



COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION
400 NORTH STREET
HARRISBURG, PA 17120

ROBERT F. POWELSON
CHAIRMAN

May 1, 2012

The Honorable Silvan B. Lutkewitte, III
Chairman
Independent Regulatory Review Commission
14th Floor, Harristown II
333 Market Street
Harrisburg, PA 17101

**Re: L-2009-2095604/57-273, Final Rulemaking
Default Service Regulations, 52 Pa. Code, Chapter 54**

Dear Chairman Lutkewitte:

Enclosed please find one (1) copy of the regulatory documents concerning the above-captioned rulemaking. Under Section 745.5(a) of the Regulatory Review Act, the Act of June 30, 1989 (P.L. 73, No. 19) (71 P.S. §§745.1-745.15) the Commission, on April 15, 2010, submitted a copy of the Notice of Proposed Rulemaking to the House Consumer Affairs Committee, the Senate Consumer Protection and Professional Licensure Committee and the Independent Regulatory Review Commission (IRRC). This notice was published at 40 *Pa.B.* 2267 on May 1, 2010. The Commission also provided the Committees and IRRC with copies of all comments received in compliance with Section 745.5(b.1).

Enclosed today is the Commission's final rulemaking, the Commission's report and IRRC's March 15, 2012, disapproval order. In preparing this final form rulemaking, the Commission has considered all comments received from the Committees, IRRC and the public.

Sincerely,

A handwritten signature in black ink that reads "Robert F. Powelson". The signature is written in a cursive style with a long, sweeping underline.

Robert F. Powelson
Chairman

Enclosures

pc: The Honorable Robert M. Tomlinson
The Honorable Lisa Boscola
The Honorable Robert Godshall
The Honorable Joseph Preston, Jr.
Legislative Affairs Director Perry
Chief Counsel Pankiw
Assistant Counsel Melia
Regulatory Coordinator DelBiondo

PENNSYLVANIA PUBLIC UTILITY COMMISSION

**REPORT TO THE
INDEPENDENT REGULATORY REVIEW COMMISSION:
DISAPPROVED REGULATION SUBMITTED WITHOUT REVISIONS**

L-2009-2095604/57-273

The Pennsylvania Public Utility Commission (Commission) is submitting this Report to the Independent Regulatory Review Commission (IRRC) and the standing Committees of the Pennsylvania Senate and House of Representatives pursuant to Section 7(b) of the Regulatory Review Act, 71 P.S. § 745.7(b) and regulatory requirements at 1 Pa. Code Chapter 311 (relating to procedures for review of disapproved final regulations). As discussed herein, the Commission respectfully resubmits, without revision or modification, the Final Form Default Service Regulations. The Commission has made no revisions to these regulations as it believes the previously submitted regulations fully meet the requirement for approval under the Regulatory Review Act, 71 P. S. §§ 745.1, *et seq.* This Report contains the original final regulations and a copy of IRRC's Disapproval Order. In addition, the Report fully responds to IRRC's concerns expressed in its Disapproval Order.

BACKGROUND

The IRRC previously reviewed these final regulations that amend the existing regulations governing default service practices appearing at Sections 54.181 through 54.188 of the Commission's regulations. 52 Pa. Code §§ 54.181-54.188. These Final Form Default Service Regulations were originally submitted to IRRC on January 27, 2012.

The sole purpose of the amendments was to update and, thus, eliminate conflict between the Commission's existing default service regulations¹ and the enacted provisions of Act 129 that contained several important changes to the default service procurement standards.² While the statutory standards in Act 129 automatically supersede those contained in the Commission's existing default service regulations, the Commission is obligated to bring its regulations in line with the state law and to avoid confusion for litigants appearing before the Commission in default service proceedings.

IRRC's Public Meeting to consider the final form default service regulations was held on March 15, 2012, during which counsel for the Commission appeared and responded to questioning by the IRRC Commissioners. Notably, no party spoke in opposition to the final form regulations. However, at the conclusion of the public meeting, the IRRC unanimously disapproved the Final Form Default Service Regulations. A Disapproval Order was issued by IRRC on March 27, 2012.

IRRC DISAPPROVAL ORDER AND FINDINGS

The relevant language from the Disapproval Order is as follows:

Since the PUC is still in the process of determining how the procurement provisions of Act 129, as they relate to default service should be interpreted and applied, and as the final-form regulation largely reiterates language from the statute without providing a clear interpretation of the statute, we question whether the regulation is

¹ The Commission's default service regulations were initially promulgated pursuant to Section 2807(e) of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2807(e) *et seq.* (the Electric Competition Act). Section 2807(e) of the Electric Competition Act, among other things, established the obligations of electric distribution companies as default service suppliers. The original default service regulations were promulgated in 2007. Those regulations established the prior standard of "prevailing market prices" for procuring default supply.

² Act 129, enacted in 2008, required the Commission to implement a number of measures related to energy efficiency, conservation and reductions in energy consumption and peak demand by electric distribution companies (EDCs). Act 129 also revised the standard governing procurement of default supply repealing the "prevailing market price" standard and replacing it with the "least cost to customers over time" standard.

premature or needed at this time. (71 P.S. § 745.5b(b)(3)(iii)). We do not believe the PUC has adequately demonstrated that the rulemaking is in the public interest prior to the completion of its investigation and submission of a clearly defined standard of interpretation of Act 129's requirements.

We have determined this regulation is consistent with the statutory authority of the PUC (66 Pa. C.S. §§ 501 and 2807) and the intention of the General Assembly. However, we have determined that the regulation does not meet the criterion of need under the Regulatory Review Act as discussed above and find promulgation of this regulation is not in the public interest.

The Commission respectfully resubmits the Final Form Default Service Regulations without revisions and urges the IRRC to reconsider and approve them because: (1) the regulations are necessary to conform the Commission's default service regulations with state law; (2) the final form regulations will avoid confusion for litigants in default service proceedings; (3) the regulations are unopposed; and (4) the pending *Retail Markets Investigation* does not provide a basis to delay approval of these final form default service regulations. Accordingly, the Commission responds to the concerns raised by the IRRC as required under 1 Pa. Code § 311.5.

CLARIFICATION RELATED TO THE STATUS OF DEFAULT SERVICE PROCUREMENT PLANS UNDER ACT 129

While the Commission is resubmitting the final form regulations for IRRC consideration without revision or modification, the Commission would like to clarify a number of points related to these regulations and their relationship to the 16 questions asked during the proposed rulemaking public comment period and the ongoing Retail Markets Investigation (RMI).

At the time the Commission proposed the rulemaking, it was hoped that the rulemaking would serve as a vehicle both to update the existing default service

regulations in order to make them more consistent with Act 129 and to provide additional clarity on the procurement requirements for default service plans by seeking comment on the 16 questions posed by the Commission.

In evaluating the comments received, two themes emerged. First, there was broad support for the Commission's approach to update its regulatory language in order to be consistent with Act 129. The Energy Association of Pennsylvania (EAP) stated, in part, that "...the proposed regulations generally incorporate the language of Act 129 verbatim... EAP agrees with this approach because it provides the maximum amount of flexibility for the Commission to consider different procurement strategies for different EDCs and at different points in time." EAP Comments at 2. PPL Energy Plus also stated that "The proposed regulations generally adopt Act 129 procurement requirements verbatim, and PPL Energy Plus has no basis to disagree with that language." PPL Energy Plus Comments at 2.

The second observation was that many commenters overwhelmingly felt that a one-size-fits-all regulatory approach to procurement issues would be problematic. This perspective is clearly provided by the comments of the Retail Energy Supply Association (RESA): "The Commission should refrain from setting any specific "bright-line" rules in its regulation or policy statement as to what this structure (i.e., the "prudent mix" of contracts) should look like for each and every default service plan due to the differences among EDCs [electric distribution companies] and the continuously evolving markets." RESA Comments at 3. Similar comments were provided by PPL Electric Utilities Corporation (Comments at 10), PECO Energy Company (Comments at 2), Metropolitan Edison Company (Comments at 3-4), and EAP (Comments at 3).

Recognizing the importance of revising existing regulations to be consistent with the current statutory language as both a criteria for review under the Regulatory Review Act and for reasons supported by interested parties, the Commission proceeded with the

rulemaking to address this uncontested issue. As for the procurement issues, the Commission ultimately agreed with the commenters as noted above that default service procurement plans were best evaluated on a case-by-case basis. Thus, the Commission issued a policy statement that maintains the flexibility EDCs stated they needed while also providing for the evaluation of procurement issues as part of litigated proceedings approving each default service procurement plan.

The Retail Markets Investigation (RMI) is a Commission proceeding initiated at Docket No. I-2011-2237952 to develop recommendations to ensure a functioning retail electric market in Pennsylvania.³ This proceeding is specifically evaluating all aspects of retail electric markets and default service, including, among other things, procurement of default service supply. The ultimate recommendation of the Commission may include policy, regulatory and/or statutory changes; but at this point, it is premature to speculate both on what the proposed future structure of default service will be and the approach necessary to implement that design.

The Commission is not waiting for the results of the RMI to implement the Act 129 procurement provisions. Rather, the Commission has been applying the procurement requirement of “least cost to customers over time” articulated in Act 129 since 2008 on a case-by-case basis.⁴ This approach has been effective and no party has sought

³ The RMI was initiated by the Commission as a component of its approval of the acquisition of the West Penn Power Company by the First Energy Corporation, Docket Nos. A-2010-2176520 and A-2010-2176732 (Order entered March 8, 2011). The Commission did not cite to Act 129 of 2008 in its reasons for initiating the investigation. *Investigation of Pennsylvania’s Retail Electricity Market*, Docket I-2011-2237952 (Order entered April 29, 2011).

⁴ This approach is consistent with Commission long-standing practice in the context of natural gas supply procurement. Natural gas distribution companies are obligated to procure gas according to a “least cost fuel procurement policy” and their rates must be “just and reasonable.” 66 Pa.C.S. § 1318. These terms are not defined in the Commission’s regulations. Rather, the law requires the issue to be litigated on an annual basis, and the NGDC has the burden of introducing evidence that its procurement plan and proposed rates satisfy this legal standard. It is a fact specific inquiry that involves the filing of expert witness testimony, evidentiary hearings, and the opportunity for cross-examination. A body of precedent has been developed through these proceedings which the Commission applies to new gas procurement cases.

reconsideration or appellate review of a post-Act 129 Commission procurement determination.

Having clarified that Act 129 procurement issues have been resolved, the Commission reiterates its strong opinion that the final form regulations should be promulgated as written. Revising the existing regulatory language to be consistent with the procurement standard contained in Act 129 avoids confusion within the regulated community and is consistent with the Regulatory Review Act's direction to avoid regulations that conflict with statutes. Here, the Commission is attempting to remedy an inconsistency in its default service regulations by removing the "prevailing market price" standard in favor of Act 129's "least cost to customers over time."

THE PROPOSED FINAL FORM DEFAULT SERVICE REGULATIONS MEET ALL OF THE STATUTORY CRITERIA UNDER SECTION 745.5b OF THE REGULATORY REVIEW ACT.

Section 745.5b establishes the criteria for IRRC review of proposed regulations. Section 745.5b(a) requires that the promulgating agency have the statutory authority to promulgate the regulation and that the regulation conforms to the intent of the General Assembly in the enactment of the statute on which the regulation was based. Section 745.5b(b) enumerates a number of factors that the IRRC must consider in determining whether the regulations are in the public interest.

In March, the IRRC determined that the Default Service Regulations are consistent with the statutory authority of the Commission and the intent of the General Assembly. IRRC did not raise any other criteria for rejection of the Default Service Regulations under Section 745.5b(b) other than Section 745b(b)(3)(iii)(need for the regulation), stating as follows: "as the final-form regulation largely reiterates language from the

statute without providing a clear interpretation of the statute, we question whether the regulation is premature or unneeded at this time.” *See* IRRC Disapproval Order at p.2.

On resubmittal, the Commission observes that Section 745.5(b)(3)(iii) was the only statutory deficiency identified by IRRC as the basis for disapproval. Accordingly, the Commission respectfully submits that the Default Service Regulations, in all other respects, comport with the other enumerated criteria listed under Section 745.5 b(b) and asks that the IRRC reconsider its determination under the Section 745.5(b)(3)(iii) standard, requiring that an agency establish a “need for the regulation,” and find that these regulations are indeed needed to conform the statute and the Commission’s regulations.

As explained above and in the Final Rulemaking Order, the principal purpose of the rulemaking was to establish consistency between the Commission’s existing regulations promulgated under the original Electric Competition Act and the new requirements of Act 129. *See PUC Final Rulemaking Order* at 8 (“[O]ur first priority needs to be updating the current default service regulations to be consistent with the requirements of Act 129”). Moreover, the precise statutory language and applicable standards for evaluation of the default supply procurement plans of electric distribution companies under both the Competition Act and, as modified under Act 129, were addressed at pages 3-6 of the Final Rulemaking Order. In that discussion, the Commission sequentially addressed each Act 129 amendment to the existing Section 2807(e). The final form regulations serve to implement each of those Act 129 amendments and remove the current conflict between the Commission’s existing regulations and current state law.

The Commission submits that the final form regulations are needed to avoid confusion to parties in the Commission’s future default service proceedings. The parties should not be faced with the prospect of reading one set of default service procurement

rules and procedures in the Commission's regulations while existing law sets forth a substantially different set of standards for the procurement of default service.

Additionally, and as explained in more detail above, the Commission also submits that the pending RMI does not provide a basis to delay approval of these final form default service regulations. There is an important distinction between the narrow purpose of these final form default service regulations and the wholly different and broader purpose of the Commission's ongoing investigation.

The RMI was initiated by the Commission to examine the state of the retail competition market and explore regulatory and/or legislative modifications which could be considered to ensure a fully functioning retail market. The final form default service regulations resulting from Act 129 were promulgated to provide clarity and to avoid confusion to parties in the default service process. Indeed, the final form regulations are needed and are essential to satisfy the regulatory review standard that the regulation not conflict with existing statutes. 71 P.S. § 745b (b)(3)(i). Any conclusion of the RMI has no bearing on the present need to establish regulatory consistency between the current default service regulations and the requirements of state law, as specified in Act 129.

CONCLUSION

The Commission contends that approval of the Final Form Default Service Regulations is necessary, appropriate and in the public interest. The Commission asserts that further disapproval of the revised regulations would perpetuate a conflict between Act 129 and the Commission's existing regulations, a standard expressly contemplated under Section 745b(3)(i) of the Regulatory Review Act (possible conflict with or duplication of statutes or existing regulations). Indeed, it is both necessary and proper for the Commission to resolve a conflict between an agency's regulation and state law. If

left unchanged, the Disapproval Order would have the unfortunate effect of perpetuating a conflict between an agency's regulation and existing state law.

Further, disapproval of the default service regulations would leave EDCs, retail electric marketers and other interested parties involved in the default service procurement process with less clarity and ambiguity with regard to the proper standard to be followed prospectively by default service suppliers. This factor is also directly relevant under Section 745b(3)(ii) (clarity and lack of ambiguity). Because IRRC's disapproval has the unfortunate effect of providing less clarity and more ambiguity in regard to default service rules, it should be reconsidered.

The Commission also would refer IRRC to the Commission's *Policy Statement Regarding Default Service and Retail Electric Markets*, approved by the Commission at Docket No. M-2009-2140580 (Order entered September 23, 2011, published in the *Pennsylvania Bulletin* on February 25, 2012), which was designed to conform certain default service procurement procedures, not well suited to specific regulations, to the requirements of Act 129. EDCs, retail electric marketers and other stakeholders are currently operating consistent with a policy statement that properly reflects Act 129 requirements while being subjected to outdated regulations that are inconsistent with Act 129.

This inconsistency between a policy statement that is consistent with Act 129 and existing default service regulations that are not consistent with Act 129 is not in the public interest and is contrary to the regulatory review standards at 71 P.S. § 745.5b(b) regarding conflict and clarity. As such, continued disapproval would have the unfortunate effect of allowing lack of clarity and inconsistency with state law and Commission policy statements to remain in place.

Finally, the Commission reiterates that the outcome of the *Retail Markets Investigation* has no bearing on the need to have in place default service regulations that are consistent with existing Act 129 requirements. This proceeding, initiated in April 2011, is a multi-phase investigation into the operation of default service markets in Pennsylvania. The proceeding has encompassed a combination of *en banc* hearings, written comments and stakeholder meetings. As explained above, the outcome of the *Retail Markets Investigation* may result in no change, minimal changes or significant changes to the structure default service. None of these possible outcomes is affected in any way by the changes mandated by the passage of Act 129. On the contrary, delaying these necessary modifications to the complex default service procurement process will inject a continuing level of needless uncertainty that is not consistent with the Commission's statutory obligations under the Electric Competition Act. Accordingly, continued delay in the approval of these important regulations is not in the best interests of Pennsylvania ratepayers.

For the reasons stated herein, the Commission requests that the IRRC reconsider and reverse its prior disapproval of the Final Form Default Service Regulations. The regulations should be approved because: (1) the final form regulations are necessary to conform the Commission's default service regulations to existing state law; (2) the final form regulations will avoid confusion for litigants in current and future default service proceedings; (3) the regulations are unopposed; and (4) the pending *Retail Markets Investigation* does not provide a basis to delay approval of these Final Form Default Service Regulations.

**INDEPENDENT REGULATORY REVIEW COMMISSION
DISAPPROVAL ORDER**

Commissioners Voting:

Public Meeting Held March 15, 2012

Silvan B. Lutkewitte, III, Chairman
George D. Bedwick, Vice Chairman
Arthur Coccodrilli, Abstained
John F. Mizner, Esq.
Lawrence J. Tabas, Esq.

Regulation No. 57-273 (#2837)
Pennsylvania Public Utility Commission
Default Service Regulations

On April 15, 2010, the Independent Regulatory Review Commission (Commission) received this proposed regulation from the Pennsylvania Public Utility Commission (PUC). This rulemaking amends 52 Pa. Code Chapter 54. The proposed regulation was published in the May 1, 2010 *Pennsylvania Bulletin* with a 45-day public comment period. The final-form regulation was submitted to the Commission on January 27, 2012.

This final-form rulemaking aligns the PUC's existing default service regulations with Act 129 of 2008 (Act 129). Act 129 had several key elements, including changes to the way electric distribution companies serving as the default service provider (DSP) for non-shopping customers (or alternative PUC-approved DSPs) purchase electricity for sale to non-shopping customers. Under the original deregulation law, the Electric Generation Customer Choice and Competition Act of 1996, DSPs were required to purchase the electricity at "prevailing market prices." (*See former* 66 Pa.C.S § 2807(e)(3).) Act 129 repealed that standard and now requires the purchases to be designed to ensure adequate and reliable service at the "least cost to customers over time."

The PUC has noted that the rulemaking generally incorporates Act 129 procurement requirements verbatim. When the proposed rulemaking was published, the PUC sought comment on 16 questions pertaining to how Act 129 should be interpreted "to ensure adequate and reliable service at the least cost to customers over time, and on how the proposed regulations should be revised to reflect the interpretation recommended by the person filing the comments."

Our comments expressed concern with the approach taken by PUC for the promulgation of the rulemaking and questioned the need for the regulation in this form and at this time. We recommended that the PUC withdraw the proposed rulemaking, evaluate the feedback provided by the regulated community on the 16 questions, and draft a new proposed regulation that does more than recite the Act 129 revisions, especially as the PUC has acknowledged that the statute is subject to interpretation. There have been no substantive changes made to the final-form version of the rulemaking.

The PUC reported to the Commission that in April of 2011, the PUC launched an investigation into Pennsylvania's competitive electricity retail market. It is our understanding that part of the investigation will focus on "end state default service models."

Since the PUC is still in the process of determining how the procurement provisions of Act 129 as they relate to default service should be interpreted and applied, and as the final-form regulation largely reiterates language from the statute without providing a clear interpretation of the statute, we question whether the regulation is premature or needed at this time. (71 P.S. § 745.5b(b)(3)(iii)). We do not believe the PUC has adequately demonstrated that the rulemaking is in the public interest prior to the completion of its investigation and submission of a clearly defined standard of interpretation of Act 129's requirements.

We have determined this regulation is consistent with the statutory authority of the PUC (66 Pa.C.S. §§ 501 and 2807) and the intention of the General Assembly. However, we have determined that the regulation does not meet the criterion of need under the Regulatory Review Act as discussed above and find promulgation of this regulation is not in the public interest.

BY ORDER OF THE COMMISSION:

The regulation #57-273 (IRRC #2837) from the _____

Pennsylvania Public Utility Commission

was disapproved on March 15, 2012 .



