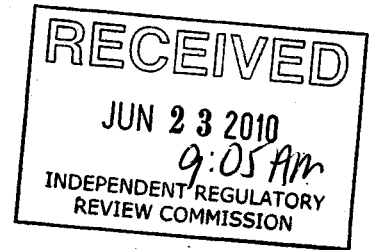


COMMONWEALTH OF PENNSYLVANIA



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June 15, 2010

HAND DELIVERED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RECEIVED
2010 JUN 15 PM 3:17
PA PUC
SECRETARY'S BUREAU

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

**Proposed Policy Statement Regarding Default Service and Retail Electric
Markets
Docket No. M-2009-2140580**

Dear Secretary Chiavetta:

I am delivering for filing the original plus fifteen copies of the Reply Comments, on behalf of the Office of Small Business Advocate, on the Proposed Rulemaking Order and Annex A.

Copies of the Reply Comments have been served on Elizabeth Barnes, via electronic mail. If you have any questions, please contact me.

Sincerely,

William R. Lloyd, Jr.
Small Business Advocate
Attorney ID #16452

Enclosures

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

Proposed Policy Statement Regarding :
Default Service and Retail Electric Markets : Docket No. M-2009-2140580

REPLY COMMENTS OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

BACKGROUND

The Electricity Generation Customer Choice and Competition Act ("Competition Act"), Chapter 28 of the Public Utility Code, 66 Pa.C.S. Ch. 28, provides that, after the recovery of stranded costs, generation rates are to be determined through market forces rather than through traditional rate base/rate of return regulation.

As originally enacted, the Competition Act required each electric distribution company ("EDC") to acquire electric energy "at prevailing market prices" to serve those customers who do not choose an electric generation supplier ("EGS") or whose EGS fails to deliver.¹ As required by the Competition Act, the Pennsylvania Public Utility Commission ("Commission") promulgated default service regulations at 52 Pa. Code §§54.181-54.189 to define the EDC's obligation.² The Commission also adopted a default service policy statement at 52 Pa. Code

¹ See 66 Pa. C.S. §2807(e)(3) (repealed)

² See 66 Pa. C.S. §2807(e)(2) (repealed). The regulations refer to an EDC as a "default service provider."

§§69.1801-69.1817. The default service regulations and policy statement became effective on September 15, 2007.

Subsequently, the act of October 15, 2008 (P.L. 1592, No. 129) (“Act 129”) repealed the “prevailing market prices” standard and imposed a new requirement that the default service provider (“DSP”) acquire default service electricity competitively through a “prudent mix” of contracts and at the “least cost to customers over time.”³

By Order entered January 19, 2010, the Commission initiated a proposed rulemaking at Docket No. L-2009-2095604 to amend the aforementioned default service regulations to reflect the enactment of Act 129. The proposed rulemaking was published on May 1, 2010, in the *Pennsylvania Bulletin*, 40 Pa.B. 2267. In addition to proposing specific amendments to the current regulations, the Commission also posed a list of questions regarding the interpretation of various provisions of Act 129. Ordering Paragraph No. 5 invited interested parties to submit comments (including answers to the questions) within 30 days of publication.

By separate Order entered January 19, 2010, the Commission initiated a proceeding at Docket No. M-2009-2140580 to amend the aforementioned default service policy statement to reflect the enactment of Act 129. The proposed amendments to the default service policy statement were published on May 1, 2010, in the *Pennsylvania Bulletin*, 40 Pa.B. 2289. Ordering Paragraph No. 4 invited interested parties to submit comments within 30 days of publication.

The Office of Small Business Advocate (“OSBA”) and numerous other parties submitted Initial Comments on June 1, 2010, in response to the Commission’s invitation.

³ See Section 3 of Act 129, amending 66 Pa. C.S. §2807(e).

Ordering Paragraph No. 5 of the proposed rulemaking at Docket No. L-2009-2095604 also invited interested parties to submit Reply Comments within 45 days of publication of the proposed rulemaking in the *Pennsylvania Bulletin*. Pursuant to that invitation, the OSBA submits the following Reply Comments.

SUMMARY

The Initial Comments of the parties demonstrate continued disagreement over whether an actively managed portfolio or a full-requirements contract is more likely to yield the “least cost to customers over time.” The Initial Comments also highlight many other disagreements over how to achieve “least cost” and a “prudent mix” of contracts, *e.g.*, the appropriate length of contracts, the role of after-the-fact prudence review, and the need for mandates to construct additional generating capacity. However, with a few exceptions, the parties appear willing to defer a resolution of these disputes to future proceedings involving the plans of individual DSPs rather than to have the Commission resolve these disputes on a generic basis through further changes in the regulations and the policy statement.

