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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Re: Implementation of Act 129 of October :
15, 2008; Default Service. : Docket No. L-2009-2095604

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COMMENTS OF
PPL ELECTRIC UTILITIES CORPORATION
TO THE PROPOSED RULEMAKING ORDER

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TO THE PENNSYLVANIA PUBLIC UTILITY COMMISSION:

I. INTRODUCTION

By Order entered January 14, 2010, the Public Utility Commission ("PUC" or the "Commission") requested comments on the Proposed Rulemaking for amendments to the Commission's default service regulations, 52 Pa. Code §§ 54.181-54.188, as required by the enactment of Act 129. The Commission indicates that the intent of the Proposed Regulations is to make the Commission's regulations consistent with Act 129. Further, the Commission requested comments on sixteen Additional Issues set forth in the Proposed Rulemaking Order. The Proposed Regulations and Additional Issues were published in the *Pennsylvania Bulletin* on May 1, 2010, with a 30-day comment period.

PPL Electric Utilities Corporation ("PPL Electric" or the "Company") is a "public utility" and an "electric distribution company" ("EDC") as those terms are defined under the Public Utility Code, 66 Pa.C.S. §§ 102 and 2803, subject to the regulatory jurisdiction of the Commission. PPL Electric furnishes electric distribution, transmission, and default service

provider (“DSP”) electric supply services to approximately 1.4 million customers throughout its certificated service territory, which includes all or portions of twenty-nine counties and encompasses approximately 10,000 square miles in eastern and central Pennsylvania.

The background for the Proposed Regulations is lengthy and complex. The Commission sets forth a comprehensive summary of that background in its Proposed Rulemaking Order. PPL Electric will not reiterate that summary here. However, the Company will note that it has fully participated in all aspects in this proceeding and looks forward to continued involvement as the process moves toward final resolution.

PPL Electric fully supports the Commission’s continued efforts to promote competition and supports the Commission’s efforts to implement the requirements of Act 129. PPL Electric believes that its familiarity and experience as a DSP will benefit the Commission and parties in this proceeding. Therefore, PPL Electric appreciates this opportunity to comment on the Commission’s Proposed Regulations to revise the existing default service regulations, as well as the opportunity to respond to the Additional Issues posed by the Commission.

At the outset, it is important to note that PPL Electric agrees with the majority of the Commission’s Proposed Regulations in this proceeding. However, the Company believes that several modifications or clarifications would be appropriate and directs its comments to those issues. In large part, the proposed regulations generally adopt Act 129 procurement requirements verbatim, and the Company has no basis to disagree with that language. However, the Commission posed sixteen (16) Additional Issues for comment to assist it in interpreting and implementing Act 129 to ensure adequate and reliable service at the least cost to customers over time. Importantly, PPL Electric believes that the Commission’s review of the various responses to these Additional Issues is crucial in order to provide DSPs with the guidance necessary to

prepare and implement DSP plans going forward. Therefore, PPL Electric submits responses to these Additional Issues and recommends that the revisions to the Commission's Proposed Regulations incorporate the Company's responses to the Additional Issues.

To facilitate review by the Commission and other interested parties, the following comments track the organization of the Commission's Proposed Regulations. Thereafter, PPL Electric will respond to the sixteen Additional Issues set forth in the Proposed Rulemaking Order.

II. COMMENTS TO THE PROPOSED REGULATIONS

A. Section 54.182. Definitions.

PPL Electric has no comments to this section.

B. Section 54.184. Default service provider obligations.

The Proposed Regulations seek to modify the default service provider obligations. PPL Electric generally agrees with this enumeration of the DSP's legal and regulatory obligations. However, the Company believes that it is critically important to hold all DSPs to these standards, including incumbent EDCs and Commission-approved alternative DSPs.

This section, as proposed, states that the Commission will determine the allocation of universal service and energy conservation responsibilities between an EDC and an alternative DSP when an EDC is relieved of its DSP obligation. PPL Electric believes that, under such circumstances, very few, if any, of those responsibilities should remain with the incumbent EDC. If an incumbent EDC has been relieved of its DSP obligation, the Commission would have had to find that such action was necessary for the accommodation, convenience, or safety of the public based upon the EDC's operational and financial fitness to serve retail customers, and its

ability to provide service under reasonable rates and conditions. Therefore, a relieved EDC must have serious performance problems and most likely cannot adequately provide universal service or energy conservation programs. Moreover, the entity stepping into the role of DSP should be capable of assuming those responsibilities and should be willing to do so.

