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INDEPENDENT REGULATORY REVIEW COMMISSION
333 MARKET STREET, 14TH FLOOR, HARRISBURG, PA 17101

August 8, 2005

Honorable Wendell Holland, Chairman
Pennsylvania Public Utility Commission
Keystone Building, 3rd Floor
400 North Street
Harrisburg, PA 17105

Re: Regulation #57-237 (IRRC #2463)
Pennsylvania Public Utility Commission
Provisions of Default Service

Dear Chairman Holland:

The date was inadvertently omitted from the first page of our comments on the above captioned regulation. Enclosed is a corrected copy with the date indicated. Except for the insertion of the date, no other changes were made to our comments. They are a verbatim copy of the original which was sent to you on July 27, 2005. An identical correction was made to the copy of the comments posted to our website at www.irrc.state.pa.us.

I hope this error has not caused you any inconvenience. If you have any questions, please call me at 783-5506, or email me at kkaufman@irrc.state.pa.us.

Sincerely,

Kim Kaufman
Executive Director

Enclosure
cc: Honorable Robert M. Tomlinson, Chairman, Senate Consumer Protection and Professional Licensure Committee
Honorable Lisa M. Boscola, Minority Chairman, Senate Consumer Protection and Professional Licensure Committee
Honorable Robert J. Flick, Majority Chairman, House Consumer Affairs Committee
Honorable Joseph Preston, Jr., Democratic Chairman, House Consumer Affairs Committee

Comments of the Independent Regulatory Review Commission

on

Pennsylvania Public Utility Commission Regulation #57-237 (IRRC #2463)

Provisions of Default Service

July 27, 2005

We submit for your consideration the following comments that include references to the criteria in the Regulatory Review Act (71 P.S. § 745.5b) which have not been met. The Pennsylvania Public Utility Commission (PUC) must respond to these comments when it submits the final-form regulation. The public comment period for this regulation closed on June 27, 2005. If the final-form regulation is not delivered within two years of the close of the public comment period, the regulation will be deemed withdrawn.

1. General – Legislative intent of the Electricity Generation Customer Choice and Competition Act; Need.

The purpose of this regulation is to implement § 2807(e) of the Electricity Generation Customer Choice and Competition Act (Act), as it pertains to an electric distribution company's (EDC's) obligation to serve retail customers. One of the key policy declarations of the Act is found in § 2802(5). It states: "Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity." The preamble states that this declaration of policy guided the PUC in drafting this rulemaking. We concur that this policy should be used as the basis for this rulemaking and note that the PUC has correctly considered other declarations of policy found in the Act. Those declarations relate to reliability, availability, customer service and protection afforded to low-income customers.

The PUC has crafted a regulation that considers competitive market forces to be more effective than economic regulation while, at the same time, ensuring a reliable and reasonably priced supply of electricity. We acknowledge that this is unprecedented territory for the PUC. When reviewing the comments, we encourage the PUC to continue to focus on the principle that competitive market forces are more effective than economic regulation, and further incorporate that principle into the final-form regulation.

In addition, we urge the PUC to consider another key concept of the Act found at § 2807(e)(3). This section states in part: ". . . 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" (Emphasis added). We believe that electric energy acquired at true prevailing market prices and sold to customers at rates that reflect those prices is the most appropriate way to bring true choice and competition to the citizens of Pennsylvania.

Having commended the PUC for undertaking this difficult task, we question the need for the rulemaking at this time. We base this question on the following. First, the PUC has noted that

the retail and wholesale energy markets will continue to evolve between now and the expiration of the last EDC rate caps in 2010. Drafting regulations today that match tomorrow's markets is an imprecise and difficult task. Second, the PUC has also stated that changes to federal and state law could affect this rulemaking. To illustrate this point, the Alternative Energy Portfolio Standards Act (AEPS), which became law in 2004, and the implementing regulations to be developed by the PUC will have a dramatic affect on how energy companies acquire electricity. Third, knowledge could be gained from the experience of other states that are making the transition from a regulated to a competitive electric market. Fourth, the experiences gained by both the PUC and the EDCs, whose rate cap periods have ended and are operating under interim guidelines, could be useful when crafting regulations at a future date. Additionally, the continuing use of interim guidelines would provide the PUC an opportunity to consider various pilot programs before it finalizes these regulations. For these reasons, we urge the PUC to carefully consider the value of delaying the promulgation of these regulations until a date closer to conclusion of the rate cap periods of the major EDCs.