Silvan B. Lutkewitte, III, Chairman



RECEIVED

INDEPENDENT REGULATORY
REVIEW COMMISSION

2012 MAY -1 PM 2: 53

Regulatory Analysis Form

(Completed by Promulgating Agency)

(All Comments submitted on this regulation will appear on IRRC's website)

(1) Agency:

Pennsylvania Public Utility Commission

(2) Agency Number: L-2009-2095604

Identification Number: 57-273

IRRC Number: 2837

(3) PA Code Cite:

52 Pa. C. S. §§ 54.181-54.188

(4) Short Title:

Final Regulations Regarding Default Service and Retail Electric Markets

(5) Agency Contacts (List Telephone Number and Email Address):

Primary Contact: James P. Melia (717-787-1859)

Secondary Contact: Robert Young (717-787-4945)

(6) Type of Rulemaking (check applicable box):

Proposed Regulation

Final Regulation

Final Omitted Regulation

Emergency Certification Regulation;

Certification by the Governor

Certification by the Attorney General

(7) Briefly explain the regulation in clear and nontechnical language. (100 words or less)

The Commission proposes amending Sections 54.181-54.188 to Title 52 of the Pa. Code pertaining to default service and retail electric markets so that the Commission's current regulations reflect changes made pursuant to Act 129, October 15, 2008, P.L. 1592, No. 129, 66 Pa. C. S. §§ 2803 et seq.

(8) State the statutory authority for the regulation. Include specific statutory citation.

The Pennsylvania Public Utility Code, 66 Pa.C.S. §2807, and the Commonwealth Documents Law, 45 P.S. §§1201, et seq. Also the Pennsylvania Public Utility Code, 66 Pa. C.S. §501 (relating to general powers).

(9) Is the regulation mandated by any federal or state law or court order, or federal regulation? Are there any relevant state or federal court decisions? If yes, cite the specific law, case or regulation as well as, any deadlines for action.

Yes. The revisions to the regulations were required by Act 129, October 15, 2008, P.L. 1592, No. 129, which was codified at Section 2807, 66 Pa. C. S. § 2807, et seq. These amendments to Section 2807 of the Public Utility Code were required to conform the existing provisions of Section 2807(e) regarding the default service provider's obligations to the additional requirements implemented pursuant to Act 129, which modified how electric utility providers must structure electric default service plans.

(10) State why the regulation is needed. Explain the compelling public interest that justifies the regulation. Describe who will benefit from the regulation. Quantify the benefits as completely as possible and approximate the number of people who will benefit.

The adoption of the amended regulations will ensure consistency between the statutory provisions of Act 129 and the Commission's regulations governing electric default service. The amendments to the regulations were necessary to implement important changes to the standards that must be applied by the Commission in reviewing and ruling upon electric utility default service plans.

(11) If data is the basis for this regulation, please provide a description of the data, explain in detail how the data was obtained, and how it meets the acceptability standard for empirical, replicable and testable data that is supported by documentation, statistics, reports, studies or research. Please submit data or supporting materials with the regulatory package. If the material exceeds 50 pages, please provide it in a searchable electronic format or provide a list of citations and internet links that, where possible, can be accessed in a searchable format in lieu of the actual material. If other data was considered but not used, please explain why that data was determined not to be acceptable.

Data was not utilized in the development of the amended regulations. The source material from which the amended regulations were derived were comments from interested stakeholders who were knowledgeable in addressing the perceived inconsistencies between the existing regulations and the provisions impacting default service from the enactment of Act 129.

(12) Describe who and how many people will be adversely affected by the regulation. How are they affected?

No parties are adversely affected. Electric utilities will benefit from the Commission's revision of its current regulations with the requirements of Act 129. Electric utilities will have better guidance as to how they must structure their electric default service programs. Consumers will benefit from being provided electric default service that is priced at a standard that assures adequate and reliable service as well as the least cost to customers over time.

(13) List the persons, groups or entities that will be required to comply with the regulation. Approximate the number of people who will be required to comply.

The main parties who will be required to comply are the default electric supplier utilities in PA. There are about a dozen investor-owned electric utilities subject to these regulations.

(14) Provide a specific estimate of the costs and/or savings to the **regulated community** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

There are no discernible costs or savings to the regulated community from having default electric suppliers comply with the amended regulations.

(15) Provide a specific estimate of the costs and/or savings to **local governments** associated with compliance, including any legal, accounting or consulting procedures which may be required. Explain how the dollar estimates were derived.

There are no cost or savings impacts on local governments associated with the amended regulations.

(16) Provide a specific estimate of the costs and/or savings to **state government** associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required. Explain how the dollar estimates were derived.

There are no cost savings to state government from implementing the revised regulations.

(17) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ N/A	\$ N/A
Regulated Community						
Local Government						
State Government						
Total Savings	N/A	N/A	N/A	N/A	N/A	N/A
COSTS:						
Regulated Community	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
Local Government						
State Government						
Total Costs						

REVENUE LOSSES:	N/A	N/A	N/A	N/A	N/A	N/A
Regulated Community						
Local Government						
State Government						
Total Revenue Losses	N/A	N/A	N/A	N/A	N/A	N/A

(17a) Provide the past three year expenditure history for programs affected by the regulation.

Program	FY -3	FY -2	FY -1	Current FY
N/A	N/A	N/A	N/A	N/A

(18) Explain how the benefits of the regulation outweigh any cost and adverse effects.

No parties are adversely affected and there are no discernible costs. Consumers will benefit from being provided electric default service priced at a standard that assures adequate and reliable service.

(19) Describe the communications with and input from the public and any advisory council/group in the development and drafting of the regulation. List the specific persons and/or groups who were involved.

The amended regulations were published in the PA Bulletin for public comment. The only parties that commented were those stakeholders with a specific interest in the subject area of the regulations (electric utilities, electric generators and marketers, trade associations and governmental advocates/public interest groups).

(20) Include a description of any alternative regulatory provisions which have been considered and rejected and a statement that the least burdensome acceptable alternative has been selected.

There were no regulatory alternatives considered.

(21) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulations.

Not applicable.

(22) How does this regulation compare with those of other states? How will this affect Pennsylvania's ability to compete with other states?

These regulations are fairly unique and do not have readily comparable counterparts in other states.

The amended regulations will not put Pennsylvania at a competitive disadvantage with other states.

(23) Will the regulation affect any other regulations of the promulgating agency or other state agencies?
If yes, explain and provide specific citations.

The amended default service regulations are related to the Commission's Policy Statement on Default Service at M-2009-2140580.

(24) Submit a statement of legal, accounting or consulting procedures and additional reporting, recordkeeping or other paperwork, including copies of forms or reports, which will be required for implementation of the regulation and an explanation of measures which have been taken to minimize these requirements.

The amended regulations will not result in any additional legal, accounting, consulting, reporting, recordkeeping or other requirements.

(25) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

Not applicable.

(26) Include a schedule for review of the regulation including:

- A. The date by which the agency must receive public comments: N/A
- B. The date or dates on which public meetings or hearings will be held: none scheduled
- C. The expected date of promulgation of the proposed regulation as a final-form regulation: N/A
- D. The expected effective date of the final-form regulation: Feb/March 2012
- E. The date by which compliance with the final-form regulation will be required: Upon publication
- F. The date by which required permits, licenses or other approvals must be obtained: N/A

(27) Provide the schedule for continual review of the regulation.

After taking effect, the regulations at 52 Pa. Code §§ 54.181-54.188 will be reviewed and revised as necessary.

**FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU**

(Pursuant to Commonwealth Documents Law)

**RECEIVED
IRRC**

2012 MAY -1 PM 2: 53

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to form and legality. Attorney General.

BY _____
(DEPUTY ATTORNEY GENERAL)

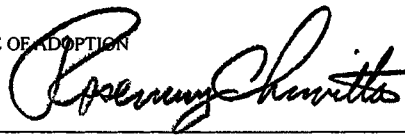
DATE OF APPROVAL

Check if applicable
Copy not approved. Objections attached

Copy below is hereby certified to be true and correct copy of a document issued, prescribed or promulgated by:

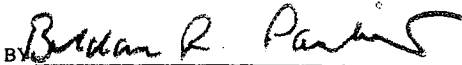
Pennsylvania Public Utility Commission
(AGENCY)

DOCUMENT/FISCAL NOTE NO. L-2009-2095604/57-273

DATE OF ADOPTION


BY _____
Rosemary Chiavetta
TITLE Secy
(SECRETARY)

Copy below is hereby approved as to form and legality. Executive or independent Agencies.

BY 
Bohdan R. Pankiw
Chief Counsel

9-22-2011
DATE OF APPROVAL

Check if applicable. No Attorney General approval or objection within 30 days after submission.

L-2009-2095604/57-273
Final Rulemaking
Default Service Regulations
52 Pa. Code, Chapter 54

The Pennsylvania Public Utility Commission on September 22, 2011, adopted a final rulemaking order which revises the Commission's default service regulations to be consistent with Act. 129. The contact person is James Melia, Law Bureau, 787-1859.

Executive Summary
L-2009-2095604/57-273

Final Rulemaking Re
Implementation of Act 129 of October 15, 2008:
Default Service and Retail Electric Markets

On May 10, 2007, the Commission issued a Final Rulemaking Order at Docket No. L-00040169 addressing default service. The default service regulations became effective on September 15, 2007. The regulations require default service providers to acquire default supply at prevailing market prices.

On October 15, 2008, the Governor enacted House Bill 2200, Act 129, which made substantial changes to the statutory standards for acquisition of electric generation supply by electric distribution companies (EDCs) for their default service customers including: requirements in regard to competitive procurement, a prudent mix of contract types and least cost service to customers over time. 66 Pa. C.S. § 2807(e)(3.1).

By Order entered January 19, 2010, the Commission initiated a rulemaking proceeding to consider amendments to our default service regulations as required by enactment of Act 129 such that our regulations shall be consistent with the Act.

This final rulemaking revises 52 Pa. Code 54.181-54.188. These revisions establish the needed consistency between the existing regulations and the requirements of the Act, improves the default supply acquisition process and establishes more fair and equitable standards for evaluating electric utility default supply plans.

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**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held September 22, 2011

Commissioners Present:

Robert F. Powelson, Chairman
John F. Coleman, Jr., Vice Chairman
Tyrone J. Christy
Wayne E. Gardner
Pamela A. Witmer, Statement

Implementation of Act 129 of
October 15, 2008; Default Service
And Retail Electric Markets

Docket No. L-2009-2095604

FINAL RULEMAKING ORDER

BY THE COMMISSION:

By this Order, the Commission issues Final Regulations amending its existing regulations at 52 Pa. Code §§ 54.181 through 54.188 to be consistent with the requirements of Act 129 which, *inter alia*, made substantial changes to the statutory standards for acquisition of electric generation supply for default service customers. In this Order, the Commission also provides guidance on the default service process and procedure based on input received in response to sixteen questions posed in its Order entered January 19, 2010.

Procedural History

On October 15, 2008, Governor Edward Rendell signed House Bill 2200, Act 129, into law. The Act became effective on November 14, 2008. Act 129 has several key elements and goals, including: Commission establishment of an energy efficiency and conservation program, mandated reductions by Electric Distribution Companies (EDCs)

in their energy consumption and peak demand, Commission review and approval of each EDC's programs and plans to achieve the mandated reductions, and penalties for an EDC's failure to achieve the mandated reductions. In addition, Act 129 made substantial changes to the statutory standards for acquisition of electric generation supply by EDCs for their default service customers, including: requirements in regard to competitive procurement, a prudent mix of contract types, least cost to customers over time, and adequate and reliable service. 66 Pa. C.S. §2807(e)(3.1).

Historically, the local electric utility company was responsible for generating, purchasing and delivering electricity to the customers' premises. However, the Electric Generation Customer Choice and Competition Act (Competition Act) of December 3, 1996 (P.L. 802, No. 138), codified at 66 Pa. C.S. §§ 2801, *et seq.*, required electric distribution companies (EDCs) to unbundle transmission, distribution and generation rates for retail customers. The Competition Act deregulated electricity generation and provided all customers in Pennsylvania with the opportunity to choose their electricity generation supplier (EGS). 66 Pa. C.S. 2806 (a). The EDC is responsible for delivering the electricity to those customers who choose to buy from an EGS. Additionally, the EDC is responsible for both acquiring and delivering electricity for those customers who do not shop or buy their electricity from an EGS or where an EGS fails to provide the promised electricity.

When an EDC acquires electricity for customers not served by an EGS, the EDC is functioning as the "default service provider" (DSP). The Competition Act provided that an EDC's generation rates be capped until the EDC had completed its stranded cost recovery. Many of the larger EDCs agreed to extend rate caps as part of their electric restructuring settlements. All generation rate caps have now expired, the most recent expirations occurring on December 31, 2010.

Following the expiration of rate caps, the Competition Act provided that default service providers “acquire electric energy at prevailing market prices” to serve default service customers and that default service providers “recover fully all reasonable costs.” 66 Pa. C.S. § 2807(e) (3). There has been disagreement over what “prevailing market prices” mean as applied to default service rates.

History of Default Service Regulations and Policy Statement

On May 10, 2007, the Commission issued a Final Rulemaking Order at Docket No. L-00040169 addressing default service. The default service regulations became effective on September 15, 2007. The Commission further issued a separate policy statement order on February 9, 2007 at Docket No. M-00072009 that contained guidelines for DSPs in the areas of procurement, rate design, and cost-recovery. The default service regulations set forth detailed requirements for default service plans. The regulations require default service providers to acquire default supply at prevailing market prices. The regulations further require that electric generation supply be acquired by competitive bid solicitations, spot market purchases or a combination of both. 52 Pa. Code § 54.186 (b) (4). Competitive bid processes are subject to monitoring by the Commission. 52 Pa. Code § 54.186 (c) (3). The regulations allow DSPs to use automatic adjustment clauses for recovery of non-alternative energy default service costs. 52 Pa. Code § 54.187(f). The Default Service Policy Statement provides additional guidance to EDCs regarding energy procurement, bid solicitation processes, default service cost elements, rate design, rate change mitigation, rate and bill ready billing, purchase of receivables programs, customer referral program and supplier tariff uniformity.

Act 129 Amendment to Default Service Obligations

Even though the retail provision of electric generation service has been subject to competition for nearly a decade, the vast majority of residential customers continue to obtain their generation supplies from their default supplier, that is, their regulated electric

distribution utility. Under the Competition Act, EDCs (or alternative Commission-approved default suppliers) were required to serve non-shopping customers after rate caps ended by acquiring electric energy “at prevailing market prices.” Act 129 explicitly repealed the “prevailing market prices” standard and declared instead that the utilities’ generation purchases must be designed to ensure adequate and reliable service at “the least cost to customers over time.” Moreover, such purchases must be in compliance with the new statutory obligations in regard to competitive procurement and a “prudent mix” of contract types. 66 Pa. C.S. § 2807(e)(3.4).

In reviewing a utility’s default service plan, the Commission must consider “the default service provider’s obligation to provide adequate and reliable service to customers and that the default service provider has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis.” 66 Pa. C.S. § 2807(e)(3.7).

Another substantive change is that contracts for supply formerly were defined as being up to 3-years in length. Now, under Act 129, a long-term purchase contract is generally defined as a contract “of more than four and not more than 20 years.” 66 Pa. C.S. § 2807(e)(3.2)(iii).

In summary, under Act 129, electric power shall be procured through competitive procurement processes and shall include one or more of the following: (1) auctions; (2) requests for proposals; or (3) bilateral agreements. 66 Pa. C.S. § 2807(e)(3.1). Additionally, the electric power that is procured shall include a prudent mix of: (1) spot market purchases; (2) short-term contracts; and (3) long-term purchase contracts of more than 4 and not more than 20 years. 66 Pa. C.S. § 2807(e)(3.2). Long term contracts may not constitute more than 25% of projected load absent a Commission determination that good cause exists for a higher percentage to achieve least cost procurement. 66 Pa. C.S. § 2807(e)(3.2)(iii).

The “prudent mix” of contracts shall be designed to ensure: (1) adequate and reliable service; (2) the least cost to customers over time; (3) compliance with the procurement methodologies described above, i.e., through auctions, requests for proposals, or bilateral agreements. 66 Pa. C.S. §§ 2807(e)(3.4) and (e)(3.1). “Bilateral contract” is a new term defined under 66 Pa. C.S. § 2803 (relating to definitions).

In terms of process, the DSP must file a plan for competitive procurement with the Commission and obtain Commission approval of the plan considering certain factors and standards under 66 Pa. C.S. § 2807(e) before the competitive process is implemented. The Commission shall hold hearings as necessary on the proposed plan. If the Commission fails to issue a final order on the default service plan or an amended default service plan within nine months of the date that the plan is filed, the plan or amended plan is deemed to be approved and the default service provider may implement the plan or amended plan as filed. 66 Pa. C.S. § 2807(e)(3.6).

When evaluating a default service plan, the Commission must consider the DSP’s obligation to provide adequate and reliable service to the customers and that the DSP has obtained a prudent mix of contracts to obtain the least cost on a long-term, short-term and spot market basis. The Commission is required to make specific findings that include: (1) the DSP’s plan includes prudent steps necessary to negotiate favorable generation supply contracts; (2) the DSP’s plan includes prudent steps necessary to obtain least cost generation contracts on a long-term, short-term and spot market basis; and (3) neither the DSP nor its affiliated interest has withheld generation supply from the market as a matter of federal law. 66 Pa. C.S. § 2807(e)(3.7).

Further, under Act 129, DSPs have a right to recover default service costs pursuant to a reconcilable automatic adjustment clause and residential and small commercial and industrial customers’ rates cannot change more frequently than quarterly.

66 Pa. C.S. § 2807(e)(3.9). Default service plans approved by the Commission prior to

the effective date of Act 129 shall remain in effect through the approved term. However, the DSP may propose amendments to an approved plan. 66 Pa. C.S. § 2807(e)(6). The DSP shall offer residential and small business customers a generation supply service that shall change no more frequently than on a quarterly basis. All default service rates shall be reviewed by the Commission to ensure that the costs of providing service to each customer class are not subsidized by other classes. 66 Pa. C.S. § 2807(e)(7).

By Order entered January 19, 2010, the Commission initiated a rulemaking proceeding to consider amendments to our default service regulations as required by the enactment of Act 129 such that our regulations shall be consistent with the Act.

Parties Filing Comments

Initial comments to the Commission's January 19, 2010 Proposed Rulemaking Order ("Order") were filed by the following parties on behalf of the electric utility industry: Energy Association of PA (EAP)), FirstEnergy (Pennsylvania Electric Company, Metropolitan Edison Company, Pennsylvania Power Company)(FirstEnergy), PECO Energy Company (PECO), PPL Electric Utilities Corporation (PPL), Allegheny Power Company (Allegheny), Duquesne Light Company (Duquesne) and Citizens Electric/Wellsboro Electric (Citizens/Wellsboro). Comments were filed by the following parties on behalf of electric generation companies: FirstEnergy Solutions (FES), P3 Group (P3), Exelon Generation (Exelon), PPL Energy Plus (PPL Energy), Constellation NewEnergy and Constellation Commodities Group, Inc. (Constellation). The following retail supplier providers and representative organizations filed comments: Pennsylvania Energy Marketers Coalition (PEMC), National Energy Marketers Association (NEMA) and the Retail Energy Supply Association (RESA). Finally, comments were filed by the Office of Consumer Advocate (OCA), Office of Small Business Advocate (OSBA), Industrial Customer Group (ICG) and Citizen Power (CP). Comments were also received from the Independent Regulatory Review Commission (IRRC) and the Office of Attorney General (AG).

Reply comments were filed by the following parties: FirstEnergy, PECO, EAP, Citizens/Wellsboro, FES, RESA, Constellation, OCA, OSBA, and ICG.

Discussion

The purpose of this rulemaking is to amend existing Commission regulations at 52 Pa. Code §§ 54.181 through 188 to be consistent with the requirements of Act 129. Initially, we address some overall comments received from IRRC.

IRRC Comments

In its comments, IRRC raised the following points:

1. IRRC is concerned that the 16 questions posed should have formed the basis for the rulemaking on default service and regulations should have been drafted based on feedback received from the parties to the questions as opposed to the Commission's approach of simply engrafting the Act 129 changes onto the existing regulations.
2. IRRC is concerned that the approach undertaken by the Commission will result in the incorporation of changes to the default service regulations, based on responses to the 16 questions, that have not been reviewed by the stakeholders, the designated standing committees and IRRC.
3. IRRC recommends the Commission withdraw the proposed rulemaking, evaluate the feedback on the 16 questions, draft new regulations based on the feedback and the reintroduce the rulemaking.
4. In the event the Commission does not withdraw the rulemaking, IRRC suggests the Commission draft an Advance Notice of Final Rulemaking (ANOFR) based on the responses received from the parties on the 16 questions and share that ANOFR with the parties.

We have carefully considered IRRC's recommendations and decline to withdraw the current rulemaking. The Commission has been grappling with the difficult task of implementing the provisions of the Competition Act in its original default service regulations. With the passage of Act 129, we were again faced with the pressing need to revise the existing default service regulations to conform to the changes imposed by Act

129. We believe that our ability to efficiently and capably comply with the provisions of both laws require us to press ahead with the current update of the regulations.