C. Section 54.185. Default service programs and periods of service.

The Proposed Regulations modify Section 54.185 to provide for a new Subsection (b). Therein, a DSP plan will be deemed approved if the Commission fails to issue a final order on the plan within nine months of the date the plan is filed. Given the relatively short procurement periods and the time necessary to procure default supply through competitive bid solicitations, PPL Electric generally agrees with this deemed approval provision. The nine-month limitation will ensure that DSPs have sufficient time to properly implement their DSP plans.

D. Section 54.186. Default service procurement and implementation plans.

The proposed amendments to Section 54.186 are largely an incorporation of the requirements set forth in Act 129. PPL Electric has no comments to this section.

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

PPL Electric strongly disagrees with the Commission's statement in paragraph (b) of this section that costs incurred for providing default service *may* be recovered through a reconcilable automatic adjustment clause. PPL Electric believes this proposed revision is inconsistent with Act 129, which specifically mandates that the "default service provider *shall* have the right to recover on a full and current basis, pursuant to a reconcilable automatic adjustment clause ... all

reasonable costs incurred under this section and a commission-approved competitive procurement plan.” 66 Pa.C.S. § 2807(e)(3.9) (emphasis added).

For purposes of statutory construction, the Pennsylvania Supreme Court has explained when the term “shall” is mandatory or permissive, stating:

The word “shall” by definition is mandatory, and it is generally applied as such. *Oberneder v. Link Computer Corp.*, 548 Pa. 201, 696 A.2d 148, 150 (Pa. 1997). However, the context in which “shall” is used may leave its precise meaning in doubt. *See Gardner v. Workers' Compensation Appeal Board (Genesis Health Ventures)*, 585 Pa. 366, 888 A.2d 758, 764-65 (Pa. 2005); *see also In re Canvass of Absentee Ballots of November 4, 2003 General Election*, 577 Pa. 231, 843 A.2d 1223, 1231-32 (citations omitted) (“Although some contexts may leave the precise meaning of the word ‘shall’ in doubt ... this Court has repeatedly recognized the unambiguous meaning of the word in most contexts.”). When the context in which “shall” is used creates ambiguity, this Court has used the factors in § 1921(c) to ascertain the legislature’s intent. *See Gardner*, at 765. This Court, however, has “recognized that the term ‘shall’ is mandatory for purposes of statutory construction when a statute is unambiguous.” *Koken v. Reliance Insurance Company*, 586 Pa. 269, 893 A.2d 70, 81 (Pa. 2006) (citations omitted).

Chanceford Aviation Props., LLP v. Chanceford Twp. Bd. of Supervisors, 592 Pa. 100, 108, 923 A.2d 1099, 1104 (2007). PPL Electric believes that Section 2707(e)(3.9) is unambiguous and, therefore, the General Assembly’s use of the term “shall” is mandatory.

For these reasons, in order for Section 54.187(b) of the DSP regulations to be consistent with the mandatory requirement of Act 129, PPL Electric believes that it is appropriate for the Commission to delete the term “may” in Section 54.187(b) and replace it with the term “shall.”

F. Section 54.188. Commission review of default service programs and rates.

The proposed amendments to Section 54.188 are largely an incorporation of the requirements set forth in Act 129. PPL Electric has no comments to this section.

III. RESPONSE TO ADDITIONAL ISSUES

PPL Electric believes that the Commission's review of the various responses to these Additional Issues, as set forth below, is crucial in order to provide DSPs with the guidance necessary to prepare and implement DSP plans going forward. Therefore, PPL Electric submits the following responses to these Additional Issues and recommends that the revisions to the Commission's Proposed Regulations incorporate the Company's responses to the Additional Issues.

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

The term "least cost to customers over time" is included in Section 2807(e)(3.4) in the context of a prudent mix of contracts. This section requires the DSP to submit a default service procurement plan that meets the requirements of a prudent mix of contracts that 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. It is through the regulatory process that the Commission determines if a default service procurement complies with this section of the statute.