2. Section 54.123. Transfer of customers to default service. – Adverse effects on prices, productivity or competition; Need; Implementation procedures.

This section establishes the standards that apply to the transfer of retail customers by an electric generation supplier (EGS) to a default service provider (DSP). Section 2807(e)(4) of the Act states: "If a customer that chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy service." We believe this language prohibits any restrictions on customers who want to obtain their energy service from the DSP. In addition, if rates are set at the prevailing market price by the DSP, there would be no need for limitations on the transfer of customers from an EGS to a DSP. Therefore, all of the language in Subsection (1)(iv) following ". . . expiration of contracts . . ." and all of Subsection (3) should be deleted because they could be interpreted as preventing customers from switching from one energy supplier to another.

3. Section 54.181. Purpose. – Adverse effects on price, productivity or competition.

Under this section, an EDC is allowed to fully recover all reasonable costs for acting as a DSP. However, this rulemaking also allows for the possibility that an EGS may serve as a DSP. If a DSP is not an EDC, that DSP should also be allowed to recover all reasonable costs associated with providing that service. This would conform to § 2807(e)(3) of the Act, which states, in part, that ". . . the electric distribution company or commission-approved alternative supplier shall . . . recover fully all reasonable costs." The final-form regulation should be amended to provide for the recovery of costs by either an EDC or an EGS serving as a DSP.

4. Section 54.182. Definitions. – Clarity.

Competitive procurement process – This definition contains the phrase "through a bid solicitation process." To give more flexibility to DSPs, as discussed in our comments on §§ 54.185 (d) and 54.186(a), this phrase should be deleted.

Default service provider – This definition includes the phrase that is being defined. Section 1.7(e) of the *Pennsylvania Code & Bulletin Style Manual* states that the term being

defined may not be included as part of the definition. Therefore, the phrase DSP should be deleted from this definition.

Fixed rate option – The phrase "seasonal differences" is included in this definition. It also appears throughout the regulation. For clarity, this term should be defined. Also, in order to better meet the "prevailing market price" standard, the phrase "may include" should be replaced with "includes."

Hourly Priced Service – Based on this definition, the hourly default service price is based on either the "RTO or ISO's LMP for energy, or other similar, mechanism." The phrase "other similar mechanism" is vague. The final-form regulation should provide examples or more detail as to what other mechanisms would be acceptable. Because substantive provisions in the definitions section are not enforceable, any substantive provisions added to the final-form regulation should be placed in the appropriate section of the regulation.

5. Section 54.183. Default service provider. – Statutory authority; Legislative intent; Implementation procedures.

Subsection (a)

This subsection establishes the incumbent EDC in each certificated service territory as the DSP. The PUC believes that this decision is in the public interest because the competitive retail market is still in transition and it is consistent with § 2802(16) of the Act. This section of the Act states, in part: "Electric distribution companies should continue to be the provider of last resort in order to ensure the availability of universal electric service in this Commonwealth unless another provider of last resort is approved by the commission."

Section 2807(e)(2) of the Act further explains the potential role of an EDC. It states:

> 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.

While it is clear that § 2802(16) of the Act requires EDCs to fill the role of provider of last resort *during* the transition period, § 2807(e)(2) leaves open what the EDCs' role should be *at the end* of the transition period. Given the declaration of policy contained in § 2802(5) of the Act, that competitive market forces are more effective than economic regulation, we question whether this decision is consistent with the intent of the General Assembly.

Subsection (b)

Under this subsection, an EDC may petition the PUC to be relieved of its default service obligation or the PUC may relieve an EDC of its default service obligation if this action is in the public interest. The final-form regulation should include the criteria that the PUC will use to determine if the removal of an EDC as a DSP is in the public interest.