The purpose of posing the 16 questions, in conjunction with the proposed regulations, was twofold: (1) to assess the views of the parties on critical legal and policy issues relevant to evaluating default service plans that come before us; and (2) to determine if any additional changes to the current regulations needed to be made in light of the responses to the 16 questions. The substance of the responses received to both the proposed regulations and the 16 questions convinced this Commission that our first priority needs to be updating the current default service regulations to be consistent with the requirements of Act 129. With reference to the 16 questions, we agree with IRRC that, in retrospect, it would have been more efficient to issue the 16 questions prior to drafting our proposed rulemaking. However, these questions developed as a result of issues arising in our review of recent default service plans—issues which we believe were critical enough to merit stakeholder input.

In the meantime, the need to incorporate Act 129 changes remains and we are compelled to move forward with those changes. We believe, as noted by IRRC and some parties, that it would be fundamentally unfair to the regulated community and stakeholders to implement significant changes to the current default service regulations based on responses received to the 16 questions at this time. That is not to say that the information obtained from these questions was not of value. The responding parties provided most helpful input into a number of complex issues—input that will inform our decision-making process in reviewing future default service plans. In fact, one theme repeated throughout the responses was that the Commission should refrain from adopting a “one-size fits all” approach to reviewing default service plans and retain a more flexible “case by case” approach which still adheres to those fundamental standards contained in the Competition Act and Act 129.

To conclude, we did not undertake any revisions to the final form default service regulations beyond the scope of the specific comments provided by the parties on the proposed changes resulting from Act 129. We will continue to review default service plans as they are filed with the additional information received in the responses to the 16 questions. If, in the future, there is a need to make further revisions based on our evolving experience with default service plans, we will initiate a new rulemaking process to update existing regulations as necessary. In particular, the Commission wishes to make clear that the focus of this rulemaking is to bring our existing default service rules into compliance with Act 129 standards. Therefore, these final form regulations should not be construed to anticipate, pre-judge or otherwise foreclose our consideration of other default supply models or adjustments to the current default service model in the pending *Retail Electricity Markets Investigation* at Docket No. I-2011-2237952. Having decided to move forward, we have responded to the concerns raised by IRRC in the context of specific sections of the regulations. These concerns are addressed later in this Order in the discussion related to each section.

Section 54.181. Purpose.

No revision to this language was proposed by the Commission as part of the proposed Rulemaking Order. However, both OCA and OSBA have suggested that the existing “Purpose” section be modified to delete the reference to “prevailing market price” and substitute the language “least cost over time” as follows to be consistent with the changes made by Act 129:

§ 54.181. Purpose.

This subchapter implements 66 Pa.C.S. § 2807(e) (relating to duties of electric distribution companies), pertaining to an EDC’s obligation to serve retail customers at the conclusion of the restructuring transition period. The provisions in this subchapter ensure that retail customers who do not choose an alternative EGS, or who contract for electric energy that is not delivered, have

access to generation supply at [prevailing market prices] the least cost over time. The EDC or other approved entity shall fully recover all reasonable costs for acting as a default service provider of electric generation supply to all retail customers in its certificated distribution territory.

RESA expresses dissatisfaction with this proposed change for the reason that the Legislature, in amending Section 2807(e) (3), did not mean to institute the “least cost standard” as the *only* standard by which to assess a DSP. RESA cites to Constellation’s comments that a DSP must include: (1) power acquired through competitive procurement processes; (2) a prudent mix of supply contracts; and (3) a plan that must ensure adequate and reliable service. RESA also states in Reply Comments that this change is unnecessary as default service rates priced at the “prevailing market” are consistent with the mandates of Act 129 and the Competition Act because they are the products of default service plans appropriately structured to stimulate retail competition. RESA then proposes its own amendatory language to make the section consistent with the mandates of the Competition Act as follows:

The provisions in this subchapter ensure that retail customers who do not choose an alternative EGS, or who contract for electric energy that is not delivered, have access to generation supply PROCURED BY A DEFAULT SERVICE PROVIDER PURSUANT TO A COMMISSION APPROVED COMPETITIVE PROCUREMENT PLAN. (New language in caps).

Initially, we agree with the OCA’s proposed change to this section since the “prevailing market prices” standard has been repealed by the legislature. To fail to recognize this important distinction would result in our failing to give the legislative changes inherent in Act 129 their proper effect.

However, we agree with RESA that to replace “prevailing market prices” with “least cost to customers over time”, while correct, is an incomplete and therefore misleading description of the multi-faceted standard that Act 129 has established. As

correctly noted by RESA, the statutory standard now includes review of the competitive procurement process employed, the “prudent mix” of supply contracts negotiated and the ability of the default plan to ensure adequate and reliable service, as well as the “least cost to customers over time” standard. Moreover, to retain the prior language would continue to perpetuate confusion among the parties and the public as to the proper standard. For these reasons, we shall adopt RESA’s suggested changes.

PECO, in Reply Comments, also disagreed with OCA’s proposed change to insert the “least cost to customers” standard for the “prevailing market price” standard but indicated that, if the change is made, the Commission should make clear that “least cost to customers over time” will be construed as part of the requirements of a “prudent mix” of contracts pursuant to Section 2807(e) (3.4) and not independently of the statutory framework of Act 129. We believe this caveat is appropriate and we reiterate that our application of the “least cost over time standard” will be construed as part of the requirements of a competitive procurement process, a “prudent mix” of contracts, and adequate and reliable service pursuant to the requirements of Act 129.

IRRC requested the Commission to identify every section of the existing default service regulations that uses the phrase “prevailing market price” and explain why it decided to retain that phrase. The AG also endorsed this change. As discussed previously, we have chosen to delete the phrase “prevailing market price” while adopting in this Order certain cautionary language proposed by RESA and PECO to insure application of the correct standard.

Finally, it should be noted that the “least cost over time” standard should not be confused with the notion that default prices will always equal the lowest cost price for power at any particular point in time. In implementing default service standards, Act 129 requires that the Commission be concerned about rate stability as well as other considerations such as ensuring a “prudent mix” of supply and ensuring safe and reliable

service. See 66 Pa. C.S. §§ 2807(e)(3.2), (3.4) and (7). In our view, a default service plan that meets the “least cost over time” standard in Act 129 should not have, as its singular focus, achieving the absolute lowest cost over the default service plan time frame but, rather, a cost for power that is both adequate and reliable and also economical relative to other options.

We recognize that amendment of the language of this section was not proposed as part of the Proposed Rulemaking Order and no other parties have had the opportunity to consider this modification. However, we consider this change to be appropriate and consistent with our objective to conform the current default service regulations to the requirements of Act 129. We will adopt this amendment and include in the final version of these regulations at Annex A to this Order.

Section 54.182 – Definitions.

“Bilateral contract” is a new term and is defined in Section 2803 as follows.

An agreement, as approved by the Commission, reached by two parties, each acting in its own independent self-interest, as a result of negotiations free of undue influence, duress or favoritism, in which the electric energy supplier agrees to sell and the electric distribution company agrees to buy a quantity of electric energy at a specified price for a specified period of time under terms agreed to by both parties, and which follows a standard industry template widely accepted in the industry or variations thereto accepted by the parties. Standard industry templates may include the EEI Master Agreement for physical energy purchases and sales and the ISDA Master Agreement for financial energy purchases and sales.

66 Pa. C.S. § 2803.

Bilateral agreements are referenced in 66 Pa. C.S. § 2807(e)(3.1)(iii). We proposed to amend 52 Pa. Code § 54.182 such that it mirrors verbatim the definition in 66 Pa. C.S. § 2803 as follows:

Bilateral contract –The term as defined in 66 Pa. C. S. § 2803 (relating to definitions).

Comments to this proposed amendment were almost unanimously supportive of this modification. Citizens/Wellsboro suggested that the definition is too restrictive and should be revised to specifically confirm that “Bilateral contracts” may be used for both physical and financial transactions. Citizens/Wellsboro’s clarification is predicated on certain circumstances associated with its recent default service plan. PECO supports this clarification as well.

We adopt the term “Bilateral contract” and its definition as proposed as it appears in Annex A to this Order. We reject the proposed change suggested by Citizens/Wellsboro for the reason that the existing definition is sufficiently clear for purposes including both physical and financial transactions. Any necessary clarifications regarding what products may qualify for inclusion in bilateral contracts can be explored in the course of review of individual EDC DSPs.

Act 129 adds additional language to the definition of a default service provider. Definitions at 66 Pa. C.S. § 2803 – Default Service Provider provides in pertinent part:

An electric distribution company within its certified service territory or an alternative supplier approved by the Pennsylvania Public Utility Commission that provides generation service to retail electric customers who: (1) contract for electric power, including energy and capacity, and the chosen electric generation supplier does not supply the service; or (2) do not choose an alternative electric generation supplier.

Whereas, 52 Pa. Code § 54.182 (Definitions) provides:

“DSP-Default Service Provider”- The incumbent EDC within a certificated service territory or a Commission approved alternative supplier of electric generation service.

Because the new definition of default service provider includes alternative supplier approved by the Commission, we proposed to amend 52 Pa. Code § 54.182 such that it mirrors verbatim the definition in 66 Pa. C.S. § 2803 as follows:

DSP—Default service provider— [The incumbent EDC within a certificated service territory or a Commission approved alternative supplier of electric generation service.] The term as defined in 66 Pa. C.S. § 2803 (relating to definitions).

Virtually all parties agreed with this proposed amendment of the definition of “Default service provider” to be consistent with the language contained in 66 Pa. C.S. § 2803 (relating to definitions) and we will adopt the proposed language. It should be noted that Duquesne and PECO requested insertion of the precise language of Section 2803 into the definition. We reject that suggestion on the basis that incorporation of the language by reference to the statute is sufficient and we have incorporated such definitions by reference in other instances in these regulations. The definition as adopted appears at Annex A to this Order.

Additionally, we deleted the term “prevailing market price” and its definition consistent with comments filed by OCA and OSBA. As the term no longer appears in these regulations, there is no need for the definition.

52 Pa. Code § 54.184. (Default Service Provider Obligations).

Section 2807(e) of the Competition Act explains the EDC’s obligation to serve. Specifically, it adds a qualifier that while an EDC collects either a competitive transition charge or an intangible transition charge or until 100% of an EDC’s customers have electric choice, whichever is longer, an EDC as a default service provider is responsible for reliable provision of default service to retail customers. Accordingly, we proposed the following language be added to 52 Pa. Code § 54.184(a).

(A) [A DSP] While an EDC collects either a competitive transition charge or an intangible transition charge or until 100% of an EDC’s customers have electric choice, whichever is longer, an EDC, as a default service provider shall be responsible for the reliable provision of default service to retail customers who are not receiving generation services from an alternative EGS within the certificated territory of the EDC that it serves or whose alternative EGS has failed to deliver electric energy.

Furthermore, Act 129 states that following the expiration of an EDC's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide the service or if a customer does not choose an alternative electric generation supplier, the default service provider shall provide electric generation supply service to that customer. This provision of default service must be pursuant to a Commission-approved competitive procurement process including one or more of the following: (1) auctions, (2) requests for proposals, or (3) bilateral agreements entered into at the sole discretion of the DSP which shall be at prices that are no greater than the cost of obtaining generation under comparable terms in the wholesale market or consistent with a Commission-approved competitive procurement process. 66 Pa. C.S. § 2807(e) (3.1). Affiliated interest agreements are subject to Commission review and approval. 66 Pa. C. S. § 2807 (e) (3.1)(iii).

We propose adding the underlined language above to 52 Pa. Code § 54.184 to reflect these additional requirements. We wish to highlight that any bilateral agreements between EDCs and their affiliated suppliers must be filed with the Commission and will be subject to review pursuant to the Chapter 21 requirements relating to review of affiliated interest agreements.

To further accommodate the new requirements set forth in Act 129, we propose to amend the following language in 52 Pa. Code § 54.184(d):

A DSP shall continue the universal service and energy conservation program in effect in the EDC's certificated service territory or implement, subject to Commission approval, similar programs consistent with [the] 66 Pa.C.S. § 2801-- [2812] 2815(relating to Electricity Generation Customer Choice and Competition Act and the amendments provided under the Act of October 15, 2008 (P.L. 1592, No. 129 (Act 129) providing for energy efficiency and conservation programs)). The Commission will determine the allocation of these responsibilities between an EDC and an alternative DSP when an EDC is relieved of its DSP obligation.

The majority of comments received were supportive of the proposed amendments to Section 54.184. Citizens/Wellsboro requested that the final regulations confirm that purchases in PJM or other RTO markets and auctions are permissible including spot purchases, capacity, ancillary services, transmission, auction revenue rights and financial transmission rights.

RESA objects to the additional proposed language in Section 54.184(a) because the language would assign the EDC the DSP role without regard to the possibility that the Commission may choose to assign the role to another entity through the procedures provided in Section 54.183(b). Additionally, RESA contends the proposed revision contemplates keeping the EDC in the role of DSP until 100% migration is reached which is unreasonable and unattainable. RESA proposes alternative language which would remove the 100% requirement and give the Commission the flexibility to select an alternative DSP “when it is no longer necessary to have the default service option or until the Commission determined that it is appropriate to assign the default service obligation to another entity.” RESA, in Reply Comments, opposes the language proposed by Citizens/Wellsboro discussed above as unnecessary.

IRRC references RESA’s concern about not acknowledging that other entities may be assigned to the default service provider role and that the new language contemplates keeping the default service provider until 100% migration is reached. IRRC asks for a more detailed explanation of why this language was included in the rulemaking.

With reference to the new language introduced in Section 54.184(a) and in response to IRRC’s request for more explanation, we reiterate that we merely incorporated the language from Section 2807(e) (1) which establishes the parameters in which a DSP must provide default service. That language provides that an EDC shall have the obligation to provide default service in two instances: (1) while the EDC collects an intangible transition charge or (2) until 100% of customers have choice. Including this language from the statute does not and is not intended to negate, in any way, the

Commission's authority and discretion to choose an alternative default service supplier who is not an EDC.

With reference to the proposed change in Section 54.184(b), we have reconsidered our proposed change and have decided not to adopt it. Upon closer review, we recognize that the proposed language could create the impression that an alternative DSP would be required to provide "connection" and "delivery" functions, which will always remain natural monopoly functions of the EDC. To avoid this inconsistency, we will retain the original language in Section 54.184(b).

We reject RESA's proposal to either make no change or to adopt their proposed language for the reason that our purpose in revising the existing DSP regulations was to conform the existing regulations to the changes implemented by Act 129. RESA's proposal to not make any language changes to Section 54.184(a) ignores the clear and specific language contained in 66 Pa. C.S. § 2807(e)(1) which dictates the parameters under which we may select an alternative DSP. RESA's proposed alternative language would have this Commission potentially exceed its authority under the existing statutory requirement by giving it the discretion to select an alternative DSP under circumstances that are not permitted under the language of Section 2807(e). In our view, in order for RESA's changes to be adopted, changes to the Commission's statutory authority for selecting DSPs would need to be implemented. This is also responsive to IRRC's request for more information on why we included the proposed language.

OSBA opposed RESA's first change in its Reply Comments as a violation of the Customer Competition statute. PECO also opposed this change posed by RESA.

A few other proposed changes were offered by the parties and IRRC.

PECO and IRRC suggest inserting the word "or" between the proposed Section 54.184(c)(3)(i) and (ii) to be consistent with current language contained in

66 Pa. C.S. § 2807(e)(3.1)(III)(A) and (B). We agree this change is appropriate and will adopt it in the final regulations.

OSBA contends some of the proposed language referencing Act 129 is redundant and should be deleted. We do not agree that the language is redundant and find it is necessary for proper clarity. We will retain the language as proposed.

Citizens/Wellsboro suggests that the final regulations recognize an additional type of competitive procurement process – purchases of products in the markets and auctions operated by the applicable RTO such as spot purchases, capacity, ancillary services, transmission auction rights and financial transmission rights. PECO supports this change as well. We reject this proposed change to the regulation as the existing language in 52 Pa. Code § 54.184(c) adequately addresses the range of competitive procurement options available to DSPs. In terms of the procurement products that may be purchased, those details are set forth in subsection (e)(3.2) and are mirrored in Section 54.186(b)(1). Among the types of products permitted are “spot market purchases” which, in the Commission’s view, would include the types of RTO-offered products and services referenced by Citizens/Wellsboro and PECO, so long as they are reasonably necessary for the provision of default service. Accordingly, Citizens/Wellsboro is already free to purchase the products enumerated from the wholesale market and we will evaluate those purchases in our review of the utilities’ DSP under the standards established by Act 129. We adopt Section 54.184 as modified herein and as included at Annex A to this Order.

52 Pa.Code § 54.185. (Default service programs and period of service).

In this Section, we proposed adding language to subsection (b) to reflect the new nine month deadline for Commission review in Act 129. 66 Pa. C.S. § 2807 (e)(3.6). If the Commission fails to issue a final order on the initial default service plan or an amended default service plan within nine months of the date that the plan or amended plan is filed, then the plan or amended plan shall be deemed approved and the DSP may implement the plan or amended plan as filed. Costs incurred through an approved

competitive procurement plan shall be deemed to be the least cost over time as per Act 129. 66 Pa. C.S. § 2807(e)(3.6). This language will replace existing subsection (b)'s language. The old language will be moved to subsection (c). Subsequent sections will move down one letter as well.

Almost all parties agreed with the proposed changes to Section 54.185. RESA proposed some additional qualifying language to Section 54.185(b) which purports to insert language that introduces a wholly different standard for evaluating default service plans than what was intended by Act 129 and the existing procedures. RESA proposes to hold hearings “to ensure that the plan is reasonably likely to promote sustainable retail market development by resulting market reflective and market responsive default service rates.”

PECO noted in Reply Exceptions that RESA's proposals would improperly modify the statutory standard against which default service plans would be evaluated. OSBA also objects to RESA's proposed language change. PECO aptly points out that Section 2807(e)(3.4) of Act 129 provides that a DSP's prudent mix of default service supply contracts shall be designed to ensure adequate and reliable service at the least cost over time. The phrase “least cost over time” is not defined in the Act, but the Act provides that “costs incurred through an approved competitive procurement plan shall be deemed to be least cost over time as required under paragraph (3.4) (ii).”

66 Pa. C. S. § 2807(e)(3.6).

We agree with the objections of PECO and OSBA and reject RESA's proposed language. Inserting RESA's proposed language requiring findings of “market effective” and “market responsive rates” as well as “competitive retail alternatives” in order for a plan to be approved would result in the injection of specific standards applicable to the Commission's decision-making process in a section that is meant to be procedural. Section 54.185 is designed to strictly govern the process for Commission review of DSPs

and RESA's proposed language would unduly restrict Commission flexibility in carrying out its responsibilities under these regulations.

RESA's proposed language change is rejected. Section 54.185 is adopted as proposed and as it appears in Annex A to this Order.

52 Pa.Code § 54.186. (Default Service Procurement and Implementation Plans).

Act 129 sets forth different standards from our current regulations that a DSP's procurement plan must adhere to. We propose deleting the old standard and replacing it with the "prudent mix" standard as outlined in Act 129. For example, instead of a plan being "designed to acquire electric generation supply at prevailing market prices to meet the DSP's anticipated default service obligation at reasonable costs," as specified in Section 54.186, Act 129 now requires the plan "include a prudent mix" of: (a) spot market purchases; (b) short-term contracts; and (c) long-term (5-20 year) contracts. 66 Pa. C. S. § 2807(e)(3.2)(i),(ii), and (iii).

In addition, the prudent mix of contracts must be designed to ensure: (1) adequate and reliable service; (2) the least cost to customers over time; and (3) compliance with the requirements of subsection (e)(3.1) regarding competitive procurement. 66 Pa. C.S. § 2807(e)(3.4). We propose to add this language to our regulation. There are two exceptions to the long-term purchase contracts under Act 129 which will be added to our regulations at subsection (b)(1)(iii)(A) and (B).

Act 129 provides that the DSP may petition for modifications to the approved procurement and implementation plans when material changes in wholesale energy markets occur to ensure the acquisition of sufficient supply at prevailing market prices. 66 Pa. C.S. § 2807(e)(6). Also, the DSP is obligated to monitor changes in wholesale energy markets to ensure that its procurement plan continues to reflect the incurrence of reasonable costs, consistent with 66 Pa. C.S. § 2807(e)(3.4) (relating to the prudent mix).

Accordingly, we will add the following language to this section in conformance with Act 129:

(e) At the time the Commission evaluates the plan and prior to its approval, in determining if the DSP's Plan obtains generation supply at the least cost over time, the Commission shall consider the DSP's obligation to provide adequate and reliable service to customers and that the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission shall make specific findings which shall include the following:

- (1) The DSP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.
- (2) The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term, and spot market basis.
- (3) Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates federal law.

A number of parties proposed minor editorial changes to this regulation.

Both OCA and Duquesne suggest deleting the term "prevailing market prices" in Section 54.186(a) and inserting language reflecting the "least cost" standard to reflect Act 129's changes to the goals of default service. Duquesne and OCA also requested that the reference to "prevailing market price" in subsection (d) be replaced to be consistent with adoption of the "prudent mix standard." RESA and PECO object to these changes in their Reply Comments.