"Least cost to customers over time" can be interpreted along two dimensions. First, the default service procurement plan includes the selection of contracts (spot, short-term, and long-term) that comprise a prudent mix. There are many possible contracts that can constitute a prudent mix and the DSP must select the mix that is best for its customers taking into account the appropriate costs and risks of each contract. The costs and risks associated with each contract are subject to the volatility of the energy markets, which include changes in generation supply, customer usage, and weather conditions. In addition, the DSP must ensure the plan provides adequate and reliable service.

The second dimension of the term “least cost to customers over time” requires the DSP to procure the contracts through a process that produces the lowest cost for the contract type. The typical DSPs in Pennsylvania procure default service through competitive solicitations such as Requests for Proposals (“RFPs”) or Auctions. The process includes a predetermined schedule for the RFP or Auction including the bid date and specified timeframe for the results to be reviewed and approved by the Commission. On the day the RFP or Auction is conducted, the bids are evaluated solely by price with the “least cost” bids being selected to serve the default service customers. The cost to customers on the day of the RFP or Auction represents “least cost to customers” based on the market conditions at that time. Over time as more procurements are conducted by the DSP, the resulting cost to customers is the weighted average of the least cost bids from all the solicitations completed for the delivery period.

It is important to note that the term “least cost to customers over time” does not mean the absolute lowest possible cost to customers. The energy markets are subject to volatility based on many factors, such as generation supply, customer usage, and weather conditions, which make it almost impossible to precisely time purchases to acquire supply at the lowest possible market prices.

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

The evaluation of whether a DSP’s procurement plan produces least cost to customers over time occurs through the regulatory review process when the plan is submitted. The DSP submits a procurement plan that includes a mixture of contracts that it believes meets the requirements of Section 2807(e)(3.4). The Commission reviews the procurement plan and determines if the plan will produce the least cost to customers over time. The only relevant

evaluation for the Commission to perform is the competitiveness of each procurement that an EDC conducts and that the results are the “least cost to customers.”

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?**

No. Section 2802 of the Competition Act deregulated the generation of electricity in Pennsylvania, and any new default service regulations that ensure the construction of generation capacity would amount to *de facto* re-regulation of the generation business. The determination of needed generation capacity should occur naturally in the market based on the expected supply and demand for energy.

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

See response to Question 3.

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?**

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 with full knowledge of how events actually unfolded. In comparing the results of the two approaches, it is critical that all costs and risks be recognized. Otherwise, the comparison may produce an inaccurate result.

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

Act 129 specifies that the “prudent mix” of contracts shall be designed to ensure: (1) adequate and reliable service; (2) the least cost to customers over time; and (3) long term contracts is defined at more than four (4) years and not more than twenty (20) years and may not constitute more than 25% of the default service provider’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. The DSP should have the discretion to propose a mix of contracts that it believes is appropriate based on the characteristics of all the default service customers. The “prudent mix” for each DSP should be established through the regulatory proceeding of the Default Service Procurement Plan filed as required by Act 129, not in the Commission’s regulations. There are an infinite number of procurement plans that can be considered a “prudent mix” and the regulatory process allows all interested parties to express their opinions on the specifics of a “prudent mix.” However, after the Commission has approved a DSP’s plan, the mix of contracts should remain in place for the term of the plan; the DSP should not have discretion to change that mix.

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

As stated in the response to Question 6, there are an infinite number of procurement plans that can be considered a “prudent mix.” PPL Electric’s approved default service procurement

plan is diversified and accumulated over time in that several different contract types are procured in each solicitation, and solicitations are conducted four times per year to accumulate the default supply, and the terms of supply contract overlap the termination of other contracts. The “prudent mix” is established through the regulatory review of a DSP’s procurement plan and it can change over time due to changing market conditions. However, a “prudent mix” does not explicitly mean that the contracts must be diversified and accumulated over time.

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?**

As stated in response to Questions 6 and 7, the parameters on the “prudent mix” are best established during the regulatory review process of a DSP’s procurement plan filing.

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

This element of the Default Service Procurement Plan filed by the DSP is best addressed through the regulatory review process. No restrictions should be applied to a procurement plan specifying a certain percentage of contracts per year.