Subsection (c)

This subsection outlines the competitive process for the replacement of an EDC acting as the DSP. Under Subsection (c)(1), an EDC or EGS wanting to be an alternative DSP must apply for a certificate of public convenience. Subsection (c)(2) also requires the applicant to demonstrate

its operational and financial fitness to serve and its ability to comply with certain laws, regulations and orders.

We have three concerns. First, what is the PUC's statutory authority to require that an EGS acquire a certificate of public convenience in order to provide default service? Second, an EDC already has a certificate of public convenience. Would a new certificate be required, or could the EDC amend its existing certificate? Third, Subsection (c)(4) states that if one or more applicants meet the standards to become the DSP, the PUC will grant a certificate of public convenience to act as DSP to the applicant best able to fulfill the obligation. The criteria the PUC will use to make this determination should be included in the final-form regulation.

6. Section 54.184. Default service provider obligations. – Clarity.

Subsection (b)

This subsection requires DSPs to comply with all applicable PUC regulations and orders. For clarity, a citation to the applicable regulations should be included in the final-form regulation.

Subsection (c)

Under this subsection, a DSP is required to continue the universal service program in effect in the EDC's certificated service territory or implement a similar customer assistance program consistent with the Act. Subchapter C of 52 Pa. Code Chapter 54, relating to universal service and energy conservation reporting requirements, imposes certain duties on EDCs. Would the DSP have to comply with all the requirements contained in Subchapter C? If the DSP is not the EDC, how will these programs be funded?

7. Section 54.185. Default service implementation plans and terms of service. – Adverse effects on prices, productivity or competition; Implementation procedures; Clarity.

Subsection (a)

This subsection requires a DSP to file a default service implementation plan no later than 15 months prior to conclusion of the existing plan or the PUC approved generation rate cap. When would a DSP selected under the competitive process contained in § 54.183(b) and (c) be required to file an implementation plan?

Subsection (b)

This subsection requires compliance with all PUC regulations pertaining to documentary filings and requires service of the plans on certain parties. We have two recommendations. First, a citation to the applicable regulations should be included in the final-form regulation. Second, as suggested by a commentator, plans should also be served on all registered EGSs in the EDC's service territory and/or made available on the EDC's website.

Subsection (c)

This subsection states the following: "A default service implementation plan must propose a minimum term of service of at least twelve months, or multiple twelve month periods, or for a period necessary to comply with subsection (f)." Some commentators believe that allowing multiple 12 month periods is too long because it may distort market prices and thereby contradict the competition goal of the Act. Other commentators believe 12 months is too short and could lead to higher prices for consumers. We believe this provision is important because it will

directly affect the procurement strategies of the DSPs and will influence how closely rates for default service will reflect prevailing market prices.

We believe it is appropriate for default service implementation plans to include details on a DSP's procurement strategy which may call for a portion of the energy to be provided under contracts with a duration of more than 12 months. However, the PUC should be cautious about approving plans that will remain in effect for multiple 12 months periods because they may not reflect the prevailing conditions in wholesale energy markets. Where DSPs want to enter long term contracts with energy suppliers, we recommend that only a limited portion of the energy purchased be for a term of service of greater than 12 months and that the term of service be no longer than 36 months.

Subsection (d)

Under this subsection, electric generation supply must be acquired through a competitive procurement process, which requires bid solicitation. We note that the § 2807(e)(3) of the Act requires EDCs to acquire electric energy at "prevailing market prices." Several commentators believe that a "competitive" process is not needed to acquire energy at the "prevailing market price." Others believe that bid solicitation is not the only method that should be allowed. Flexibility should be provided by allowing an EDC or an alternate EDC to acquire energy using appropriate procurement processes with varying terms of service that reflect the prevailing market price. The EDC or the alternate EDC would then have the duty to demonstrate that the selected process procured energy at the prevailing market price.

Subsection (i)

Under this subsection, the implementation plan must include reasonable credit requirements or "other reasonable assurances of any supplier of electric generation services' ability to perform, as approved by the Commission." The phrase "other reasonable assurances" is unclear. The final-form regulation should explain what other assurances the PUC would approve. Similarly, how would these be "approved by the Commission"? Would they be evaluated as part of the review of the plan or as a part of another process?