In its Initial Comments, the OSBA set forth its views on the significant policy disputes. Therefore, the OSBA’s Reply Comments will focus selectively on those issues not addressed in the OSBA’s Initial Comments and on those issues requiring clarification or additional emphasis. It should not be inferred that the OSBA’s failure to respond to a specific comment of another party constitutes the OSBA’s agreement with that comment.

The Retail Energy Supply Association (“RESA”) requested that the Commission provide an additional comment period if the Commission decides to amend the regulations and the policy statement in ways which are significantly different than the versions of those documents

published in the *Pennsylvania Bulletin* on May 1, 2010.⁴ The OSBA endorses RESA's request. In support of that endorsement, the OSBA notes that the Commission provided multiple opportunities for comment before finalizing the current regulations and policy statement.

COMMENTS ON THE REGULATIONS

§54.184. Default service provider obligations.

According to RESA, the Commission's proposed amendment to Section 54.184(a) ignores the fact that an EDC could be supplanted as the DSP. Although there may be merit to RESA's point, the remedy proposed by RESA includes the insertion of language that would allow the Commission to "[determine] that it is no longer necessary to have a default service option."⁵

Contrary to RESA's implication, the Commission is prohibited by statute from terminating the default service option. RESA is correct that the Commission has the statutory authority to approve a DSP other than the EDC.⁶ However, the statute explicitly states that "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 chose an alternative electric generation supplier, *the default service provider shall provide electric generation supply service to that customer . . .*"⁷

⁴ RESA Initial Comments, at 13.

⁵ RESA Initial Comments, at 38-39.

⁶ See the definition of "Default service provider" in 66 Pa. C.S. §2803.

⁷ See 66 Pa. C.S. §2807(e)(3.1) (emphasis added).

§54.185. Default service programs and periods of service.

RESA proposed the insertion of language in Section 54.185(b) that would limit the scope of hearings on a proposed default service plan “to ensure that the plan is reasonably likely to promote sustainable retail market development by resulting in market-reflective and market-responsive default service rates and including all the costs of provisioning default service in the default service rate.”⁸

There are at least two problems with RESA’s proposed edit. First, the statute explicitly provides that “[t]he commission shall hold hearings as necessary on the proposed plan.”⁹ Nothing in the statute limits the scope of those hearings in the manner proposed by RESA. Second, the language proposed by RESA includes issues that could legitimately be raised in those hearings. However, nothing in the statute designates the likelihood of “market-reflective and market-responsive default service rates” as the *sine qua non* in determining if a mix of competitively-procured contracts will assure “adequate and reliable service” and “[t]he least cost to customers over time.”¹⁰

ANSWERS TO THE QUESTIONS OF INTERPRETATION

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

In their discussion of what constitutes “least cost to customers over time,” both the Pennsylvania Energy Marketers Coalition (“PEM”) and the National Energy Marketers

⁸ RESA Initial Comments, at 40.

⁹ See 66 Pa. C.S. §2807(e)(3.6).

¹⁰ See 66 Pa. C.S. §2807(e)(3.4).

Association (“NEM”) argued that the default service rates of residential and small commercial customers should be adjusted monthly.¹¹ Adopting this proposal would violate the statutory requirement that “[t]he default service provider shall offer residential and small business customers a generation supply service rate that shall change no more frequently than on a quarterly basis.”¹²

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

According to West Penn Power Company (“West Penn”), the acceleration of the residential procurement schedule in its current default service plan is responsible for the fact that “a typical Allegheny Power residential customer’s bill will increase only 4.1 percent over 2010 levels, assuming the remaining procurements are the same as the average price in the first four auctions.”¹³ Although it may not have been West Penn’s intent, the OSBA is concerned that this alleged “fact” could be read as support for the use of an actively managed portfolio and “market-timing” for small commercial and industrial (“Small C&I”) customers.¹⁴

Rather than accepting West Penn’s allegation as “fact,” the Commission should analyze the procurement results reported by West Penn’s parent, Allegheny Energy.¹⁵ Those procurement results are as follows:

¹¹ PEM Initial Comments, at 3; NEM Initial Comments, at 4.

¹² See 66 Pa. C.S. §2807(e)(7).

¹³ West Penn Initial Comments, at 2-3.

¹⁴ The OSBA discussed the acceleration of West Penn’s residential procurement schedule in the OSBA Initial Comments, at ¶1-14.

¹⁵ See Allegheny Energy news release dated May 21, 2010, captioned “Allegheny Power Completes Fifth Auction for Post-2010 Electricity Supply in Pennsylvania”. The OSBA discussed the reported procurement results in the OSBA Initial Comments, at 14, footnote 18.