We adopt OCA and Duquesne's suggestion to replace the language "prevailing market price" in Sections 54.186 (a) and (d) with the language "least cost to customers over time". As the "least cost to customers over time" is now the prevailing standard

established in Act 129, we believe that replacement of language referencing “prevailing market price” is necessary in order to have our current regulations correctly reflect the Act 129 legislation. In adopting this change, we reject OSBA’s suggestion to delete the Section 54.186 (d) standard as unnecessary.

OCA proposes deleting some language at Section 54.186(b)(2)(iii) substituting reference to subparagraph (b)(1)(iii) with Section 54.184(c) for the sake of clarity. OSBA comments that the reference to “(b)(1)(iii)” in Section 54.186(b)(2)(iii) be changed to simply “(b)(1)” for correctness. The AG also endorses OSBA’s change. We agree with OSBA’s change as more appropriate and adopt it.

RESA suggests additionally adding the language “...through a competitive procurement process” to the proposed language at Section 54.186 (e)(1) to insure consistency with Section 2807(e). We have reviewed the proposed language change and accept this change as it is appropriate to reinforce the concept that one of the Commission’s obligations under the Competition Act is to ensure that a competitive process exists. IRRC has requested specifically whether we have incorporated this change and our foregoing response addresses that concern.

Citizens/Wellsboro and ICG suggest that the proposed language at Section 54.186(b)(1)(iii)(A) (relating to DSPs offering negotiated rate service to a customer with a peak demand of 15 MW or greater at one meter location) would be better located in Section 54.187 which addresses rate design and cost recovery. We have reviewed this proposed change and reject it. We believe the present location of the language is appropriate and best reflects our desire to conform the regulation to the requirements of Act 129.

Citizens/Wellsboro request clarification of the language at Section 54.186(b)(1)(iii) to allow long-term contracts of four but not more than 20 years. The

proposed language provides for contracts “... of more than 4 and not more than 20 years” which parallels the language in Act 129. Citizens/Wellsboro suggests changing the language to include a contract “...of at least four years but not longer than 20 years.” Citizens/Wellsboro requests that the language be clarified so as to provide that the shortest long-term contract be four years.

We agree that this is a point in need of clarification. Our proposed language does not clearly state whether a 4 year contract is a short-term or long-term contract. By adopting the language of Section 2703(e)(3.2)(iii), we only perpetuate the ambiguity. We believe the Legislature’s intent was to define a 4 year contract as a short-term contract and a contract greater than 4 years but not greater than 20 years as a long-term contract. We therefore reject the suggested change of Citizens/Wellsboro and revise the language of Section 54.186(b)(1)(iii) to parallel the language adopted in our order at M-2009-2140580 (Final Policy Statement) which clearly provides for long-term contracts as greater than 4 years in length but not greater than 20 years.

OSBA proposes that Section 54.186(b) (1) should properly track the language in Section 2807(e)(3.2)(iii) that requires a hearing when a default service plan is filed that includes long term contracts as more than 25% of the projected load. We adopt this change. OSBA also suggests that new Section 54.186(b)(5) make clear that all products itemized in this section are to be acquired through a competitive procurement process. RESA supports the latter change. We believe that the language is sufficiently clear as stated and the language remains as initially proposed.

To conclude, we adopt Section 54.186 as modified herein and reflected in Annex A to this Order.

52 Pa. Code § 54.187. (Default Service Rate Design and the Recovery of Reasonable Costs).

Act 129 states that a default service provider shall have the right to recover on a full and current basis, through a reconcilable automatic adjustment clause under Section 1307, all reasonable costs incurred under 66 Pa. C.S. § 2807 and a Commission-approved competitive procurement plan. 66 Pa. C.S. § 2807(e)(3.9). This language was added to Section 54.187(b) and the phrase “default service rate schedule . . . designed to recover fully all reasonable costs incurred by the DSP during the period default service is provided to customers, based on the average-cost to acquire supply for each customer class” was stricken as the methodology has changed.

Additionally, consistent with 66 Pa. C.S. § 2807(e)(3.8), we added language under Section 54.187(a) regarding when the Commission may modify contracts or disallow costs when, after a hearing, the party seeking recovery of the costs of a procurement plan is found to be at fault for either: (1) not complying with the Commission-approved procurement plan; or (2) the commission of fraud, collusion, or market manipulation with regard to these contracts.

We changed, consistent with 66 Pa. C.S. § 2807(e) (3.8), language in Subsection (b) allowing for recovery through reconcilable automatic adjustment under 66 Pa. C.S. § 1307. We combined the first two sentences of Subsection (g) into (b) as they are redundant. We removed the phrase “or more frequently” from Subsection (i) to comply with Act 129.

In its comments, IRRC correctly suggested that the word “or” should be inserted at the end of Section 54.187(a)(1) and we have made this change.

In their comments, PECO and PPL both suggest changing “may” to “shall” in Section 54.187(b) to be consistent with the Act 129 language that mandates that “the

default service provider *shall* have the right to recoverall reasonable cost incurred under this section...” 66 Pa. C.S. § 2807(e)(3.9) (emphasis added). IRRC also endorsed this change. We agree with this change and will adopt it.

Both Duquesne and OCA suggest deleting the language “prevailing market price” from Sections 54.187 (i), (j), (k) and (l) and substitute the language “...least cost to customers over time...”. Both parties state that the purpose of this change is to bring the language into compliance with Act 129. RESA disagrees for the reason stated previously. We agree that these language changes are appropriate to conform to Act 129 requirement and we adopt them.

OCA suggests revising section 54.187(i) to read as follows:

(i) Default service rates shall be adjusted no more frequently than on a quarterly basis for all customer classes with a maximum registered peak load up to 25 kW, to ensure the recovery of costs reasonably incurred in acquiring electricity at the least cost to customers over time[prevailing market prices and to reflect the seasonal cost of electricity]. DSPs may propose alternative divisions of customers by maximum registered peak load to preserve existing customer classes.

The OCA submits that Act 129 prohibits a DSP from changing rates more frequently than quarterly, but does not prohibit a DSP from offering more stable rates. OCA states that Act 129 could have easily been written to require quarterly changes if that was the General Assembly’s intent. The OCA submits, however, that Act 129 places an emphasis on rate stability. As such, a DSP must offer a residential rate that changes no more frequently than quarterly, but it may provide additional stability through even less frequent rate changes. We have reviewed this change and believe it is appropriate and consistent with the intent of Act 129 to promote rate stability. We will adopt this change. IRRC also endorses adding this language.

OSBA suggests adding some additional wording to Section 54.187(b) to fully conform to 66 Pa. C.S. §2807(e)(3.9). The specific words to be inserted are "...on a full and current basis." This appears to be an oversight in the drafting and we will incorporate this language. IRRC also endorses this change.

OSBA suggests updating language in Section 54.187(h) to incorporate any demand side related requirements that arise from enactment of 66 Pa. C.S. §§ 2806.1 and 2807(f). OSBA did not suggest what specific language should be inserted. We have reviewed the comments of OSBA on this point and conclude that the proposed language is sufficient and OSBA's change is not warranted.

OSBA also expresses dissatisfaction with the use of language in renumbered Section 54.187(j) because it continues to allow for adjustment of default service rates "...on a quarterly basis or more frequently..." for customers with a peak load of 25 kW to 500kW. OSBA suggests changing the language to provide for adjustment of default service rates on a basis no more frequently than quarterly because many EDCs charge the same default service rate for residential and non-residential customers up to 500 kW. Additionally, as the OSBA makes clear, the definition of what precisely defines a small business customer, in terms of peak load, is not always clear. OSBA cites to a number of existing EDC tariffs that charge the same default service rates for residential customers as are charged to small business customers. OSBA's proposed change would bring Section 54. 187(j) (renumbered) in line with the change proposed by OCA for Section 54.187(i) (renumbered) discussed above. RESA objects to this change because it would prevent small business customers from taking advantage of market responsive rates which could not be adjusted more frequently than quarterly over time.

We reject OSBA's proposed change as it goes beyond the scope of changes required by Act 129. We will retain the original language.

We adopt the revisions as discussed above and amend Section 54.187 as reflected in Annex A.

52 Pa. Code § 54.188. (Commission Review of Default Service Program and Rates).

Act 129 provides that a DSP shall file a plan for competitive procurement with the Commission and obtain Commission approval of the plan considering the standards in paragraphs (3.1), (3.2), (3.3) and (3.4) before the competitive process is implemented. 66 Pa. C.S. § 2807(e)(3.6). The Commission is required to hold hearings as necessary on the proposed plan or amended plan and if the Commission fails to issue a final order on the plan or amended plan within nine months of the date the plan is filed, the plan or amended plan is deemed to be approved and a DSP may implement the plan.

66 Pa. C.S. § 2807(e)(3.6). At the outset, we note that the initial Proposed Rulemaking did not specify that the nine month review period applies to both the initial and any amended plan filing pursuant to 66 Pa. C.S. § 2807(e)(3.6). We have added the necessary language to clarify that point. We also incorporate provisions of Section 2807(e) (3.7).

Additionally, Section 2813 (relating to procurement of power) provides that the Commission may not order a DSP to procure power from a specific generation supplier, from a specific generation fuel type or from new generation only except as provided under the act of November 30, 2004, (P.L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act (AEPS).

We have also codified the provisions of House Bill 1530 of 2007, which was signed into law on July 17, 2007. This law added Section 2807(e)(5) to the Public Utility Code and authorized electric distribution companies to offer negotiated rates to some very large industrial customers subject to Commission review. It also permitted some electric distribution companies to construct or acquire an interest in electric generation

facilities for the purposes of serving very large industrial customers, subject to certain conditions. We addressed this change under Section 54.188(h).

Accordingly, we added the following language under this section to reflect the considerable changes to this regulation:

(a) A DSP shall file a plan or amended plan for competitive procurement with the Commission and obtain Commission approval of the plan or amended plan considering the standards in 66 Pa. C.S. § 2807(e)(3.1), (3.2), (3.3), and (3.4) (relating to duties of electric distribution companies) before the competitive process is implemented. The Commission shall hold hearings as necessary on the proposed plan or amended plan. A default service program will initially be referred to the Office of Administrative Law Judge for further proceedings as may be required.

(b) [The Commission will issue an order within 7 months of a program's filing with the Commission on whether the default service program demonstrates compliance with this subchapter and 66 Pa. C. S. §§ 2801-2812 (relating to the Electricity Customer Choice and Competition Act)] If the Commission fails to issue a final order on the plan or amended plan within 9 months of the date the plan or amended plan is filed, the plan or amended plan shall be deemed approved and the DSP may implement the plan or amended plan as filed. Costs incurred through an approved competitive procurement plan shall be deemed to be the least cost over time as required under 66 Pa. C.S. § 2807(e)(3.4)(ii).

* * * * *

(d) [Upon receiving written notice, the Commission will have 1 business day, to approve or disapprove the results of a competitive bid solicitation process used by a DSP as part of its procurement plan. When the Commission does not act within 1 business day the results of the process will be deemed approved. The Commission will not certify or otherwise approve or disapprove a DSP's spot market energy purchases made pursuant to a Commission-approved procurement plan. The Commission will monitor the DSP's adherence to the terms of the approved default service program and 66 Pa.C.S. §§ 2801—2812 (relating to the Electricity Generation Customer Choice and Competition Act).] The Commission may initiate an investigation regarding implementation of the DSP's default service program and, at the conclusion of the investigation, order remedies as may be lawful and appropriate. The Commission will not deny the DSP the recovery of its reasonable costs for purchases made pursuant to an approved competitive procurement process unless the DSP concealed or misled the Commission regarding its adherence to the program, or otherwise violated the provisions of this subchapter or the code. Except as provided under the act of November 30, 2004, (P.L. 1672, No. 213), known as the

Alternative Energy Portfolio Standards Act, the Commission may not order a DSP to procure power from a specific generation supplier, from a specific generation fuel type or from new generation only. At the time the Commission evaluates the plan and prior to approval, the Commission shall consider the default service provider's obligation to provide adequate and reliable service to customers and the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission shall make specific findings which include:

(1) The DSP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.

(2) The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis.

(3) Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates Federal law.

* * * * *

(f) A DSP shall submit tariff supplements on a NO MORE FREQUENTLY THAN quarterly ~~or more frequently~~ basis, consistent with § 54.187(h) and (i) (pertaining to default service rate design and recovery of reasonable costs), to revise default service rates to ensure the recovery of costs reasonably incurred in acquiring electricity at THE LEAST COST TO CUSTOMERS OVER TIME ~~prevailing market prices~~. The DSP shall provide written notice to the named parties identified in § 54.185(b) of the proposed rates at the time they are filed with the Commission. The exceptions shall be limited to whether the DSP has properly implemented the procurement plan approved by the Commission and accurately calculated the rates. The DSP shall post the revised PTC for each customer class within 1 business day of its effective date to its public internet domain to enable customers to make an informed decision about electric generation supply options.

(g) 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.

(h) The DSP may, in its sole discretion, offer large customers with a peak demand of 15 megawatts or greater at one meter location in its service territory any negotiated rate for service at all of the customers' locations within the service territory for any duration agreed upon by the DSP and the customer.

(1) Contract rates shall be subject to Commission review to ensure all costs are borne by the parties to the contract and no one else.

(2) If no costs related to the rates are borne by other customers, the Commission shall approve the contract within 90 days of its filing at the Commission, or it shall be deemed approved.

(i) The DSP shall offer residential and small business customers a generation supply service rate that shall change no more frequently than on a quarterly basis. All default service rates shall be reviewed by the Commission to ensure that the costs of providing service to each customer class are not subsidized by any other class.

On these proposed changes, OCA largely agreed with the proposed language but suggested modifying Section 54.188(f) to permit a DSP to submit tariff supplements on a "...no more frequently than quarterly basis..." to be consistent with Act 129 which prohibits a DSP from changing rates more frequently but does not prohibit a DSP from offering more stable rates. OCA submits this change is necessary to comply with Act 129 and is consistent with the change proposed by OCA in Section 54.187(i) discussed above. We will adopt this change as necessary for consistency with the requirements of Act 129. This change also addresses IRRC's concern.

OSBA objects to the deletion of language that requires the Commission to approve or disapprove competitive bid results within one business day in Section 54.188(d). OSBA requests reinstatement of that provision to avoid a potential increase in default service rates. We reject OSBA's proposed change as the elimination of the one business day requirement for consideration was necessary to conform the existing regulation to the requirements of Act 129. We are not convinced that repeal of this provision will cause wholesale suppliers to add risk premiums to their bids thereby increasing default service rates. Further, the new language in Section 54.188(d) provides for the Commission to institute an investigation into a DSPs default service plan and order remedies as appropriate.

RESA proposes to add the language "... through a competitive procurement process..." to Section 54.188(e) (1). RESA has proposed this language be added to previous sections of the regulations. Upon review, we accept this change as appropriate for reasons stated previously with regard to the same change in Section 54.187. IRRC was also in favor of this modification. Section 54.188 is adopted consistent with the modifications discussed herein and as contained at Annex A to this Order.

Additional Questions

This Commission is proposing regulations that generally incorporate Act 129 procurement requirements into the existing regulatory framework. As there remained some ambiguity in the statutory interpretation of Act 129 procurement requirements, the Commission requested comment in its Proposed Rulemaking Order on 16 questions designed to assist the Commission on how Act 129 should be interpreted in order to ensure adequate and reliable service at the least cost to customers over time and on how the proposed regulations should be revised to reflect the interpretation recommended by the person filing the comments.

We have reviewed the answers filed by the various parties and express our appreciation for the time and analysis devoted by the parties on these important policy concerns. We have considered the responses in our formulation of the final regulations but, more importantly, will utilize these responses to inform our evaluation of DSP plans going forward. However, we have not unilaterally made any changes to the regulations based on the comments received. In this regard, we are mindful of EAP's comment that "it is neither necessary nor wise to attempt to resolve all the ambiguities in Act 129's procurement language" in regulations passed a short time after Act 129 was passed. (EAP Comments, p. 2). Moreover, we agree with those comments that emphasize that the language of Act 129 is broad enough to allow the Commission to exercise its discretion to balance a number of policy goals for default service.

Another consideration, raised by RESA, was that the Commission issue a further set of proposed regulations in light of the comments received to these policy questions. We are mindful of RESA's concern. We have chosen not to alter the proposed regulations based on comments received on these questions because of the need to first achieve the goal of harmonizing the current regulations to the Act 129 standards. We assure the parties that any future decisions to amend these regulations as a result of the comments received on the policy questions, the outcome of the current investigation into default service or developments resulting from evaluation of future DSP plans will be subject to the full rulemaking processes.

In the sections which follow, we briefly summarize the substance of comments received on each question by interest group followed by our tentative conclusions on the subject area addressed by the question. Because of the sheer volume of comments and the amount of repetition of particular points, our summary cannot and does not cite to each comment with particularity although all comments were reviewed closely.

1. What is meant by "least cost to customers over time?"¹

On this point, the EDCs were fairly uniform in their position that "least cost to customers over time" should not be narrowly construed nor should it be the only standard by which to measure the adequacy of a default service plan. For example, PECO states in its comments that:

While "least cost" is not precisely defined, the Act makes clear that satisfaction of the "least cost" standard is not a one-dimensional test; instead, the Commission must consider various factors to determine whether a proposed procurement plan meets Act 129's requirements. Section 2807(e) (3.2) provides that the generation supply to be procured by DSPs through competitive processes must consist of a "prudent mix" of supply products, and while the Act itself does not define "prudent mix," it is linked to the Act's definition of "least cost," because a DSP's prudent mix of

¹ See 66 Pa. C.S. § 2807(e)(3.2), (3.4) and (3.7).

contracts "shall be designed to ensure... adequate and reliable service [at] the least cost to customers over time..." 66 Pa. C.S. § 2807(e)(3.4).

(PECO Comments, pp. 4-5).

PECO goes on to state that, given the dynamic nature of electricity markets, the circumstances of each customer group and the different needs of customers regarding price stability, DSPs should be permitted to design procurement plans to achieve least cost over time in a manner that considers the specific needs of customers and service territories. PECO asserts that the Commission should make specific findings that each default service plan includes "prudent steps necessary to obtain low cost generation." 66 Pa. C.S. § 2807(e)(3). (PECO Comments, p. 5-6).

PPL states that the term "least cost to customers over time" can be interpreted along two dimensions: (1) the default service plan includes the selection of contracts that comprise a prudent mix that can consist of a variety of products subject to price volatility, changes in generation supply and customer usage characteristics in a manner that assures adequate and reliable service; and (2) the DSP is required to procure the contracts through a process that produces the lowest cost for the contract type, e.g., competitive solicitations such as requests for proposals (RFPs) or auctions. "Least cost to customers over time" does not mean the absolute lowest possible cost to customers because energy markets are subject to volatility based on many factors such as generation supply, customer usage and weather conditions. (PPL Comments, pp. 6-7).

EAP comments that the phrase is ambiguous because it is not clear what time period is being contemplated and one cannot be certain that a particular strategy will result in a "least cost over time" result. FirstEnergy Solutions agrees with EAP in its Reply Comments.

The generators (P3, Constellation, PPL Energy, Exelon) provided extensive comments on this point. Exelon interprets the “least cost” language in Act 129 as not endorsing a “cookie cutter” approach to procurement but rather provides the DSP with a range of options to procure energy and provide price stability. PPL Energy recommends specifically a mix of short term and intermediate term contracts and spot market purchases as best suited to achieve the “least cost” standard. In its definition of the least cost standard, Constellation provides an extensive analysis of Act 129 requirements as contained in 66 Pa. C.S. § 2807(e)(3.7) (i)-(iii) emphasizing its interpretation of this provision by focusing on competitive procurements for wholesale supply that maximizes supplier participation, utilization of RFP Structures and auctions (termed competitive bid processes or CBPs). Constellation praises the Commission’s utilization of RFP and auction structures but also recommends that attention be paid to how other states manage their CBP wholesale supply agreement requirements to ensure that Pennsylvania’s EDC competitive procurement plans are equally attractive to potential bidders as other jurisdictions’ competitive procurement processes. In this regard, Constellation recommends the Commission develop “best practice” documents through the Retail Markets Working Group that promote the most competitive processes for procurement of wholesale default service supply.

Retail marketers also commented on the “least cost” question. NEMA and PEMC submit that the “least cost procurement” standard should be implemented consistent with competitive market policies, should rely on market-based pricing and that utility pricing of commodity service to commercial and industrial customers should consider such offerings as monthly and hourly pricing.

RESA provides extensive and well-researched comments providing, from its perspective, an analysis of the following topics: (1) the purpose of the Electric Choice Act was to develop a competitive retail market; (2) Act 129 confirms that default service is intended to be a back-stop to the competitive market; and (3) the implementation of

Act 129 did not change the “end state” goal of the Competition Act which is to give consumers generation choice through a competitive process that ensures safe and reliable service at the least cost to customers over time. RESA makes some additional recommendations specifically: (1) that a default service plan should only be approved as “least cost” if it results in default service rates that approximate “the market price of energy”; and (2) that default service plans are to be structured to achieve an “end-state” where customers receive no generation service from default suppliers; and (3) RESA recommends the Commission ensure a default service plan that is reasonably likely to result in a market reflective and market responsive service rate and recovers all costs related to providing default service.