Subsection (j)

This subsection requires default services plans to identify all existing "long-term generation contracts" between EDCs and retail customers. The phrase "long-term" is vague and should be replaced with a specific time frame.

Subsection (k)

This subsection states that default service implementation plans "should include copies of any proposed confidentiality agreements." The term "should" is non-regulatory language which indicates that this provision is optional. The PUC should either replace the word "should" with "shall" or delete this provision from the final-form regulation.

Subsection (m)

This subsection allows the PUC to issue further orders which would specify the form and content of implementation plans. We agree that PUC orders are the best way to specify the form of default service implementation plans. However, the required "content" should be included in this section and, if changes are needed, be promulgated by amending this regulation through the rulemaking process.

8. Section 54.186. Default service supply procurement. – Adverse effects on prices, productivity or competition; Implementation procedures; Clarity.

Subsection (a)

This subsection requires a DSP to procure electricity through a competitive procurement process or a replacement procurement process approved by the PUC. We question the need to prescribe the manner in which electricity is procured by the DSP. As noted above, the Act requires the procurement of electricity at the "prevailing market price." The method of procurement should not matter if that condition is met. Therefore, the requirement that electricity be acquired only through the competitive procurement process should be modified.

Subsections (b) and (e)

The phrase "bid evaluation criteria" appears in Subsections (b)(2)(vi) and (e). What bid evaluation criteria, other than price, will be acceptable to the PUC? If there are any, they should be included in the regulation.

Subsection (d)

This subsection states that the competitive procurement process may be subject to direct oversight by the PUC or an independent third party. It is our understanding that the competitive procurement process *shall* be subject to oversight. Therefore, the optional term "may" should be replaced with the mandatory term "shall."

Subsection (f)

The PUC's verification of compliance with a competitive procurement process is addressed under this subsection. The scope of the PUC's review should be limited to the compliance with the approved default service implementation plan.

Also, in Subsection (f)(2), the PUC should amend the language to state that the review period will be *no more* than three business days. This would allow all participants in the competitive procurement process to know the results of the bid solicitation.

Subsection (g) and also § 54.187(i) and § 54.188(e)

These subsections provide instructions for procuring energy when there is insufficient supply, an EGS fails to deliver supply, or a competitive procurement process has been rejected. All three subsections conclude with the following sentence: "The default service provider shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa.C.S. § 2807(e)(3) (relating to duties of electric distribution companies), when selecting from the various options available in these energy markets." We have two concerns. First, the phrase "acquisition strategies" is vague and should be defined. Second, will this process be subject to review and approval by the PUC?

9. Section 54.187. Default service rates and the recovery of reasonable costs. – Reasonableness; Clarity.

Subsection (a)

This subsection requires the use of three types of charges for recovering costs associated with providing default service. They include a generation supply charge, a customer charge and an automatic energy adjustment charge to recover costs incurred under the AEPS. The first two are

non-reconcilable charges. The other charge reflects the statutory recovery mechanism contained in the AEPS.

Commentators have suggested a wide-range of options, from unbundling to reconciliation, on how these costs should be handled. To promote competition, the PUC is requiring unbundling of the charges. To further promote competition, the PUC should maintain the proposed language that does not permit the reconciliation of the generation supply and customer charges. This approach would keep the EDCs on a more equal competitive footing with EGSs.

Subsection (a)(1)

This subsection relates to the generation supply charge. Subsection (a)(1)(vi) references "other reasonable, identifiable generation supply acquisition costs." These costs should be specified in the final-form rulemaking.

Subsection (a)(2)

This subsection relates to the customer charge. We have three concerns.

First, the PUC should ensure that no customer care costs are recovered through generation, distribution or transmission rates. Embedded customer care costs related to generation service and to distribution and transmission service should be separated.

Second, if small utilities have not performed the necessary cost of service studies to determine an appropriate "customer charge," how is this cost determined?