10. **Should there be a requirement that on a total-DSP basis, the “prudent mix” means that some quantity of the total-DSP 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?**

No requirements should be established as to the quantity of default service load that should be served through spot market purchases, short-term contracts, and long-term contracts. The only requirement established in Act 129 is that no more than 25% of projected load should

be supplied with long-term contracts. As stated in response to other questions, the quantities of spot market, short-term, and long-term contracts are best addressed during the regulatory review of a default service procurement plan filing. Over time, it is likely that the “prudent mix” will change with market conditions, which change can be reflected in the DSP’s future Default Service Procurement Plan filings.

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?**

There should be no 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. Rather, a DSP should be permitted to develop plans based on the characteristics of each rate class. For example, a high percentage of the Large Commercial and Industrial rate classes currently are purchasing their supply from Electric Generation Suppliers (“EGSs”), which makes long-term contracts for DSP supply impracticable.

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?**

No. DSP’s in Pennsylvania generally use competitive solicitations, such as RFPs or Auctions to procure the default service and hence do not have “positions” that require the use of hedges. Without having a position in the market, a hedge would be an unnecessary risk for the DSP and ultimately for the default service customers. The use of full requirements contracts

shifts this risk to the suppliers who determine if the use of future contracts are appropriate hedges for their respective positions.

PPL Electric does not believe the DSP should be required to hedge its positions with futures contracts, such as natural gas. A hedge is a financial instrument that can produce a positive or negative result. When entering into a hedge, a bet is placed based on an expectation of future prices. Sometimes the bet pays off (produces a gain) and sometimes the bet does not pay off (produces a loss).

A DSP without the expertise to deal in the futures market would be at risk for trading these types of products. Additional costs would be required to acquire the expertise to properly utilize future contracts to hedge the default service load. Ultimately, the costs of acquiring the necessary expertise and any losses incurred in the futures market would increase the cost of electric supply to DSP customers.

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

The “prudent mix” can be different for each different customer class; no standard mix should be established. *See* response to Questions 6, 7, and 8.

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

The answer varies based on the market conditions at the time of the supplier bankruptcy. If the contract price of a bankrupt supplier is higher than the market price, it is likely another supplier will “step-up” and fulfill the contract at the same price, which will result in little or no impact to the default service customers. If the contract price of a bankrupt supplier is below the current market price, it is likely that another supplier will not “step-up” and fulfill the contract at

that price. The DSP will then be required to purchase replacement supply from the spot market until other arrangements can be made to find replacement supply for the remaining term of the contract. Any additional costs due to a bankruptcy can be mitigated by the performance security held by the DSP. However, increasing the performance security provisions would increase costs for suppliers and result in higher costs for the default service customers.

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?**

No. Section 2807(e)(3.8) of the statute permits the Commission to conduct an after-the-fact-review to disallow costs only for non-compliance with the approved default service plan, or the commission of fraud, collusion, or market manipulation. Any other disallowance of costs incurred by a DSP to obtain supply to meet its default service obligations would be inconsistent with Act 129 and other provisions of law.

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.”**


The obligation to comply with the AEPS Act should be addressed in the regulations. The DSP must obtain generation or Alternative Energy Credits to comply with the AEPS Act just as it must obtain any other products required for the provision of default service (capacity, ancillaries, congestions, etc.). The Commission’s regulations should address all of these products as essential components of DSP supply.

IV. CONCLUSION

As stated above, PPL Electric generally supports the majority of the Commission's proposals in this proceeding. However, as discussed in the foregoing comments, the Company believes that several modifications and clarifications would be appropriate. Accordingly, PPL Electric respectfully requests that the Commission modify its Proposed Regulations consistent with the Company's comments.

Respectfully submitted,

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Date: June 1, 2010

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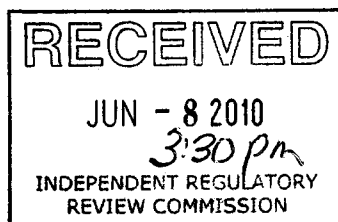
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RE: Implementation of Act 129 of October 15, 2008; Default Service
Docket No. L-2009-2095604

Dear Secretary Chiavetta:

Enclosed please find the original and fifteen copies of the Comments of PPL Electric Utilities Corporation for the above-referenced proceeding. Copies have been provided as indicated.

Respectfully Submitted,

Christopher T. Wright

CTW/skr

Enclosures

cc: Elizabeth Barnes (*via email - ebarnes@state.pa.us*)