OCA defines the “least cost over time” standard as changing the role of the DSP from that of a passive purchaser of default supplies at market prices and places on the DSP an affirmative obligation to assess which products will produce the lowest costs to customers. The key element of this language change is the shift of the DSP from simply matching its purchases to market prices at a particular point in time to seeking a mix of resources at “the least cost to customers over time.” The OCA submits that the new standard requires that a DSP develop a procurement plan that will capture the benefits of the competitive wholesale market and bring power to its default customers at rates that reflect the lowest costs to customers over the term of the plan and beyond. Such prices may be higher or lower than the prevailing market prices at any given point in time. But the overarching goal is to provide service to customers at the least cost over the course of time. When developing its procurement plan, each DSP should avoid sole reliance on short term purchases in order to develop continuity in rates over the years as well as focus on rate stability. (OCA Comments, p. 6).

OSBA suggests that because the Commission approved a request by West Penn to accelerate certain of its default service plan procurements for its residential customers and because the Commission supported its decision using Act 129’s least cost

requirement, that it was, in effect, overruling its previous position regarding retail competition. More specifically, OSBA states that “some of the changes [to Act 129] are inconsistent with some of the decisions made and preferences expressed by the Commission prior to the enactment of Act 129.” OSBA opines that, as a result, the Commission’s commitment to retail competition “may have to change.”

Reply Comments of PECO focus mostly on RESA as follows:

(1) PECO disagrees with RESA and other parties that a default service plan should only be approved as “least cost” if it results in default service rates that approximate “as close as possible to the market price of energy.” PECO interprets this position of RESA as emphasizing reliance on spot market prices and short term contracts. Such an approach conflicts with Act 129’s objective of achieving price stability.

(2) PECO disagrees with RESA’s statement that default service plans are to be structured to promote retail competition to achieve an “end-state” goal where customers receive no generation services from default suppliers. The Competition Act, as modified by Act 129, envisioned a continuing role for DSPs to regularly propose procurement plans for Commission review. The requirement to follow a “least cost over time” standard does not diminish the Commission’s commitment to retail competition.

(3) PECO believes it is important for the Commission to affirm that a procurement plan based on full requirements contracts is consistent with “least cost” standards. Further PECO disputes OCA’s assertion that Act 129 imposes an affirmative obligation on DSPs to assess which products will produce lowest cost to consumers. PECO asserts that some products such as FR contracts provide price stability and other benefits although they are not strictly speaking the least cost product available.

(PECO Reply Comments, pp. 9-11).

OCA, in Reply Comments, responds to the comments of NEMA disputing the point made by NEMA that the “prevailing market price” standard should be read in conjunction with the “least cost to customer” standard as essentially identical.

RESA, in Reply Comments, reacts strongly to OSBA’s assertion that passage of Act 129 and the changes to the Competition Act now require the Commission to reconsider its position on retail choice. RESA notes that Act 129 did not make any

changes to numerous sections of the Competition Act, did not evidence any legislative intent for the Commission to change its focus from retail competition and in fact certain newly added language at 66 Pa. C.S. § 2807(e) (3.1) makes clear that the competitive market remains the preferred choice for electricity supply over default service. RESA goes on to explain that if the legislature had intended the Commission to no longer focus on developing retail competition then it would have clearly stated that directive. Nor does Act 129 give the Commission statutory authority to change its focus from the original directive under the Competition Act of fostering the development of a robust and functionally competitive market. RESA then disputes OSBA's citation to the acceleration of the default supply procurement plan of Allegheny in 2009 as supportive of the notion that the "least cost over time" standard is more important to the Commission than retail competition. Finally, RESA reiterates its position that the "least cost to customers" standard is just one of the factors under Act 129 and the Act that the Commission must consider.

Our conclusion on this difficult question, based on the extensive and thoughtful comments received, is that the Legislature, in utilizing the language "least cost over time" did not provide a clear-cut definition of the term. As such, we must be guided by the comments received as well as our own experience and sound discretion in implementing both the Competition Act and Act 129 consistent with the plain language and, where ambiguous, the legislative intent.

We find many of the points raised by the parties as valid although certain interpretations of the language are, to a degree, strained. The conclusions reached herein do not represent a final, definitive position on the meaning and application of the term "least cost to customers over time" but represent guidance regarding how the Commission will evaluate default service plans going forward. The conclusions reached herein represent an evolutionary step in an ongoing process recognizing that further legislative changes as well as changes in the Commission's own policies regarding

default service may occur in the future, for example, as a result of our investigation into default service.

Initially, we must agree with the EDCs, particularly EAP, PECO and PPL, that the term “least cost to customers over time” standard is somewhat ambiguous and not susceptible to a precise “one size fits all” definition. EDCs, that have the primary responsibility under the Competition Act to procure generation supply requirements as well as the expertise to perform these activities, should be permitted the flexibility and latitude to accomplish the goal of achieving the “least cost” standard in a manner that meets the need of their customers and service territories. We also agree with those parties, especially PPL, that the standard must give the DSP sufficient latitude to select contracts that constitute a “prudent mix” which includes a sufficient variety of products that adequately take into consideration price volatility, changes in generation supply, customer usage characteristics and the need to assure safe and reliable service. We also endorse the concept advanced by one commenter that the “lowest cost” standard should reflect DSP strategies that produce the lowest cost by contract type (long, intermediate and short term as well as spot market prices).

Additionally, we endorse the concepts advanced by generators that the “least cost” language of Act 129 does not represent the adoption of a “cookie-cutter” or “one size fits all” approach to procurement but provides the DSP with a range of options to procure energy that maximizes the types of energy products available and balances the concerns of “least cost” with energy stability and minimizing volatility. We do not endorse, at this time, the position of those parties that recommend solely a mix of just short and intermediate term contracts and spot purchases as that unduly limits the range of supply products available.

We are heartened by those parties, such as Constellation, that believe the Commission’s current utilization of RFP and auction structures have been successful.

We also find valuable Constellation's suggestion that attention be paid to how other states with competitive retail markets manage their competitive bid processes and wholesale supply agreement requirements to ascertain improvements to our processes. We adopt Constellation's suggestion to ask parties, as part of our default service investigation, to examine and comment on the experiences of other states' competitive bid processes and make concrete suggestions on how our processes may be improved.

As to the comments of OCA, we generally agree with the OCA's premise that the "least cost" standard necessitates the changing of the DSP's role from a passive purchaser of default supplies at market prices and places on the DSP an affirmative obligation to assess which products will produce the lowest cost to customers. We caveat our endorsement of this point with the recognition that certain products, such as full requirements (FR) contracts, provide price stability and other benefits although they may not be the least cost product available. (See PECO Reply Comments, pp. 9-11). Also, as noted later, our agreement with OCA on the DSP role evolving from that of a "passive purchaser" to more active manager is not an endorsement of the market portfolio approach which is addressed later.

We also agree with OCA that the new standard requires the DSP to develop a procurement plan that will capture the benefits of the competitive wholesale market and reflect the lowest rates to customers over the term of the plan and beyond. OCA also recommends avoidance of sole reliance on short term purchases as a means of achieving rate stability. While we agree with OCA conceptually in its response to this question, we diverge somewhat in later questions with OCA's recommendations on how to achieve specific goals as part of the DSP procurement process.

We note with interest RESA's extensive comments on this question. We disagree with RESA's overall recommendations as to the proper interpretation of the "least cost" standard as mandating that default service rates approximate, on a prospective basis, the

market price of energy. Such an interpretation would signal retention of the “prevailing market price” standard that has been expressly replaced under Act 129. Moreover, this interpretation conflicts with the Act 129 objective of achieving price stability which dictates consideration of a range of energy products, not just those that necessarily reflect the market price of electricity at a given point in time. Price stability benefits are very important to some customer groups in that exposing them to significant price volatility through general reliance on short term pricing would be inconsistent with Act 129 objectives. We also reject for the same reasons, a recommendation by NEMA for use of a “monthly-adjusted, market-based commodity rate for small commercial and residential customers” as inconsistent with the “least cost” requirement under Act 129.

We also disagree with RESA’s assertion that default service plans are to be structured to promote retail competition to achieve an end-state goal where customers receive no generation service from default suppliers. As PECO noted, this is a misreading of the relevant statutes. The Competition Act, as modified by Act 129, envisioned a continuing role for DSPs to regularly propose procurement plans for Commission review. The requirement to follow a least cost procurement standard does not diminish the Commission’s commitment to retail competition including a continuing role for DSPs, which may be either an EDC or an alternative Commission-approved DSP.

As stated earlier in this Order, the “least cost over time” standard should not be confused with the presumption that default prices will always equal the lowest cost price for power at any particular point in time. In implementing default service standards, the Commission must be concerned about rate stability as well as other considerations such as ensuring a “prudent mix” of supply and ensuring safe and reliable service. In our view, a default service plan that meets the “least cost over time” standard should not have, as its singular focus, the achievement of the absolute lowest cost over the default service plan time frame but rather a cost for power that is both relatively stable and also economical relative to other options. In this regard, we agree with those points raised by

both PECO and PPL. To reiterate our prior point, the “least cost over time” standard should not be viewed as synonymous with maximizing market timing benefits at the expense of price stability and economy.

Finally, we disagree with RESA’s assertion that the “least cost” standard mandates that a default service plan be reasonably likely to result in a “market-reflective and market-responsive” service rate that recovers all costs related to providing default service. We interpret this standard, not contained in either the Competition Act or Act 129, to mean a preference for short term and spot price supplies which ignore both the Act 129 concerns of price stability and a “prudent mix” of products. We do not believe that adoption of RESA’s suggested standard is consistent with the “least cost” standard contained in Act 129 and would not adequately protect retail customers from volatility and risks inherent in the energy market. Price stability benefits are very important to some customer groups, so an interpretation of “least cost” that mandates subjecting all default service customers to significant price volatility through general reliance on short term pricing is inconsistent with Act 129’s objectives. This is especially true given that the statute specifically enumerates short-term (up to 4 years) and long-term (over 4 to 20 years) contracts as part of the “prudent mix” of contracts that should be included in a default service plan. 66 Pa. C.S. § 2807(e)(3.2).

In response to OSBA’s point that our decision in a specific West Penn default service case somehow may be interpreted as a retreat from our commitment to retail competition, OSBA’s inference is incorrect. Initially, we would note that our specific decision to permit the acceleration of West Penn’s procurement process especially for residential customers was driven by a unique and significant drop in the cost of both coal and gas prices which presented a rare opportunity to take advantage of a drop in commodity prices. We also note that the six tranches that were accelerated only represented 13% of the utilities’ portfolio thus preserving the diversification element of the portfolio approach.

The Commission's response to this unique situation, supported by OCA and other parties, does not represent a retreat by this Commission from its commitment to retail competition. As noted by Constellation and RESA in their Reply Comments, Act 129 did not make any changes to those portions of the Competition Act relating to retail competition. Also, as OSBA itself points out, the Commission's decision in the amendment of West Penn's default service procurement filing implicitly recognized that Act 129's terms were not applicable to the previously approved default service for West Penn since Act 129 had not been in effect at the time the default service plan was filed.

At this juncture, we will continue to evaluate the degree to which DSP plans meet the "least cost to customers over time" standard on a case by case basis guided by the observations expressed herein.

2. What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time?

Responses to this question varied regarding establishing specific timeframes for evaluating whether a DSP's procurement plan produces "least cost to customers over time."

EDC parties such as EAP generally favored 2-3 years while Citizens/Wellsboro specified not less than five years. FirstEnergy recommended using the specific period provided for in the default service plan. PECO specified two years but noted that attention should be paid to ongoing price stability benefits associated with long term contracts which may need to be considered. Duquesne's position was similar to PECO. PPL stated that the length of the time period was not the issue but rather the principal concern should be in evaluating the competitiveness of the procurement process and the determination of whether the default service plan produces the "least cost to customers."

Various EDC parties noted that the Commission should continue to treat the evaluation process of default service plans on a “case by case” basis and that neither the relevant provisions of the Competition Act nor Act 129 provided for “after the fact” review of EDC procurement decisions except for instances of noncompliance or fraud/collusion/market manipulation. 66 Pa. C.S. § 2807(e)(3.8). This position was largely echoed by the generator parties.

OCA, OSBA and RESA all recommended against specifying a specific time period. OCA states that the key inquiry should be whether the DSP’s plan will produce the “least cost to customers over time” and if the procurement plan will actively engage the default market to procure the best mix of products to meet the needs of default service customers. OSBA notes that no time frame is cited in the relevant statutes so none should be imposed herein. RESA believes the present default service plan evaluation process works well.

OCA reacts in Reply Comments to the recommendations of those parties that the time period over which the least cost period extends should be a definite time period. OCA argues that the “least cost over time” standard should not be constrained to the period of each approved plan as it might preclude consideration of long-term contracts that typically extend beyond the period of each approved plan. The key inquiry should be whether the DSP has established a procurement plan by which it will actively engage the wholesale market to procure the best mix of products to benefit its particular mix of default service customers.

PECO cautions, in response, not to adopt a fixed long term evaluation period as such a requirement will unduly restrict the Commission’s review of procurement plans and potentially result in erroneous results given the unavailability of reliable long term pricing information.

Based on the foregoing, we find no compelling reason to prescribe specific time periods for purposes of evaluating whether an EDC plan meets the standard of producing the “least cost to customers over time.” As both PPL and OCA noted, the principal concern should be the evaluation of the competitiveness of the default service plan and whether the plan produces the “least cost to customers over time” and procures the best mix of products for the benefit of default service customers. We recognize that most default service plans encompass a 2-3 year period by virtue of how EDCs structure their procurement processes as well as to be consistent with the function of the wholesale markets. We are also aware that the need to incorporate long term contracts into the product mix results in a certain amount of product overlapping more than one default service plan term. We do not discern a need to establish precise time constraints that would unduly constrain the flexibility of DSPs to design a procurement plan that best fits the character of the customer base and the service territory. We will continue to evaluate on a case by case basis the adequacy of plans as they are currently filed with this Commission.

3. **In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission’s default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania?**

The parties were mostly unanimous in opposition to the suggestion that the Commission’s default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania. Among the EDC parties, Allegheny contends that PJM already facilitates a coordinated transmission and generation planning process that responds to reliability issues. Allegheny notes that requiring that new capacity be built in Pennsylvania outside of the PJM planning process may lead to uneconomic development of generation and additional cost to customers.

PECO notes that the need for new generation capacity is best determined by the competitive markets.

Generation parties also weighed in against this proposal. Exelon contends that implementation of state-specific regulations for generation construction would frustrate the benefits of the regional nature of the RTO and could lead to higher electric rates. PPL Energy opines that such a provision would contravene the “least cost” standard under Act 129. Constellation urges the Commission to work with PJM to ascertain what generation capacity may be needed in a future period.

RESA opposes such a revision to the regulations because such a requirement would contravene the Competition Act and the requirement in the Act of allowing market forces, not economic regulation, to control the cost of generating electricity. OSBA opposes the proposal for the reason that ratepayers would be required to bear the cost of any state-mandated new generation.

The OCA appears to obliquely support the proposal in conjunction with entry into long term contracts with any new generation facilities.

CP endorses the concept of developing regulations to ensure construction of needed capacity.

ICG suggests that the Commission should seek to promote construction of new capacity and require that a portion of that capacity be dedicated to economic development on a cost of service basis. These units could be owned by the default service provider, a competitive developer or the Commonwealth.

FES in Reply Comments, opposes ICG’s suggestions to promote construction of new generation capacity and the assertion that administratively mandated additional units can reduce prices to customers. OSBA also opposes ICG on this point.

PECO, in reply, observes that attempts to insure construction of new generation in Pennsylvania through long term contracts would result in increased risks being borne by retail customers. PECO also contends that bidders for such contracts face uncertainty due to lack of transparent market prices for longer term generation and delivery and significant credit/collateral requirements to protect customers from financial exposure associated with supplier default. Long term contracts tied to specific generating resources may include additional risks associated with plant outages, fuel costs, development delays and other factors.

After consideration of the many helpful comments received, we decline at this time to consider revising the current default service regulations to provide for construction of needed generation in Pennsylvania. Our reluctance to move further on this proposal is based on the potential uncertainty that such a requirement would present to the current operation of PJM wholesale markets as well as the potential for contravening provisions of our Competition Act and the provisions of Act 129 which mandate establishment of a least cost standard for evaluating EDC plans. Additionally, we reject ICG's suggestion for the reason that it raises a number of issues which ICG fails to address such as who would bear the cost and risk of financing and building these additional generation facilities.

4. If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised?

This Policy question elicited a limited number of responses. In light of our response to Question No. 3, we decline to act on any of the suggestions contained herein but appreciate the input received on this important issue.

Among the EDC parties, many indicated their primary preference would be to have no regulatory requirement addressing needed generation capacity. If such a requirement were imposed, FirstEnergy suggests the development of a competitively neutral mechanism that would allow the cost to be borne by all delivery service customers.

Among the generator parties, PPL Energy questioned whether the Commission has the legal authority to promulgate such regulations. Exelon offers that such regulations must require DSP shareholders to assume all construction and operation costs, should not permit DSPs to enter into any contracts for new generation unless the price is less than the existing market price for power, must specify a competitive process based on lowest cost to customers and require new resources to be integrated in a way that does not frustrate wholesale market rules. Constellation cautions that if the Commission forges ahead with such regulations, that the requirements for new generation be narrowly tailored to seek only products that are appropriate to the need identified and that the costs for resources should be allocated to appropriate transmission customers in specific transmission regions.

OCA notes that the implementation of such regulation must be considered in light of the current regulatory prohibitions that a DSP's procurement cannot be from a generating unit with a specific fuel type and that DSPs are prohibited from procuring power from new generation only. OCA reminds the Commission that it is not prohibited from requiring DSPs to design long-term competitive procurements, e.g. long-term contracts, that facilitate new construction in order to ensure adequate and reliable service.

In light of our determination made in response to Question 3 and the very valid legal and policy concerns raised in response to both Questions 3 and 4, we decline for the time being to take further action regarding additional default service regulations that would ensure the construction of needed capacity in Pennsylvania. However, we reserve the option of revisiting the issue should market conditions dictate.

5. Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time?

This question generated significant debate among the commenting parties.

PPL explained the difference between the two approaches as follows:

Both approaches, full requirements and managed portfolio, can produce the least cost to customers over time; however, allocation of the risks and costs associated with the supply for each approach must be considered. In the full requirements approach, the default service provider procures all the energy needs for the default service customers at a fixed price. Under this approach, all the associated risks are borne by the full-requirements suppliers, such as changes in load shape, migration of customers to and from default service, and changes in market prices for energy, capacity, ancillary services, and alternative energy credits to meet the default service supply obligation. PPL Electric has employed the full requirements approach.

A managed portfolio approach includes purchasing and/or selling physical and financial products based on market and default supply conditions. In other words, the DSP is active in the market at all times to manage the risks described above (changes in load shape, migration of customers to and from default service, and changes in market prices for energy, capacity, ancillary services, and alternative energy credits). These risks and associated costs are borne by the DSP and are ultimately passed on to the default service customers. For example, if more customers migrate from default service than anticipated, the DSP may have too much supply, which can be sold in the spot market. However, the price received for those sales could be higher or lower than the price paid to purchase the supply initially. To manage these risks, the DSP would need expertise in trading in the commodity markets, which is not a core business function. Additional costs would be incurred to acquire this expertise resulting in higher default service costs.

Under a full requirements approach, the winning supplier essentially employs a managed portfolio approach to supply the default service customers. The full requirements supplier is active in the commodities markets and has the necessary expertise to manage these risks.

Neither approach, full requirements nor managed portfolio, eliminates any of these risks or costs. Rather, the risks and costs are simply shifted between suppliers and customers. Any effort to compare these two approaches must, of necessity, track the results that would be produced by each over the same period of time and under identical conditions. Because the fundamental difference between the two approaches is an assessment of risk based on imperfect information, it is essential that any such comparison reflect real-time decision-making and not hindsight. (PPL Comments, pp. 8-10).

Other EDCs utilize the full requirements (FR) approach. Allegheny considers its FR approach as a form of managed portfolio (MP) because customers get the benefit of service based on “the best pieces of many managed portfolios.” FirstEnergy states there is clear evidence, in its opinion, that the MP approach shifts the volumetric risk associated with default service supply from suppliers to buyers of default service leaving them more exposed to price volatility than does the laddered portfolio of full requirements contracts. FirstEnergy submits that requiring EDCs to time the market is unlikely to produce the least cost to customers over time and may require additional EDC infrastructure and employees to conduct the managed portfolio activity. Duquesne opines that the supply procurement method should be left up to the discretion of the DSP and the Commission’s regulations should remain flexible and consider the appropriate approach on a case by case basis.

PECO highlights the fact the Commission has approved both types of procurement processes at various times and should maintain a flexible “case by case” approach in light of the specific circumstances of each DSP and its customers. However, on balance, FR suppliers manage their own risk whereas the MP approach shifts the risk from suppliers to customers. PECO concludes that FR procurement approaches are better positioned to manage risk and this approach should remain an option in designing future default service plans.

