLUSION

WHEREFORE, the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance respectfully request that the Pennsylvania Public Utility Commission modify the proposed Provider of Last Resort regulations to address the issues of concern raised in IECPA, et al.'s Comments, as well as reject the proposals raised by other entities that would detrimentally impact large commercial and industrial customers, as discussed in these Reply Comments.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By

  
David M. Kleppinger

Charis Mincavage

100 Pine Street

P.O. Box 1166

Harrisburg, PA 17108-1166

Phone: (717)232-8000

Fax: (717)237-5300

Counsel to the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance

Dated: June 27, 2005

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

RULEMAKING RE ELECTRIC  
DISTRIBUTION COMPANIES'  
OBLIGATION TO SERVE RETAIL  
CUSTOMERS AT THE CONCLUSION  
OF THE TRANSITION PERIOD PURSUANT  
TO 66 PA C.S. § 2807(e)(2)

DOCKET NO. L-00040169

Comments of the Pennsylvania Department of Environmental Protection

Introduction

The Pennsylvania Department of Environmental Protection (DEP), which is home to the Office of Energy and Technology Development, has a direct interest in the final form of the POLR regulations for several reasons and is pleased to offer these comments in reply to the responses of other commentators.

Act 213 of 2004, the Alternative Energy Portfolio Standards Act, charges the Pennsylvania Department to work with the Commission to implement the act. The final form of the POLR regulations will impact the implementation of Act 213 and, therefore, the design of the final POLR regulations should consider Act 213 implementation.

Additionally, DEP's Office of Community Revitalization and Local Government Services, works closely with the Pennsylvania Department of Community and Economic Development to support sound local economic development projects. Therefore, the maintenance of competitive, reliable and consistent electricity pricing is of great concern to DEP and the Commonwealth generally.

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Our reply comments will focus on the following issues: (1) POLR generation portfolios should be required to include AEPS resources which should be part of a “blended price,” (2) The importance of staggering contracts and allowing for longer-term contracting as part of the POLR competitive procurement process, and (3) POLR should provide both fixed and hourly price options for large industrial and commercial customers.

DEP concurs with the comments of a number of commentators, including OSBA and IECPA that the purpose of electricity restructuring in Pennsylvania was primarily to provide lower-cost electricity service for customers. We reiterate that competition is a potential means to that end and not an end in itself and that the final form of the POLR regulation should account for the objective of low-cost, reliable, and consistent electricity service for all customers classes.

#### POLR and the Alternative Energy Portfolio Standards Act

We agree with the comments of the Office of Consumer Advocate and the Office of Small Business Advocate that Act 213 compliant resources should be required to be obtained through the POLR competitive procurement process. This will ensure that EDCs are on track to meet their Act 213 commitments and preclude the necessity for unwarranted invocation of the Act’s Force Majeure provisions, as EDCs will be planning to meet their Act 213 compliance requirements through POLR rather than potentially waiting to meet them through other means such as the spot market.

The cost of acquiring Act 213 resources should be included in a “blended price” for generation. In other words, DEP does not support a separate customer charge for Act

213 compliance. As pointed out by the Office of Small Business Advocate, “Electric energy generated from alternative energy sources has the potential to offset volatility in the market price for electricity.” As a result, we believe that a “blended price” which combines the acquisition costs of all generation acquired through the competitive procurement process properly addresses both the costs and benefits of non-Act 213 and Act 213 eligible electric resources.

#### Competitive Procurement Process – Length of Contracts

DEP agrees with the comments of the Office of Consumer Advocate addressing the length of procurement contracts associated with the competitive procurement process. DEP does not believe that serving 100% of load through annual contracts is the best way to serve the public interest. Rather the combination of staggered contracts which allow for longer terms of up to five years will allow default service providers to hedge risk over longer terms, providing customers with price certainty and stability.

Additionally, longer term contracting will be necessary in order to ensure the development of alternative energy generating resources. Therefore, for alternative energy sources, the Commission should consider special provisions that allow for even longer-term contracts for default service providers seeking to meet their Act 213 compliance requirements. This approach complements the comments above relating to the inclusion of Act 213 resources in the competitive procurement process. The extent to which default service providers can contract for their Act 213 electricity over longer terms means that the market for deployment of those resources will develop and the cost of capital for developing those resources will be lower, thereby reducing electricity costs.

### Pricing Options for Larger Commercial and Industrial Customers

DEP concurs with the comments of the Industrial Energy Consumers of Pennsylvania that default service providers should be able to offer both fixed and hourly pricing options for large commercial and industrial customers. As we noted above, the goal of electricity restructuring in Pennsylvania was to reduce electricity prices. Competition is a means to achieve this end. As IECPA noted in their comments, eliminating the option for default service providers to offer fixed-price products reduces competition, therefore, reducing the number of products in the market and decreasing the benefits of competition leading to potentially higher prices for customers. IECPA notes and we concur that, "EGSs will have the opportunity to significantly raise their fixed prices above what the market would otherwise bear merely because the competitive market would be the only option for customers seeking fixed price options."

Ensuring that large commercial and industrial customers have the maximum opportunity to choose a variety of low-cost, reliable electricity service options is critical to Pennsylvania's economic development. We strongly urge the commission to consider the benefits of maximizing the number of pricing options available to large commercial and industrial customers through the POLR regulation.

Respectfully Submitted,

Pennsylvania Department of  
Environmental Protection

A handwritten signature in black ink, appearing to read 'E Thumma', with a long horizontal line extending to the right.

Eric Thumma  
Director  
Bureau of Energy, Innovations and  
Technology Deployment  
400 Market Street  
P.O. Box 8772  
Harrisburg, PA 17105-8772  
Phone: 717-783-0542  
Fax: 717-783-2703