Finally, as a commentator suggested, a "distribution credit," which would only include incremental costs related to customer care service, could replace this charge. Has the PUC contemplated instituting a distribution credit, as suggested by the commentator?

Subsection (a)(2)(iv)

In this subsection, what are "other reasonable and identifiable administrative or regulatory expenses"?

Subsection (a)(3)

The automatic energy adjustment charge is addressed in this subsection. It is not clear how this annually reconciled mechanism will operate in conjunction with the competitive procurement process. This should be clearly explained in the final-form regulation.

Subsection (b)

This subsection requires that "a default service plan must include a **fixed** rate option for all residential customers" (Emphasis added). In order to promote competition, the PUC should require that fixed rate options include a seasonal or monthly variation to reflect the prevailing market price. Also, the final-form regulation should include language to require the DSP to offer, as an option, an hourly rate to residential customers.

Also, because this provision relates to what must be included in an implementation plan, it should be deleted from this section and placed in § 54.185, relating to default service implementation plans and terms of service. The same concern applies to Subsections (c), (f) and (g).

Subsection (c)

This subsection provides that non-residential customers with a registered peak demand of 500 kilowatts or less must be given a fixed rate option. Again, in order to promote flexibility and a greater role for market pricing, the PUC should also require that the fixed rate option include seasonal or monthly variations. DSPs should also be required to offer the option for hourly pricing.

Several commentators have offered a wide range of peak demand levels that they feel would be more appropriate, ranging from 25 kilowatts to 1 megawatt. Another commentator requests flexibility in determining the threshold. In addition, the threshold has already been established at 300 kilowatts for Duquesne Light. The PUC should explain why it chose the 500 kilowatt peak demand threshold in this section as well as in Subsection (d).

Subsection (d)

This subsection establishes that DSPs "shall include an hourly rate in its implementation plan for all default service customers" with a peak demand level of greater than 500 kilowatts. Commentators claim that hourly pricing for these customers will limit the DSP's flexibility in meeting requirements of the AEPS because alternative energy credit acquisition "will be quite limited with prices higher relative to longer-term contracts." The PUC should explain how this provision will affect DSPs in meeting the AEPS requirements.

Subsection (f)

We have two comments on this subsection.

First, the terms "demand side response" and "demand side management programs" should be defined.

Second, a commentator has asserted that offering demand side response and demand side management programs could impose a hardship on small EDCs. Does the PUC anticipate any negative effect on small EDCs?

Subsection (g)

This subsection provides that implementation plans may include "mechanisms that allow default service providers to adjust their prices" in certain circumstances. The "mechanisms" that could be used should be clearly set forth in the final-form regulation. Does the PUC intend to use the AEPS clause as a mechanism?

Subsection (h)

This subsection states that a DSP's projected and actual costs for providing service may not be subject to PUC review and reconciliation except in "extraordinary circumstances." What are these "extraordinary circumstances"? These should be set forth in the final-form regulation.

10. Section 54.188. Commission review of default service implementation plans. – Reasonableness; Clarity.

Subsection (b)

Some commentators indicate that the six-month review period established by this subsection is not long enough. They note that rate cases usually take nine months. The PUC should consider extending the time period for review of a default service implementation plan to nine months.

Subsections (c) and (e)

In keeping with the theme of our initial general comment, the PUC should consider reviewing plans to ensure that they are properly designed to result in the lowest price, produce a reliable supply and include only reasonable cost recovery.

Subsection (g)

This subsection contains the phrase, "and other applicable laws." If there are other "applicable laws" that must be followed, the PUC should provide a cross-reference to these laws.

11. Section 54.189. Default service customers. – Legislative intent; Clarity.

Some commentators believe switching rules are necessary to provide predictability as to the size of the DSPs' potential customer bases. They contend that this would allow DSPs to more accurately predict their customers' load and to procure energy at lower prices, resulting in more affordable energy for default customers. Others believe that the Act and the spirit of competition prohibit any rules that would hinder customers from changing their supplier of electric service.

Section 2807(e)(4) of the Act states the following: "If a customer that chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy service." The PUC should ensure that no limitations are placed on customers to prevent switching from one energy supplier to another.