Citizens/Wellsboro, alone among the EDCs, argues in favor of the MP approach as more likely to produce least cost to customers over time for DSPs serving a small territory. Citizens/Wellsboro takes issue with other parties' support for the full requirements standard in its Reply Comments.

Generator parties support the FR approach. P3 states that EDCs should be "outcome neutral purchasers" for their customers who do not choose a competitive supplier. PPL Energy advances the concern that, for an EDC to pursue a MP approach, it would have to actively manage a portfolio of power supply products and do so at a lower cost than the market. An MP approach may result in commodity positions by the EDC that creates a volumetric and price exposure resulting in higher prices to customers. Exelon notes that both approaches are difficult to compare but that the intent of Act 129 to produce least cost and price stability militates toward a "prudent mix of standard and full requirements products." Constellation explains in great detail its internal processes associated with supply procurement-functions that would be difficult and expensive for an EDC to duplicate including the need to employ experienced personnel.

FES, in Reply Comments, believes that a FR solicitation is the best method of supply procurement but that no "one size fits all" approach that will work in every market. FES asserts that each DSP should be able to work with stakeholders in default supply proceedings to craft a solution that balances competing interests. FES states that an MP approach entails an unjustifiably high level of risk and is not appropriate for default supply procurement. If the Commission were to implement an MP approach, FES believes that no after the fact review process should be imposed as part of that process.

RESA also endorses the FR model. RESA considers the FR approach, if properly structured and without an overreliance on long term contracts, to be the best way to achieve the goals of the Competition Act. Under the FR approach, the wholesale supplier bears the risk of customer migration, weather, load variation and economic activity and

factors the costs of these risks into a risk premium. If the risk premium is not sufficient to cover ultimate cost, the supplier cannot seek additional cost recovery from the customer or the DSP. Alternatively, the MP approach places all the management and market timing risk on customers and reflects the cost of bearing that risk in the default service rate. Under the MP model, it is virtually impossible, in RESA's view, to assume that a utility portfolio manager will outperform the wholesale supply manager. While RESA has a clear preference for the FR approach, it is possible to construct a managed portfolio plan that minimizes customer risk and requires all direct and indirect procurement costs are recovered. RESA recommends more short-term block purchases and spot purchases.

OCA advocates reliance on the MP approach for the following reasons:

1. OCA has long advocated for the MP approach because it has not seen any empirical evidence indicating the superiority of the FR approach.
2. The FR approach shifts risks to third party suppliers who are compensated by customers for the risk associated with variation of load and other risk factors that are factored into the winning bid. Suppliers also add in additional profit margins over and above the margins factored in to compensate full requirements middlemen.
3. Under the MP approach, the DSP can directly access the generation products in the wholesale market without the need to pay an additional level of profit.
4. OCA opines that recent procurements demonstrate that the MP approach is a lower cost alternative to the FR approach. In support, OCA cites to recent procurements by PPL, PECO and FirstEnergy affiliates where the winning bids for block energy purchases was significantly less than full requirements purchases. Therefore block and spot purchase should be part of a prudent mix of products for default service.
5. OCA cites to a movement away from the FR approach based on recent procurement results from Illinois and New Jersey.
(OCA Comments, pp. 12-19).

OSBA makes the following points: (1) there are fundamental economic differences between the FR and MP approach; (2) there are advantages and disadvantages

to both methods; (3) the Commission has previously expressed preference for the FR approach but encourages further EDC study of the MP approach; and (4) there is not enough empirical evidence to support the definitive use of one method over the other.

In their Reply Comments, Citizens/Wellsboro takes issue with many of Constellation's initial comments and requests the Commission recognize that an MP procurement standard has worked well and has enabled it to manage certain congestion events.

PECO, in its Reply Comments, disputes the validity of OCA's reliance on the procurement results in Illinois and New Jersey as being supportive of the MP approach. PECO alleges these programs can be distinguished based on the state-specific circumstances that underlay their development. As to the evidence offered by OCA in recent EDC procurements, supporting the MP approach, PECO seizes on OCA's admission that "comparisons of block and full requirements products cannot be made on a direct comparison basis because block purchases do not include all attributes required for default service supply and do not reflect all costs to consumers." Additionally, PECO highlights the fact that block price purchased power will vary based on the timing of purchases, delivery locations and ratemaking differences.

OCA filed extensive Reply Comments in support of the MP procurement approach reiterating the following points:

1. Under the MP approach, each DSP will procure power directly from the wholesale market through a variety of products tailored to specific load. In order to balance the precise load, the DSP would access the energy balancing services of spot purchases and sales. A portfolio approach provides the default service provider with the latitude needed to procure products available to meet its least cost obligation.
2. The MP approach will allow the DSP to lower the cost of its supply portfolio when customers participate in Act 129's energy efficiency, demand response and time of use programs.

3. The FR approach shifts the obligation to meet default service load to third party suppliers who are obligated to meet default service to a set percentage of default load regardless of the level of retail shopping that takes place in the service territory. The risks associated with the variation in load are assigned a risk premium cost by bidders that are priced into the winning bids and paid for by default service customers. These profit margins are in addition to the profit margins the generation suppliers build into their supply of the products to FR middlemen.
4. Under the MP approach, the DSP can directly access the generation products available in the wholesale market without the need to pay an extra level of profit and risk premiums to FR suppliers. There is no empirical evidence that the FR approach produces the least cost product.
5. Constellation is in error in saying the MP approach requires the DSP to time the market.
6. The experience of Citizens/Wellsboro with the MP approach is proof the MP approach is superior. Also, EDCs have managed to recently procure block and spot purchases directly at prices that were less than their FR purchases for the same period.
7. The MP approach is most consistent with both the supply and demand aspects of Act 129. A portfolio approach allows the discretion to include a variety of resources and products and affords the flexibility to incorporate new products into the supply mix such as energy efficiency, demand response, smart meter and TOU requirements to customers.
(OCA Reply Comments, pp. 3-10).

RESA responds to OCA's arguments in support of the MP approach as follows:

1. OCA, in advocating the MP approach, never explains how this approach will impact the development of the competitive market.
2. Default service customers will be required to pay all of the costs associated with building an EDC infrastructure necessary for EDCs to perform all functions associated with MP approach.
3. Requiring EDCs to perform the MP function ignores the fact that wholesale suppliers compete with each other to win a supply contract and have an incentive to drive down costs as low as possible insulating customers from being forced to pay over inflated or unreasonable costs.

4. OCA fails to address how default service customers are benefitted when they are forced to pay the full costs of unforeseen risks under the MP method. Under the MP approach, default service customers pay the full cost of future risks where the EDC fails to perform. Under the FR approach, there is an insurance component built into the supply contract that insulates default service customers from those risks.
5. OCA fails to explain how an EDC can adequately take on, as a core business function, the role of active portfolio manager. (RESA Reply Comments, pp. 9-13).

This is indeed a complex and difficult issue. We appreciate the efforts the parties make in their comments to explain the advantages and disadvantages of the FR and MP methods. The question that we must address is whether we should be encouraging EDCs, as default suppliers, to be adopting, as a core function, the responsibility to act as a portfolio manager for procurement of their default supply - a function that has traditionally been the province of the electric supplier.

The major benefit associated with the FR approach is that the procurement function is delegated to the electric supplier which is presumably better equipped with the necessary personnel and infrastructure to perform the activities associated with acquiring electric supplies in the complex and ever changing wholesale market environment. The FR process insulates default supply customers from the volatility associated with wholesale market conditions with the supplier bearing the risks of factors such as customer migration, weather, load variation and economic activity. For assuming these risks and performing the portfolio manager function, the supplier charges a risk premium (or profit) that is factored into the winning bids and paid for by default service customers.

Alternatively, the MP approach shifts the obligation to meet default service requirements to the EDC to procure power directly from the wholesale market essentially supplanting the role of the electric supplier. Under the MP approach, the EDC becomes an active market participant with the responsibility to manage risks such as changes in

load shape, customer migration to and from default service and changes in prices for capacity, energy and other ancillary services as well as the vagaries of weather and economic conditions. Instead of being insulated from the impacts of these risks, default service customers are directly exposed to the impacts of the EDCs expertise in managing its portfolios.

Most Pennsylvania EDCs have preferred the FR approach given the balance of risks and rewards. Electric suppliers understandably favor this approach as it is their core business function - a function largely the result of electric deregulation under the Competition Act. One utility, Citizens/Wellsboro, has successfully utilized the MP approach to the benefit of its customers. Recent plans, as pointed out by OCA, have been approved which have included spot and block purchases resulting in lower prices than under the FR approach. This fact, argues OCA, coupled with experiences in New Jersey and Illinois, the potential for excess profits to generation suppliers as well as the lack of empirical evidence that the FR approach is more cost effective than the MP approach militates in favor of the MP approach. In contrast to OCA's position, RESA opines that suppliers cannot seek additional cost recovery from the customer or the DSP if the risk premium is not sufficient to cover the cost of procured power.

On balance, we are not persuaded that the MP approach is superior to the FR approach in achieving the "least cost to customers" while also achieving the other objectives of "prudent mix" of products and price stability. The MP approach has clear advantages to the retail markets and the retail customer provided the EDC is capable of performing the full range of portfolio management functions. Based on the uniformity of comments received from those parties that actually perform these functions, the EDCs and electric suppliers, we do not feel confident in expressing a preference for the MP method at this time as the preferred means of default supply procurement. Our principal concerns are that EDCs do not currently possess the requisite expertise and infrastructure to perform these portfolio management duties and the risks to retail customers from EDC

inexperience in performing these functions is too great. We are also mindful of the fact that the current default supply process, with the EDC acting as the default supplier and distribution entity purchasing its supply from electric suppliers knowledgeable about the workings of the wholesale electric market, is a product of the Competition Act, which created the market structure we now operate within. Requiring DSPs to adopt the role of electric market portfolio manager may be inconsistent with our charge under the Competition Act. Finally, we note here that, after the restructuring of the electric utility industry in Pennsylvania mandated by the Competition Act, generation planning and management is no longer a core function of an EDC's business. As such, to impose MP duties would tend to divert management attention from the EDC's core function of providing safe, reliable and adequate *delivery* of electric generation service.

Consequently, we will not require nor do we specifically endorse the use of the MP approach at this time. We do express a preference for continued reliance by DSPs on the FR approach to the extent this method best suits the DSP's particular procurement needs. DSPs are, of course, free to modify their procurement methodologies as necessary to incorporate aspects of the MP approach where appropriate given the level of confidence the DSP has in its own ability to perform the portfolio management function, the DSP's customer characteristics and usage patterns and the service territory.

We will continue to evaluate default service plans on a "case by case" basis recognizing that the maximum degree of flexibility given to EDC DSPs has proven to produce the best results for customers. Further, we encourage utilities such as Citizens/Wellsboro to continue to utilize those procurement methodologies that best meet the needs of its customers and which comply with the required standards under our regulations.

6. What is a “prudent mix” of spot, long-term, and short-term contracts?

What constitutes a “prudent mix” of contracts was subject to a number of varying definitions. Among the EDCs, PPL, PECO and FirstEnergy did not specify fixed percentages. PPL’s position is that the DSP should have the discretion to propose a mix of contracts that is appropriate based on the characteristics of its customers. Moreover, there are an infinite number of procurement plans that can be considered “prudent” and the DSP review process allows all parties to weigh in on the subject. PPL cautions, however, that once the Commission has approved a plan, the mix of contracts should remain in place for the term without alteration. FES agrees with this position in its Reply Comments. FirstEnergy notes that the “prudent mix” of contracts must focus on low cost, comply with Act 129 requirements and include an acceptable amount of risk. While default service rules require a separate portfolio for each class, EDCs should not be required to offer all types of contracts (long, intermediate, short, spot) for each customer class.

PECO states as follows:

- 1) “Prudent mix” is linked to “least cost” and should take into account benefits of price stability.
- 2) A “prudent mix” of contracts will differ for each customer class.
- 3) The “prudent mix” of contracts may vary in the future as wholesale and retail markets evolve.
- 4) The degree to which a “prudent mix” of contracts will ensure adequate and reliable service will be influenced by such factors as contract and credit requirements.
- 5) The Commission should not place unnecessary constraints on the definition of “prudent mix”.

(PECO Comments, pp. 13-15).

Duquesne supports leaving the “prudent mix” of contracts definition to be determined on a “case by case” basis but has determined fixed percentages of products to

be an optimal “prudent mix” for its own purposes. Allegheny recommends specific percentages of contract types for service to its customer classes.

Among the generator parties, Exelon and Constellation advocate for a “case by case” determination based on the needs and characteristics of the customer class. PPL Energy offers the perspective that a “prudent mix” should consist of short and intermediate term contracts and spot purchases. Alternatively, PPL Energy states that suppliers should be permitted to provide customers with a diverse supply of demand response, energy efficiency and alternative energy products in addition to more traditional supply sources. FES endorses the “case by case” approach.

OCA does not advocate for a specific “prudent mix,” preferring a flexible approach that varies between DSPs and market conditions.

RESA notes that a “prudent mix” of contracts is that which will result in a competitive, sustainable retail market, ensures customers of the least cost over time and should result in a plan that produces market reflective and market responsive rates reflecting all of the relevant costs incurred by the EDC to provide default service. RESA cautions against a “one size fits all” approach to the “prudent mix” standard recognizing that the transition to a fully competitive end-state will result in a varying mix of contracts depending on where the market segment is in the transition process. RESA advocates for an end-state that relies on short term contracts and spot purchases and less on long term contracts. RESA notes that over-reliance on long term contracts runs the risk of customers being forced to pay higher “out of date” rates during a period of declining prices. RESA firmly opposes the use of long term contracts.

ICG maintains the position that, at a minimum, two types of products must be included to constitute a mix. Providing only hourly priced service does not result in a

“prudent mix” of spot, long-term and short-term contracts for the large commercial and industrial customers. FES opposes this suggestion in its Reply Comments.

CP advances the notion that the language of Act 129 requiring a prudent mix of spot market purchases, short-term contracts and long-term contracts means that all three types of purchases must be part of each and every procurement type.

In Reply Comments, Citizens/Wellsboro takes issue with RESA’s market reflective/market responsive proposal terming it a restatement of the prevailing market price procurement standard that Act 129 eliminated.

PECO disagrees in response to suggestions that a “prudent mix” must include some minimum combination of spot price, short-term and long-term contracts. Adoption of minimum procurement provisions reduces the flexibility of DSPs to develop procurement plans that reflect different DSP and customer characteristics and evolving wholesale and retail markets. Minimum procurement requirements are best considered as part of individual default service plan evaluations.

In evaluating this question, we are guided by the language of Section 2807(e) (3.2) of the Public Utility Code which states that electric power procured pursuant to a default service plan shall include a prudent mix of the following: spot market purchases, short-term contracts and long-term contracts entered into as a result of an auction, RFP or bilateral contract. There is no guidance given regarding what constitutes the composition of a “prudent mix.”

On this point, there was substantial agreement that the term “prudent mix” be interpreted in a flexible fashion. RESA states that a “prudent mix” should be that combination of contracts that will result in a competitive, sustainable retail market that assures default service customers of generation service at the least cost over time. PECO

makes the point that “prudent mix” be linked to “least cost” and take into account price stability. PPL and PECO both recommend that the DSP have the discretion to propose a mix of contracts that are appropriate based on customer characteristics. Most of the generators advocate for a “case by case” determination. Some generators recommend a diverse supply of demand response, energy efficiency and alternative energy products. OCA prefers an approach to developing a “prudent mix” that allows for variation between DSPs.

We agree with the majority of parties that the “prudent mix” of contracts be interpreted in a flexible fashion which allows the DSPs to design their own combination of products that meets the various obligations to achieve “least cost to customers over time,” ensure price stability, and maintain adequate and reliable service. As we have done on other aspects of the plan review process, we will continue to review each plan on a “case by case” basis that independently evaluates the merits of each default service plan where input from stakeholders is assured. We reaffirm our commitment that a “prudent mix” include a combination of spot purchases, short, intermediate and long-term contracts recognizing the limitation of 25% on long-term contracts under Section 2807(e)(3.2)(iii).

We do reject the positions of those parties that “prudent mix” be defined to always require a specific mix or percentage of types of contract components in each default service plan or a minimum of two types of products. We also reject the position of RESA that long term contracts should not be part of the “prudent mix” standard. Our concern with adopting specific parameters is that adoption of specific component requirements creates constraints that limit the flexibility of the DSP to design a combination of products that meets the requirements under the Competition Act and Act 129.

7. Does a “prudent mix” mean that the contracts are diversified and accumulated over time?

To a degree, this question overlaps with Question 6 and the responses also repeated in large measure parties’ response to Question 6. The purpose of this question was to delve more deeply into the benefits of diversification and accumulation of contracts in meeting default service procurement requirements. The majority of responding parties were generally in favor of interpreting the “prudent mix” as including diversification and accumulation of contracts that incorporates such concepts as laddering and dollar cost averaging.

Among the EDCs, PPL states that a “prudent mix” is established through the procurement process that involves four solicitations a year. The “prudent mix” can change over time due to changing market conditions but the term does not mean that contracts must be diversified and accumulated over time. Allegheny employs a “dollar cost averaging” method for procurement with its various affiliates. In this manner, Allegheny can mitigate extraordinary market events and assure its customers consistent value. Duquesne points out that having more contracts does not always mean less risk and staggering contracts may not always be warranted when a fixed price full requirements contract represents less risk for customers.

PECO makes the important point that “diversity” of contracts should not be confused with a “prudent mix” where full requirements contracts can include significant mitigation risks for customers by ensuring fixed prices regardless of congestion costs, usage patterns, weather and other factors.

The generators (Exelon, PPL, Constellation) generally support the proposition that procurement plans can potentially be achieved by contracts that are diversified and accumulated over time. Utilizing a laddering approach with varying procurement periods and different contract durations can benefit customers through cost averaging. Where a

portfolio of FR contracts are laddered, customers are insulated from market price volatility that may occur where supply contracts are all purchased at one time.

RESA supports diversified contracts accumulated over time as long as the contracts are short-term. RESA states that laddering long-term contracts does not make the default service rate market reflective because they will not reflect the true market price of electricity.

Certain parties recommended specific restrictions on the number and types of products offered. Citizens/ Wellsboro and ICG recommend offering at least two products. Allegheny states that only spot purchases are appropriate for industrial customers.

OCA generally supports diversification of supply contracts as part of a portfolio approach both in timing of purchases and in terms of products procured.

OSBA cautions that the Commission should retain its current practice of requiring DSPs to conduct multiple procurements. The Commission should not mandate the timing of procurements or the mix of products.

OCA, in its Reply Comments, opposes proposals by Citizens/Wellsboro, ICG and Allegheny that seek to impose certain restrictions on the types of products offered.

The tenor of the comments received on this question affirm our prior understanding that, on balance, accumulation and diversification of contracts is a beneficial practice for DSPs to engage in when developing their procurement plans. We agree with those parties that utilizing such practices as laddering contracts, with varying procurement periods and contract durations over multiple procurements provide definite

benefits in terms of minimizing the impacts of market volatility and decreasing customer risk.

Therefore, we continue to endorse the use of contract diversification and accumulation as part of the default supply procurement process, but leave it to the DSPs to develop those methods of accumulation and diversification that best meet the needs and characteristics of the customer base and service territory. Our review of the individual default service plans will provide an opportunity for interested parties to critique shortcomings in the methods employed by individual DSPs. We reject the recommendations of those parties such as RESA, ICG and Citizens/Wellsboro that seek to set limits on the numbers and types of products that should be included as part of the procurement portfolio.

8. Should there be qualified parameters on the “prudent mix”? For instance, should the regulations preclude a DSP from entering into all of its long-term contracts in one year?

On this point, EDCs generally opposed specific parameters on what constitutes a “prudent mix” recommending instead a “case by case” evaluation of each plan as it is filed. The EDCs generally recommend that the Commission should retain flexibility in its regulatory review process by not prescribing restrictive parameters.

Among the generators, Exelon and Constellation prefer maintaining the present plan review process that provides maximum flexibility and rejects the establishment of specific parameters. PPL Energy recommends implementing regulations that restrict DSPs from entering into contract types all in one year although it recognizes that there may be situations where entry into contracts in one year may be appropriate.

The OCA likewise recommends against implementing an overly restrictive set of parameters for product mix achieved by each DSP, recognizing that DSPs should be

expected to incorporate “best practices” to ensure diversity of supply and limit over-reliance on any one product.

OSBA recommends deferral of any decision until the Commission has more opportunity to analyze the results of current default service plans.

As with our response to Question 7, the majority of comments recommend against setting firm qualified parameters on what constitutes a “prudent mix” insofar as setting requirements reduces the flexibility of the DSP to design a procurement plan that best suits the requirements and characteristics of the customer base and the service area. We agree with those parties that setting specific requirements unduly reduces flexibility of the DSP to achieve a “prudent mix” that meets the “least cost over time” standard while ensuring rate stability and adequate and reliable service. We will leave to the DSP the appropriate design of the procurement process recognizing that we reserve the discretion to review and approve the DSP’s plan when it is filed. We do not at this time see the need to implement regulations restricting a DSP from entering into all of its long-term contracts in one year.