Summary: Results of First Five Auctions
Average weighted retail generation price per MWh

	Residential Customers	Small and Medium Non-Residential Customers
1 st Auction (April 17, 2009)	\$72.80	N/A
2 nd Auction (June 5, 2009)	\$71.64	\$75.40
3 rd Auction (October 16, 2009)	\$65.29	\$67.24
4 th Auction (January 22, 2010)	\$62.27	\$65.26
5 th Auction (May 21, 2010)	\$59.39	\$63.38
Average of All Auctions	\$69.35	\$66.19

Assuming the accuracy of Allegheny Energy's reporting, the price paid in each residential procurement since the first one (in April 2009) has been lower than the price paid in each of the preceding residential procurements. Furthermore, the average price in the Small C&I procurements (which were not accelerated) is lower than the average price in the residential procurements. Therefore, the implication is that the typical residential customer would have faced a smaller increase when the rate caps expire than the 4.1% increase touted by West Penn.

3. 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?

According to the Industrial Customer Groups, "the Commission should seek to promote the construction of new generation capacity and should require that a portion of that capacity be dedicated to economic development on a cost-of-service basis."¹⁶

¹⁶ Industrial Customer Groups Initial Comments, at 3.

The statute prohibits default service rates which require one class to subsidize another class.¹⁷ Therefore, if the Commission were to adopt the suggestion of the Industrial Customer Groups, any economic development incentive, e.g., below-market rates, provided to large commercial and industrial (“Large C&I”) customers would have to be financed by the government or by above-market rates imposed on other Large C&I customers. It would not be lawful to require residential or Small C&I customers to finance an economic development incentive for Large C&I customers.

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

The OSBA rests on its Initial Comments.

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?

As part of its criticism of full-requirements contracts, the Office of Consumer Advocate stated that “winning suppliers [of full-requirements contracts] must incorporate a profit margin to make their participation [in an auction or RFP] meaningful.” According to the OCA, a DSP would be able to avoid the profit margins imposed by “the full requirements middlemen” by acquiring default service electricity through its own managed portfolio.¹⁸

However, the OCA presented no evidence that the avoided profit margins would exceed the personnel and other administrative costs the DSP would have to incur to manage a portfolio in-house. The OCA also presented no evidence that the avoided profit margins would exceed the

¹⁷ See 66 Pa. C.S. §2807(e)(7).

¹⁸ OCA Initial Comments, at 12-13.

costs the DSP would have to incur to hire an outside portfolio manager rather than relying on the DSP's in-house personnel. Finally, the OCA ignored the fact that the portfolio manager's charges would include the portfolio manager's profit margin.

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

The OSBA rests on its Initial Comments.

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

The OSBA rests on its Initial Comments.

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?*

The OSBA rests on its Initial Comments.

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

The OSBA rests on its Initial Comments.

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?*

The OSBA rests on its Initial Comments.

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?

The OSBA rests on its Initial Comments.

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?

The OSBA rests on its Initial Comments.

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

The OSBA rests on its Initial Comments.

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

The OSBA rests on its Initial Comments.

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?

According to the Citizens' Electric Company of Lewisburg, PA ("Citizens") and Wellsboro Electric Company ("Wellsboro"), the Commission's decision in their recent default service cases confirms that "Act 129 does not permit an after-the-fact review of the 'cost reasonableness standard'" and that "[o]nce the PUC approves a level of discretion in a default

service plan, the Commission cannot subsequently review the reasonableness of the costs incurred under the plan, as long as the DSP follows the conditions approved by the Commission.”¹⁹

However, Citizens’ and Wellsboro overstated the Commission’s holding. Although the Commission did conclude that “there is clearly no statutory mandate for an after-the-fact prudence review,” the Commission did *not* conclude that it lacks the authority to conduct an after-the-fact review of the reasonableness of cost recovery under a managed portfolio plan.²⁰ In that regard, the Commission concluded as follows:

We also agree with the Companies [Citizens’ and Wellsboro] that the fact of the Wellsboro investigation [into the reasonableness of congestion costs], which the OSBA discusses at length, obviates the need for the establishment of an after-the-fact prudence review. Clearly, this Commission has the authority to examine any facet of a default service program during its operation in the event that circumstances warrant it.²¹

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 OSBA rests on its Initial Comments.

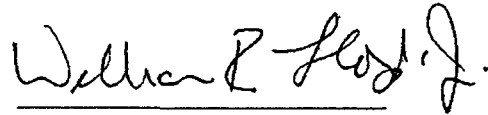
¹⁹ Citizens’/Wellsboro Initial Comments, at 6-7.

²⁰ *Joint Default Service Plan for Citizens’ Electric Company of Lewisburg, PA and Wellsboro Electric Company for the Period of June 1, 2010 through May 31, 2013*, Docket Nos. P-2009-2110798 and P-2009-2110780 (Order entered February 26, 2010), at 32-33.

²¹ *Id.*

WHEREFORE, the OSBA respectfully requests that the Commission consider the OSBA's Initial Comments and Reply Comments before adopting a contrary position advocated by any other party.

Respectfully submitted,



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Dated: June 15, 2010