9. Should the DSP be restricted to entering into a certain percentage of contracts per year?

On this question, the parties’ responses were largely dictated by their response to Question 8. EDCs opposed any restrictions on DSPs entering into a certain percentage of contracts per year expressing a preference for a “case by case” review of each procurement plan. Generators opposed any restriction, recommending the more flexible regulatory approach of evaluating each case on its own merits recognizing that there is a multiplicity of procurement plans.

OCA also opposes this requirement and cautions against approving a plan that has too many contracts expiring in one year. OSBA recommends deferral of any decision until the Commission has more opportunity to analyze the results of current default service plans.

As with our discussion of Questions 8 and 9, we refrain from taking a position in favor of or recommending the establishment of fixed percentages of contracts per year as such a step would reduce the flexibility of DSPs to design procurement plans that best suit their own supply requirement and the requirements of retail customers.

- 10. Should there be a requirement that, on a total plan basis, the “prudent mix” means that some quantity of total plan default service load must be served through spot market purchases, some quantity must be served through short-term contracts, and some quantity must be served through long-term contracts?**

As with the prior three questions, EDCs generally resisted any requirement that the definition of “prudent mix” means a specific quantity of spot market purchases, long-term contracts and short-term contracts. EDCs believe that a “prudent mix” will evolve over time and that a minimum quantity of specific electricity products should not be prescribed. PPL states that it is likely that the “prudent mix” will change with market conditions and can be reflected in future DSP procurement plan filings. Similarly, the generators do not endorse a specific quantity requirement for electricity products noting that the 25% limit on DSP projected load should be the limit on any fixed requirements.

OCA does not endorse a specific requirement but urges that all three types of purchases be considered as part of the default service portfolio approach. OSBA concedes in its comments that there is no clear guidance on this issue and that the Commission has already determined there is no legal requirement there must be, as part of a default service plan, a specific quantity of load served by specific products.

ICG opines that the prudent mix standard can vary by class as long as at least two products are offered. ICG asserts that providing only hourly priced service does not result in a “prudent mix” for large commercial and industrial customers.

RESA presents a forceful analysis on why increased reliance on long-term contracts is not to be recommended for the following reasons: (1) a substantial percentage of supply will be based on prices that are substantially out of date; (2) long-term contracts deprive customers of price decreases in a time of declining prices; (3) long-term fixed price contracts impede the legislative goal of promoting retail competition; (4) there is no guarantee that long-term fixed price contracts will produce lower rates for customers; and (5) long-term contracts require suppliers to factor in higher capital costs into bid prices.

Based on the comments received and our further consideration, we do not believe it is prudent or necessary at this time to establish specific percentages of default service load that should be served under long-term contracts, short-term contracts or spot market purchases. We do agree with OCA that all types of contract products be considered. We also find merit in the points raised by RESA against increased reliance on long-term contracts and we caution parties not to be overly wedded to long-term contracts as a major factor in their portfolio requirements. In declining to set fixed quantities for portfolio requirements, we allow DSPs maximum flexibility to design their default service plans with a minimum of restrictions while retaining our ability to review and evaluate plans on a case by case basis.

- 11. Should there be a requirement that some quantity of each rate class procurement group’s load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely on only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP?**

On this point, the EDCs resist imposing requirements that portions of each rate class be served by specific quantities of product. PECO and Duquesne oppose any fixed requirements. FirstEnergy and Citizens/Wellsboro indicate that a DSP should be permitted to rely on one or two product categories if necessary. Allegheny and PPL point out that a DSP should be permitted to develop plans based on the characteristics of each rate class. The generators uniformly opposed this requirement.

RESA recommends default service plans be designed to gradually transition toward a robust and competitive end-state. ICG prefers that a prudent mix contain more than one product. OCA prefers a mix of all products for residential customers. OSBA points out that the Commission has already decided there is no legal requirement that the “prudent mix” for each rate class include specific quantities from each product.

Based on the comments received and our further consideration, we do not believe it is prudent or necessary at this time to establish specific quantities of default service load that should be served under long-term contracts, short-term contracts or spot market purchases. As indicated in our responses to Questions 8 through 10, prescribing specific parameters and minimum load or product parameters limits the flexibility of the DSP to design a default service portfolio that best fits the needs of its service territory and customer base.

12. Should the DSP be required to hedge its positions with futures including natural gas futures because of the link between prices of natural gas and the prices of electricity?

EDCs generally opposed any requirement to hedge their positions with futures products including natural gas futures. PPL states that DSPs generally use RFPs and auctions for procurement and thus do not have to hedge nor should DSPs be required to hedge positions as there is risk associated with hedging and specialized expertise is

required to perform this function in a competent manner. PECO and Citizens/Wellsboro state that DSPs should be permitted, but not required, to utilize hedges because properly structured hedges can provide protection against price changes in wholesale electricity markets. FirstEnergy opposes mandated hedging and notes that requiring the use of one market method over another is unlikely to result in the lowest cost to customers over time.

Generators largely oppose the use of mandated hedging. PPL Energy highlights the commodity risk and lack of DSP expertise as primary reasons for not endorsing this method. Exelon notes that there may be instances when a DSP can use gas hedging options to reduce risk and in those cases should be permitted to do so.

RESA opposes hedging as it is fraught with risk and, when it fails, customers will pay the consequences. RESA cites to prior Commission statements that it is “generally skeptical of DSP’s ability to beat the market.”

OCA indicates that hedging products should be the types of products considered for inclusion in a portfolio if they can contribute to price stability, but these products should not be mandated. OSBA recommends the Commission defer a decision on this question.

Based on the extent of comments received, we do not see a compelling reason to require DSPs to employ hedging strategies, either natural gas or other hedging vehicles, as part of their default service plan. As noted by the parties, DSPs do not typically have the in-house expertise to engage in these potentially risky practices that may result in additional cost to ratepayers. The use of hedging strategies does have its benefits in providing price stability in times of price volatility and we encourage DSPs to consider hedging as part of the total mix of available procurement strategies if the DSP has a level of confidence that hedging can be employed in a beneficial manner.

13. Is the “prudent mix” standard a different standard for each different customer class?

The consensus EDC response on this question was in the affirmative - that the “prudent mix” standard applies to all customer groups but since each customer group is different, the appropriate default service product will differ from one group to the next. PECO notes that the product mix for industrial and commercial customers will differ from the products for small commercial and residential customers, as the former classes are generally more sophisticated and have more competitive opportunities than the latter classes. Generators endorsed the “case by case” approach allowing for different product mixes by customer class considering the overall mandate of the default procurement process which is to achieve the least cost and greatest price stability to customers.

OCA is generally supportive of the concept that the “prudent mix” standard be interpreted as allowing for customer class specific product mixes.

OSBA also agrees with this proposition but cautions that long-term contracts will usually not be part of a “prudent mix” for small and medium commercial and industrial customers. Further, because medium-sized higher load factor customers (commercial and industrial) have a higher propensity to shop, long-term contracts may be imprudent for serving that group.

The Commission notes there was substantial unanimity on this point and agrees with the parties that the “prudent mix” standard should be interpreted to allow for a class-specific product mix that best matches the needs of each DSP customer class. However, DSPs are advised to carefully review and update as necessary the usage characteristics of each customer class when developing class-specific product mix. We will continue to analyze DSP proposals of this nature on a “case by case” basis.

14. What will be the effects of bankruptcies of wholesale suppliers and default service suppliers on the short and long-term contracts?

We requested this information to better inform our future judgments regarding the evaluation of risk associated with supplier bankruptcy, to elicit information on the current “best practices” employed by DSPs and to evaluate whether additional regulations on this point are necessary.

PPL notes that its response to supplier bankruptcies will be dictated by market conditions at the time of the bankruptcy. Both PPL and Allegheny make the point that the outcome of supplier bankruptcy will depend on whether the contract price (at time of supplier failure) is less than or more than the market price. If the former, the DSP can more easily obtain a lower-priced substitute supply. If the latter, the DSP may have to absorb the loss.

PECO notes that the effects of bankruptcies involving long-term contracts are likely to be greater than the impacts of bankruptcy involving short-term contracts, as the duration of the load obligation of the former lasts longer and increases the degree of market uncertainty.

FirstEnergy, PECO and other EDCs stressed the importance of establishing firm credit requirements upfront in order to minimize counterparty risk.

Generators echo the importance of designing adequate credit protection mechanisms in supplier contracts to protect all parties against the potential for supplier failure. Constellation recommends that default supply procurement mechanisms be structured to account for all risk including, but not limited to, risks to the financial standing of the wholesale suppliers. Exelon recommends that supplier agreements

require the posting of collateral equal to the difference between the contract price and the market price-collateral which can be retained for contingency procurement requirements.

RESA endorses the inclusion of contingency provisions in the default service plan that sets forth a process to address situations where the supplier is unable to perform pursuant to the procurement contract.

OCA and OSBA generally refer to the existing regulation requirement that specifies that default service programs include contingency plans to ensure the reliable provision of service when a wholesale supplier fails to meet its contractual obligations. OCA urges the DSP to have a contingency plan that provides for obtaining replacement supply through competitive means on the wholesale market including the possible use of the MP approach. PECO, in Reply Comments, argues against OCA's position on this point noting OCA offers no data to support its claim.

CP suggests that, in the event of a supplier bankruptcy, the DSP be responsible for any cost differential between the contracted cost of supply and the replacement cost for the same supply. CP provides no support for the proposal. EAP, FirstEnergy and PECO vehemently oppose this suggestion terming it a contradiction of Act 129 and Section 2807(e) (3.9), as well as Commonwealth Court precedent that entitles DSPs to recovery of all costs on a full and current basis.

We appreciate the parties' input on these important issues and commend EDCs and suppliers alike for pro-actively addressing the potential for supplier bankruptcy or other circumstances involving supplier inability to perform. Moreover, we agree with the comments of the EDCs and generators that adequate credit protection mechanisms should be a part of all supply contracts to protect customers in the event of a bankruptcy or other inability to perform. However, we do not propose to make any specific changes to either our regulations or policy statement regarding DSP credit and collateral provisions or

other measures to safeguard customers in the event of supplier bankruptcy in this rulemaking. DSPs are already required to detail these credit protection mechanisms and procedures through the default service filing and review process in our regulations. In the event circumstances dictate a need to revise our regulations, we will institute an additional rulemaking to address the issue.

We further reject CP's suggestion for holding DSPs responsible for cost differentials due to supplier failure as inconsistent with Section 2807(e)(3.9) and appellate precedent which ensures full cost recovery.

DSPs should strive to provide as much detail as possible including sample contract language and explanations in their default service plans regarding the DSP procedures in the event of supplier bankruptcy and/or other potential scenarios involving supplier failure. We endorse RESA's proposal to include contingency provisions in the default service plan that set forth a process to address situations where wholesale suppliers are unable to perform pursuant to the procurement contract. Moreover, we believe our DSPs are capable of independently developing procedures for addressing supplier bankruptcy - procedures that are best designed to minimize impacts on ratepayers when these unfortunate events occur.

15. Does Act 129 allow for an after-the-fact review of the “cost reasonableness standard” in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase?²

EDC parties were fairly adamant in their position that Act 129 does not allow for an “after the fact” review of the cost reasonableness standard based on the language of Section 2703 (e) (3.8) of the Competition Act that permits the Commission to conduct an “after the fact” review to disallow costs only for non-compliance with approved default

² See Section 2807(e)(3.9), which provides the EDC with the right to recover “all reasonable costs” incurred under Section 2807 and under an approved competitive procurement plan.

service plans or where there is the commission of fraud, collusion or market manipulation.

Generator parties concur in this assessment. Constellation observes that adoption of the MP as opposed to the FR approach may invite EDC market-timing practices that could necessitate “after the fact” regulatory and prudence review by the Commission.

RESA and OCA also oppose an “after the fact” review of DSP procurement plans on the same legal grounds, with the exception of those provisions listed under Section 2807(3.8).

OSBA favors an “after the fact” review where the DSP has substantial discretion in the nature and timing of default service with reference to the occurrence of conditions provided for at Section 2807(e)(3.8).

In their Reply Comments, EAP, Citizens/Wellsboro, FirstEnergy and PECO all contest OSBA’s interpretation that, under certain circumstances, “after the fact” review may be proper. These parties, especially PECO, do not believe that the reference to “reasonable costs” in Section 2807 (e)(3.9) is intended to create the opportunity for general after the fact prudence review in light of the very limited exceptions to full cost recovery set forth in Section 2807(e)(3.8). PECO suggests that if the Commission grants a certain level of discretion to the DSP in the procurement review process, then there should be no second guessing of that discretion through additional cost recovery proceedings.

We have also carefully considered the extensive comments on this question and agree with the majority of the parties who interpret the language of Act 129 as not legally permitting an “after the fact” review of default service plans except for the two exceptions provided for under Section 2807(3.8). These exceptions are: (i) failure to

comply with the Commission-approved procurement plan, and (ii) evidence of fraud, collusion or market manipulation with respect to the contracts. We herein reject OSBA's proposed interpretation. To interpret our authority to allow "after the fact" review would, in our view, unduly subject DSPs to a level of second-guessing and regulatory scrutiny that is inconsistent with the purpose of both the Competition Act and Act 129. Further, this limitation on our ability to conduct "after the fact" reviews of a DSP procurement plan (other than under Section 2807(3.8)) puts additional responsibility on this Commission to carefully analyze, scrutinize and, where need be, challenge the DSP on the details of its procurement plan.

However, by not exercising after the fact review, we are not giving the DSPs unfettered discretion in the design of their default service plans. We encourage the DSPs to clearly articulate in their filings reasonable parameters and constraints applicable to their supply acquisition schedules and hedging mechanisms.

- 16. How should the requirement that "this section shall apply" to the purchase of AECs be implemented. Section 2807(e)(3.5) states that "... the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc."**

On this question, the EDCs' general position is that the requirements for the purchase of AECs should be identical to and treated no differently than any other component of the total power supply. FirstEnergy, Duquesne and PPL contend that there is no single correct way to procure AECs - bilateral agreements, auctions, RFPs as well as long-term, short-term and spot purchases are all includable and essential components of default service supply. Allegheny advocates for spreading the renewable obligation across many winning bidders as a means of inviting competition and creating diversity of supply for renewable resources.

PECO provided the most detailed response to the question from the EDC perspective:

1. Section 2807(e)(5) provides that Section 2807(e) “shall apply” to the procurement of any type of energy by a DSP for electric generation service, including energy or AECs required to satisfy the requirements of the AEPS.
2. This provision is intended to ensure that the framework of competitive procurement established by Act 129 is also applied to the purchase of AECs. DSPs should acquire AECs through auctions and RFPs and should be in accordance with a Commission-approved plan.
3. AECs should also be procured through a “prudent mix” of contracts designed to ensure “least cost over time” but there is no requirement that the AEC component of a “prudent mix” address adequacy and reliability since those generation service-related obligations are not related to AEC compliance obligations.
4. Establishing “least cost” for AEC procurements should take into account the benefits of price stability for customers since wide variations in AEC pricing could have significant effects on retail rates.
5. Procurement of all AECs through short-term and spot purchases should be avoided as should undue reliance on only long-term contracts due to the negative price characteristics associated with over reliance on these resources.
6. Given the developing nature of the AEC markets, the Commission should permit a variety of procurement plans for AEPS compliance. DSPs should be able to obtain AECs from full requirements suppliers as well as enter into long-term, short-term and spot purchases to address shortfalls at the end of the AEPS compliance year.
7. The Commission should interpret Section 2807(e)(3.5) flexibly to both facilitate AEPS compliance and help ensure “least cost” to customers for AECs.

(PECO Comments, pp. 19-20).

Allegheny states that renewable obligations are included as part of the full-requirement RFP process and are included in the purchased product from the wholesale market. Allegheny advocates for spreading the renewable obligation across many winning bidders, thus inviting competition and creating the opportunity for diversity of

supply of renewable resources resulting in lower renewable pricing for the benefit of customers. For the spot market load served by the EDC, each EDC should be allowed to present plans to the Commission that allow for the procurement of renewable credits through a separate RFP process layering in competitively bid purchase contracts over time to serve the expected load and then transacting in the spot market to balance the load as necessary.

PPL states that the Commission regulations should explicitly address that AECs are to be considered part of default supply.

Exelon emphasizes that the DSP should have flexibility in how it proposes to secure required AECs and that the language of the statute clearly states that simply because AECs are required to be purchased pursuant to the AEPS does not exclude these energy products from the over-arching goals of Act 129 to achieve least cost and price stability for default service customers. Constellation states that each EDC must account in its default service plan for how it will meet the requirements of the AEPS. One way of meeting this obligation is to include the AEC requirement within the obligations placed on a wholesale FR product supplier.

RESA makes the important point that this Commission recommended, in its Act 129 Proposed Rulemaking Order at p. 25, that DSPs should utilize long-term contracts to meet their requirements under the AEPS. However, RESA also recommends that DSPs' utilization of long-term contracts for procurement of AECs fulfills the requirement of utilizing long-term contracts under Act 129. RESA further suggests that EDCs be permitted to procure long-term renewable contracts while assigning the AECs to all load serving entities on a load ration share basis and recover the costs of long-term procurements through non-bypassable charges. RESA contends this approach takes the long-term contract out of the default service price and puts EGSs on the same footing as EDCs.

OCA briefly indicates that, in its view, the DSP must actively engage the market for AECs in the same manner as it would procure other sources of default service supply.

OSBA observes that the prudent way to conduct competitive procurement of AECs will vary between DSPs and between rate class procurement groups. OSBA suggests that the acquisition of AECs be included as part of the full requirements contracts serving the default service loads of small business customers.

PECO, in Reply Comments, states that it would be appropriate, in light of the developing alternative energy market, to apply Section 2807(e) (5) on a case by case basis instead of creating specific regulatory requirements at this time.

Of the many comments received, we are inclined to adopt PECO's detailed recommendations as the best statement of our position on this issue. We generally agree with PECO that the "shall apply" provision of Section 2807(e)(5) should be interpreted to ensure that the framework of competitive procurement established by Act 129 is also applied to the purchase of AECs. In so doing, it is appropriate for DSPs to acquire AECs through a variety of methods, including FR purchases, as well as long-term, short-term and spot purchases. We adopt the recommendations of those parties that advocate allowing EDCs to present plans to the Commission that allow for procurement of renewable credits through separate RFPs that layer in competitively bid purchase contracts over time and then purchasing from the spot market to balance the load. We do not believe that undue reliance on a particular product is advisable given the relatively recent development of the AEC market and the pricing of certain renewable products such as solar, which may not reflect the market price of power. Finally, the Commission continues to support flexibility to permit DSPs to acquire needed renewable AECs in a manner that facilitates compliance with both the Competition Act and Act 129.

RESA suggests that a DSP can fulfill any requirement for incorporating a long-term contract requirement into a default service plan through long-term contracts for its Act 129 requirements. We do not agree with this interpretation, which would effectively limit the use of long-term contracts to procurement of renewable requirements. As we have stated throughout this Order, we are adopting a position that maximizes a DSP's flexibility to meet its default supply requirement, the "prudent mix" obligation and the "least cost to customers over time" mandate by not limiting the degree to which the DSP utilizes whatever component it chooses to achieve the "prudent mix" standard.

Finally, we decline to recommend adopting any further regulations in this areas until we have sufficient experience with the developing market in renewable resources and reserve the right to address this area in future rulemaking proceedings.

In summary, we are adopting these final-form regulations in order to implement the Act 129 changes to the statutory standards for the acquisition of electric generation supply by EDCs for their default service customers, including: requirements in regard to competitive procurement, a prudent mix of contract types, least cost to customers over time, and adequate and reliable service.

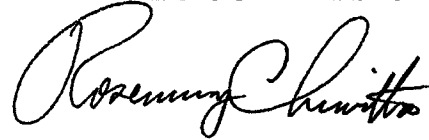
Accordingly, under Sections 501,1301, 1501 and 2807 of the Public Utility Code, 66 Pa. C.S. §§ 501,1301, 1501 and 2807; Sections 201 and 202 of the Act of July 31, 1968, P.L. 769 No. 240, 45 P.S. §§ 1201-1202 and the regulations promulgated at 1 Pa. Code §§ 7.1, 7.2 and 7.5; Section 204(b) of the Commonwealth Attorneys Act, 71 P.S. § 745.5 and Section 612 of the Administrative Code of 1929, 71 P.S. § 732 and the regulations promulgated thereunder at 4 Pa. Code §§ 7.231-7.324, we are considering adopting the proposed regulations set forth in Annex A, attached hereto; **THEREFORE,**

IT IS ORDERED:

1. That the amendments to 52 Pa. Code §§ 54.181-188, *et seq.*, as set forth in Annex A, are adopted.
2. That the Secretary shall submit this Order and Annex A to the Governor's Budget Office for review of fiscal impact.
3. That the Secretary shall submit the Order and Annex A to the Office of Attorney General for approval as to legality.
4. That the Secretary shall certify this Order and Annex A and deposit them with the Legislative Reference Bureau for publication in the Pennsylvania Bulletin.
5. That this Final Rulemaking shall become effective upon publication in the Pennsylvania Bulletin.
6. That the Secretary shall submit this Order and Annex A for review by the designated standing committees of the General Assembly, and for review and approval by the Independent Regulatory Review Commission.
7. That a copy of this Order and Annex A be filed at Docket No. M-2009-2140580 and Docket No. L-2009-2095604 and be served upon all parties of record and statutory advocates.

8. That the contact person for this matter is James P. Melia, Assistant Counsel, Law Bureau (717)787-1859.

BY THE COMMISSION,

A handwritten signature in cursive script, appearing to read "Rosemary Chiavetta".

Rosemary Chiavetta
Secretary

(SEAL)

ORDER ADOPTED: September 22, 2011

ORDER ENTERED: October 4, 2011

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ANNEX A

TITLE 52. PUBLIC UTILITIES

PART I. PUBLIC UTILITY COMMISSION

Subpart C. FIXED SERVICE UTILITIES

CHAPTER 54. ELECTRICITY GENERATION CUSTOMER CHOICE

Subchapter G. DEFAULT SERVICE

§ 54.181. Purpose.

This subchapter implements 66 Pa.C.S. § 2807(e) (relating to duties of electric distribution companies), pertaining to an EDC's obligation to serve retail customers at the conclusion of the restructuring transition period. The provisions in this subchapter ensure that retail customers who do not choose an alternative EGS, or who contract for electric energy that is not delivered, have access to generation supply ~~at~~ PROCURED BY A DEFAULT SERVICE PROVIDER PURSUANT TO A COMMISSION APPROVED COMPETITIVE PROCUREMENT PLAN ~~prevailing market prices~~. The EDC or other approved entity shall fully recover all reasonable costs for acting as a default service provider of electric generation supply to all retail customers in its certificated distribution territory.

§ 54.182. Definitions.

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

* * * * *

Bilateral contract – The term as defined in 66 Pa.C.S. § 2803 (relating to definitions).

* * * * *

DSP—Default service provider – [The incumbent EDC within a certificated service territory or a Commission-approved alternative supplier of electric generation service] The term as defined in 66 Pa.C.S. § 2803.

* * * * *

~~Prevailing market price—The price that is available in the wholesale market at particular points in time for electric generation supply.~~

* * * * *

§ 54.184. Default service provider obligations.

(a) [A DSP] While an EDC collects either a competitive transition charge or an intangible transition charge or until 100% of an EDC's customers have electric choice, whichever is longer, an EDC as a default service provider shall be responsible for the reliable provision of default service to retail customers who are not receiving generation services from an alternative EGS within the certificated territory of the EDC that it serves or whose alternative EGS has failed to deliver electric energy.

(b) [A DSP shall comply with the code and Chapter 1 (relating to rules of administrative practice and procedure) to the extent that the obligations are not modified by this subchapter or waived under § 5.43 (relating to petitions for issuance, amendment, repeal or waiver of regulations.] The obligation to serve includes:

(1) The connection of customers.

(2) The delivery of electricity.

(3) The production or acquisition of electricity for customers.

A DSP SHALL COMPLY WITH THE CODE AND CHAPTER 1 (RELATING TO RULES OF ADMINISTRATIVE PRACTICE AND PROCEDURE) TO THE EXTENT THAT THE OBLIGATIONS ARE NOT MODIFIED BY THIS SUBCHAPTER OR WAIVED UNDER § 5.43 (RELATING TO PETITIONS FOR ISSUANCE, AMENDMENT, REPEAL OR WAIVER OF REGULATIONS).

(c) Following the expiration of an EDC's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply service and the chosen EGS does not provide the service, or if a customer does not choose an alternative EGS, the default service provider shall provide electric generation supply service to that customer pursuant to a Commission-approved competitive procurement process that shall include one or more of the following:

(1) Auctions.

(2) Requests for proposals.

(3) Bilateral agreements entered into at the sole discretion of the default service provider which shall be at prices that are:

(i) No greater than the cost of obtaining generation under comparable terms in the wholesale market, as determined by the Commission at the time of execution of the contract.—OR

(ii) Consistent with a Commission-approved competition procurement process. Agreements between affiliated parties, INCLUDING BILATERAL AGREEMENTS BETWEEN ELECTRIC UTILITIES AND AFFILIATED GENERATORS, shall be subject to review and approval of the Commission under 66 Pa. C. S. §§ 2101-2107 (relating to relations with affiliated interests). The cost of obtaining generation from any affiliated interest may not be greater than the cost of obtaining generation under comparable terms in the wholesale market at the time of execution of the contract.

(d) A DSP shall continue the universal service and energy conservation program in effect in the EDC's certificated service territory or implement, subject to Commission approval, similar programs consistent with [the] 66 Pa. C. S. § § 2801—[2812] 2815 (relating to Electricity Generation Customer Choice and Competition Act and the amendments provided under the act of October 15, 2008 (P.L. 1592, No. 129) (Act 129) providing for energy efficiency and conservation programs). The Commission will determine the allocation of these responsibilities between an EDC and an alternative DSP when an EDC is relieved of its DSP obligation.

§ 54.185. Default service programs and periods of service.

* * * * *

(b) The Commission will hold hearings as necessary on the proposed plan OR AMENDED PLAN . If the Commission fails to issue a final order on the plan OR AMENDED PLAN within 9 months of the date that the plan is filed, the plan OR AMENDED PLAN will be deemed to be approved and the default service provider may implement the plan OR AMENDED PLAN as filed. Costs incurred through an approved competitive procurement plan shall be deemed to be the least cost over time.

(c) Default service programs must comply with Commission regulations pertaining to documentary filings in Chapter 1 (relating to rules of administrative practice and procedure), except when modified by this subchapter. The DSP shall serve copies of the default service program on the Pennsylvania Office of Consumer Advocate, Pennsylvania Office of Small Business Advocate, the Commission's Office of Trial Staff, EGSs registered in the service territory and the RTO or other entity in whose control area the

DSP is operating. Copies shall be provided upon request to other EGSs and shall be available at the DSP's public internet domain.

[(c)] (d) The first default service program shall be for a period of 2 to 3 years, or for a period necessary to comply with subsection [d] (e) (4), unless another period is authorized by the Commission. Subsequent program terms will be determined by the Commission.

[(d)] (e) A default service program must include the following elements:

* * * * *

[(e)] (f) The Commission may, following notice and opportunity to be heard, direct that some or all DSPs file joint default service programs to acquire electric generation supply for all of their default service customers. In the absence of such a directive, some or all DSPs may jointly file default service programs or coordinate the scheduling of competitive bid solicitations to acquire electric generation for all of their default service customers. A multiservice territory procurement and implementation plan must comply with § 54.186.

[(f)] (g) DSPs shall include requests for waivers from the provisions of this subchapter in their default service program filings. For DSPs with less than 50,000 retail customers, the Commission will grant waivers to the extent necessary to reduce the regulatory, financial or technical burden on the DSP or to the extent otherwise in the public interest.

§ 54.186. Default service procurement and implementation plans.

(a) A DSP shall acquire electric generation supply at ~~prevailing market prices~~ **THE LEAST COST TO CUSTOMERS OVER TIME** for default service customers in a manner consistent with procurement and implementation plans approved by the Commission.

(b) A DSP's procurement plan must adhere to the following standards:

(1) The procurement plan shall be designed [to acquire electric generation supply at prevailing market prices to meet the DSP's anticipated default service obligation at reasonable costs.] so that the electric power procured under § 54.184(c) (relating to default service provider obligations) includes a prudent mix of the following:

(i) Spot market purchases.

(ii) Short-term contracts.

(iii) Long-term purchase contracts, entered into as a result of auction, request for proposal or bilateral contract that is free of undue influence, duress or favoritism of ~~more~~ GREATER than 4 YEARS IN LENGTH and BUT not ~~more~~ GREATER than 20 years. The default service provider shall have sole discretion to determine the source and fuel type. Long-term purchase contracts shall be 25% or less of the DSP's projected default service load unless the Commission, AFTER A HEARING, determines for good cause that a greater portion of load is necessary to achieve least cost procurement.

(A) EDCs or Commission-approved alternative suppliers may offer large customers with a peak demand of 15 megawatts or greater at one meter at a location in its service territory any negotiated rate for service at all of the customers' locations within the service territory for any duration agreed upon by the EDC or alternative supplier and the large customer.

(B) The Commission may determine that a contract is required to be extended for a period longer than 20 years if the extension is necessary to ensure adequate and reliable service at least cost to customers over time.

(2) A prudent mix of contracts shall be designed to ensure:

(i) Adequate and reliable service.

(ii) The least cost to customers over time.

(iii) Compliance with the requirements of ~~paragraph (1)(iii)~~ SUBSECTION (B)(1).

[(2)] (3) DSPs with loads of 50 mW or less shall evaluate the cost and benefits of joining with other DSPs or affiliates in contracting for electric supply.

[(3)] (4) Procurement plans may include solicitations and contracts whose duration extends beyond the program period.

[(4)] (5) Electric generation supply shall be acquired by competitive bid solicitation processes, spot market energy purchases, short and long-term contracts, auctions, bilateral contracts or a combination of [both]them.

[(5)] (6) The DSP's supplier affiliate may participate in a competitive bid solicitation process used as part of the procurement plan subject to the following conditions:

* * * * *

(d) The DSP may petition for modifications to the approved procurement and implementation plans when material changes in wholesale energy markets occur to ensure the acquisition of sufficient supply at ~~prevailing market prices~~ **THE LEAST COST TO CUSTOMERS OVER TIME**. The DSP shall monitor changes in wholesale energy markets to ensure that its procurement plan continues to reflect the incurrence of reasonable costs, consistent with 66 Pa. C. S. § 2807 (e)(3) (relating to duties of electric distribution companies).

(e) At the time the Commission evaluates the plan and prior to its approval, in determining if the DSP's plan obtains generation supply at the least cost, the Commission will consider the DSP's obligation to provide adequate and reliable service to customers and that the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission will make specific findings which include the following:

- (1) The DSP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.
- (2) The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term, and spot market basis.
- (3) Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates Federal law.

§ 54.187. Default service rate design and the recovery of reasonable costs.

(a) The Commission may modify contracts or disallow costs when after a hearing the party seeking recovery of the costs of a procurement plan is found to be at fault for the following:

- (1) Not complying with the Commission-approved procurement plan; OR
- (2) The commission of fraud, collusion, or market manipulation with regard to these contracts.

(b) The costs incurred for providing default service [shall] SHALL ~~may~~ be recovered ON A FULL AND CURRENT BASIS through a [default service rate schedule. The rate schedule shall be designed to recover fully all reasonable cost incurred by the DSP during the period default service is provided to customers , based on the average cost to acquire supply for the customer class] reconcilable automatic adjustment clause under 66 Pa. C. S. § 1307 (relating to sliding scale of rates; adjustments), all reasonable costs incurred under

66 Pa.C.S. § 2807(e)(3.9) (relating to obligation to serve) and a Commission-approved competitive procurement plan. The use of an automatic adjustment clause shall be subject to audit and annual review, consistent with 66 Pa.C.S. § 1307(d) and (e).

[(b)] (c) Except for rates available consistent with subsection [(f)] (g), a default service customer shall be offered a single rate option, which shall be identified as the PTC and displayed as a separate line item on a customer's monthly bill.

[(c)] (d) The rates charged for default service may not decline with the increase in kilowatt hours of electricity used by a default service customer in a billing period.

[(d)] (e) The PTC shall be designed to recover all default service costs, including generation, transmission and other default service cost elements, incurred in serving the average member of a customer class. An EDC's default service costs may not be recovered through the distribution rate. Costs currently recovered through the distribution rate, which are reallocated to the default service rate, may not be recovered through the distribution rate. The distribution rate shall be reduced to reflect costs reallocated to the default service rate.

[(e)] (f) A DSP shall use an automatic energy adjustment clause, consistent with 66 Pa.C.S. § 1307 [relating to sliding scale of rates; adjustments] and Chapter 75 (relating to alternate energy portfolio standards), to recover all reasonable costs incurred through compliance with the Alternative Energy Portfolio Standards Act (73 P. S. § § 1648.1—1648.8). The use of an automatic adjustment clause shall be subject to audit and annual review, consistent with 66 Pa.C.S. § 1307(d) and (e), regarding fuel cost adjustment audits and automatic adjustment reports and proceedings.

[(f)] (g) [A DSP may use an automatic energy adjustment clause to recover reasonable non-alternative energy default service costs. The use of an automatic adjustment clause be subject to audit and annual review, (d) and (e).] A DSP may collect interest from retail customers on the recoveries of under collection of default service costs at the legal rate of interest. Refunds to customers for over recoveries shall be made with interest, at the legal rate of interest plus 2%.

[(g)] (h) The default service rate schedule must include rates that correspond to demand side response and demand side management programs, as defined in section 2 of the Alternative Energy Portfolio Standards Act (73 P. S. § 1648.2), when the Commission mandates these rates pursuant to its authority under 66 Pa.C.S. Chapter 1 (relating to general provisions).

[(h)] (i) Default service rates shall be adjusted on a NO MORE FREQUENTLY THAN quarterly basis [,or more frequently] for all customer classes with a maximum registered peak load up to 25 kW, to ensure the recovery of costs reasonably incurred in acquiring

electricity at THE LEAST COST TO CUSTOMERS OVER TIME ~~prevailing market prices and to reflect the seasonal cost of electricity~~. DSPs may propose alternative divisions of customers by maximum registered peak load to preserve existing customer classes.

[(i)] (j) Default service rates shall be adjusted on a quarterly basis , or more frequently, for all customer classes with a maximum registered peak load of 25 kW to 500 kW, to ensure the recovery of costs reasonably incurred in acquiring electricity at THE LEAST COST TO CUSTOMERS OVER TIME ~~prevailing market prices and to reflect the seasonal cost of electricity~~. DSPs may propose alternative divisions of customers by maximum registered peak load to preserve existing customer classes.

[(j)] (k) Default service rates shall be adjusted on a monthly basis, or more frequently, for all customer classes with a registered peak load of equal to or greater than 500 kW to ensure the recovery of costs reasonably incurred in acquiring electricity at THE LEAST COST TO CUSTOMERS OVER TIME ~~prevailing market prices and to reflect the seasonal cost of electricity~~. DSPs may propose alternative divisions of customers by registered peak load to preserve existing customer classes.

[(k)](l) When a supplier fails to deliver electric generation supply to a DSP, the DSP shall be responsible for acquiring replacement electric generation supply consistent with its Commission-approved contingency plan. When necessary to procure electric generation supply before the implementation of a contingency plan, a DSP shall acquire supply at THE LEAST COST TO CUSTOMERS OVER TIME ~~prevailing market prices~~ and fully recover all reasonable costs associated with this activity that are not otherwise recovered through its contract terms with the default supplier. The DSP 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.

§ 54.188. Commission review of default service programs and rates.

(a) A DSP shall file a plan OR AMENDED PLAN for competitive procurement with the Commission and obtain Commission approval of the plan OR AMENDED PLAN considering the standards in 66 Pa. C.S. § 2807(e)(3.1), (3.2), (3.3), and (3.4) (relating to ~~duties of electric distribution companies~~ OBLIGATION TO SERVE) before the competitive process is implemented. The Commission will hold hearings as necessary on the proposed plan OR AMENDED PLAN. A default service program will initially be referred to the Office of Administrative Law Judge for further proceedings as may be required.

(b) [The Commission will issue an order within 7 months of a program's filing with the Commission on whether the default service program demonstrates compliance with

this subchapter and 66 Pa.C.S. § § 2801—2812 (relating to the Electricity Generation Customer Choice and Competition Act).] If the Commission fails to issue a final order on the plan OR AMENDED PLAN within 9 months of the date the plan OR AMENDED PLAN is filed, the plan OR AMENDED PLAN will be deemed approved and the DSP may implement the plan OR AMENDED PLAN as filed. Costs incurred through an approved competitive procurement plan will be deemed to be the least cost over time as required under 66 Pa. C.S. § 2807(e)(3.4)(ii).

* * * * *

(d) [Upon receiving written notice, the Commission will have 1 business day, to approve or disapprove the results of a competitive bid solicitation process used by a DSP as part of its procurement plan. When the Commission does not act within 1 business day the results of the process will be deemed approved. The Commission will not certify or otherwise approve or disapprove a DSP's spot market energy purchases made pursuant to a Commission-approved procurement plan. The Commission will monitor the DSP's adherence to the terms of the approved default service program and 66 Pa.C.S. §§ 2801—2812 (relating to the Electricity Generation Customer Choice and Competition Act).] The Commission may initiate an investigation regarding implementation of the DSP's default service program and, at the conclusion of the investigation, order remedies as may be lawful and appropriate. The Commission will not deny the DSP the recovery of its reasonable costs for purchases made pursuant to an approved competitive procurement process unless the DSP concealed or misled the Commission regarding its adherence to the program, or otherwise violated the provisions of this subchapter or the code. Except as provided under the Alternative Energy Portfolio Standards Act (73 P. S. §§ 1648.1-1648.8), the Commission may not order a DSP to procure power from a specific generation supplier, from a specific generation fuel type or from new generation only. At the time the Commission evaluates the plan and prior to approval, the Commission will consider the default service provider's obligation to provide adequate and reliable service to customers and that the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission will make specific findings which include:

(1) The DSP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.

(2) The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis.

(3) Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates Federal law.

* * * * *

(f) A DSP shall submit tariff supplements on a NO MORE FREQUENTLY THAN quarterly ~~or more frequent~~ basis, consistent with § 54.187(h) and (i) (pertaining to default service rate design and recovery of reasonable costs), to revise default service rates to ensure the recovery of costs reasonably incurred in acquiring electricity at ~~prevailing market prices~~ THE LEAST COST TO CUSTOMERS OVER TIME. The DSP shall provide written notice to the named parties identified in § 54.185(b) of the proposed rates at the time of the tariff filings. The tariff supplements shall be posted to the DSP's public internet domain at the time they are filed with the Commission. A customer or the parties identified in § 54.185(b) may file exceptions to the default service tariffs within 20 days of the date the tariffs are filed with the Commission. The exceptions shall be limited to whether the DSP has properly implemented the procurement plan approved by the Commission and accurately calculated the rates. The DSP shall post the revised PTC for each customer class within 1 business day of its effective date to its public internet domain to enable customers to make an informed decision about electric generation supply options.

(g) If a customer 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.

(h) A DSP may, in its sole discretion, offer large customers with a peak demand of 15 megawatts or greater at one meter location in its service territory any negotiated rate for service at all of the customers' locations within the service territory for any duration agreed upon by the DSP and the customer.

(1) Contract rates shall be subject to Commission review to ensure all costs are borne by the parties to the contract and no one else.

(2) If no costs related to the rates are borne by other customers, the Commission will approve the contract within 90 days of its filing at the Commission. If the Commission does not approve the contract within the 90-day period, it shall be deemed approved.

(i) The DSP shall offer residential and small business customers a generation supply service rate that shall change ON A no more frequently than ~~on a quarterly basis~~. Default service rates shall be reviewed by the Commission to ensure that the costs of providing service to each customer class are not subsidized by any other class.

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17120**

**Rulemaking – Default Service
and Retail Electric Markets**

**Public Meeting - September 22, 2011
2095604-LAW
Docket No. L-2009-2095604**

**STATEMENT OF
COMMISSIONER PAMELA A. WITMER**

Prior to joining my staff, Shelby Linton-Keddie was employed by a law firm that served as counsel to a party that submitted comments in the above-referenced proceeding. Therefore, to avoid any appearance of impropriety arising from her previous employment, I wish to note that I have not been advised by Shelby Linton-Keddie regarding this matter.

DATE: September 22, 2011


**PAMELA A. WITMER
COMMISSIONER**



TRANSMITTAL SHEET FOR REPORT PURSUANT TO SECTION 7(b) and 7(c)
OF THE REGULATORY REVIEW ACT

I.D. NUMBER: L-2009-2095604 57-273
SUBJECT: Default Service Regulations
PA CODE: 52 Pa. Code, Chapter 54
AGENCY: PUC

2012 MAY -1 PM 2:53

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IRRC

TYPE OF REPORT

- Agency Report contains final-form regulation **without revision**, the findings of the Commission and agency response and recommendation pursuant to Section 7(b) of the Regulatory Review Act.
- Agency Report contains the **revised** final-form regulation, the findings of the Commission and agency response and recommendation pursuant to Section 7(c) of the Regulatory Review Act.

FILING OF REPORT

DATE	SIGNATURE	DESIGNATION
5/1/12	<i>S. Steffert</i>	HOUSE COMMITTEE: (Godshall)
5/1/12	<i>Mary Walmer</i>	SENATE COMMITTEE: (Tomlinson)
5/1/12	<i>K. Cooper</i>	INDEPENDENT REGULATORY REVIEW COMMISSION