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June 15, 2010

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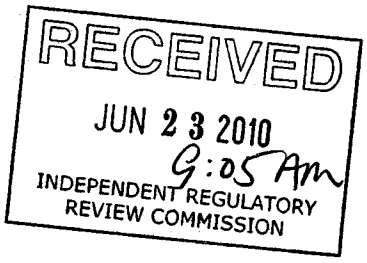

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

On behalf of the Retail Energy Supply Association ("RESA") enclosed for filing please find the original of its Reply Comments along with the electronic filing confirmation with regard to the above-referenced matter.

Sincerely yours,

Deanne M. O'Dell

Deanne M. O'Dell, Esq.

DMO/lww

Enclosure

cc: Elizabeth Barnes, w/enc. (via email only)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

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Date: June 15, 2010

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I. INTRODUCTION

The purpose of this proceeding is to ensure that the Commission's default service regulations incorporate the full scope of the Commission's authority and responsibilities under the Electricity Generation Customer Choice and Competition Act ("Choice Act") to approve default service plans that act as backstops to the competitive generation service provided by electric generation suppliers ("EGS").[1] Because Act 129 amended the Choice Act in 2008, the Commission proposed revisions to its current regulations and sought comment from interested stakeholders on its proposed revisions as well as sixteen additional questions.[2] The Retail Energy Supply Association ("RESA")[3] – a trade association of power marketers, independent power producers, and a broad range of companies each of whom support the electric services industry and seek to develop a more competitive power industry – and sixteen other interested stakeholders filed comments. The Commission also provided interested stakeholders with the opportunity to file Reply Comments.

While RESA generally agrees with the overwhelming majority of comments submitted, the comments filed by the Office of Small Business Advocate ("OSBA") and the Office of Consumer Advocate ("OCA") take an exaggerated, unsupported and incorrect view of the impact of Act 129 on the Choice Act. As discussed further below, both parties' fundamental position is

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1 66 Pa. C.S. § 2807(e).

2 *Implementation of Act 129 of October 15, 2008; Default Service,* Docket No. L-2009-2095604, Proposed Rulemaking Order entered January 19, 2010 ("*Act 129 Proposed Rulemaking Order*").

3 RESA's members include ConEdison *Solutions*; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Energy Plus Holdings, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Gexa Energy; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; Sempra Energy Solutions LLC. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

that Act 129 "repealed" the "prevailing market prices" standard with the allegedly new singular standard of "least cost to customers over time." This is inaccurate and overly simplistic.

First, RESA respectfully disagrees with OSBA's supposition that the Commission must change its commitment to retail competition.[4] Act 129 does not change the overall goal of the Choice Act to provide all electric service customers with a "properly functioning and workable competitive retail electricity market"[5] – and the Commission has not "turned away" from this overall goal. On the contrary, Act 129 reaffirmed the goals of the Choice Act that all retail consumers should be provided with "direct access" to the competitive retail market because "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[6]

Second, Act 129 affirmed the Choice Act's intent that default service plans should be a backstop to the competitive market. This is important because prior to the Choice Act, all customers were forced to receive their generation supply from the monopoly electric distribution company ("EDC"). The Choice Act expressly changed this model going forward and directed the Commission to develop regulations and policies to foster the creation of a fully functional competitive retail electricity market. Once this market develops, consumers will then rely primarily on the competitive market for their generation services and would use default service (which – unless transferred to another entity – would be provided by the EDC) as a backstop. Nothing in Act 129 changes this. To meet this overall goal, the Commission is still required to

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4 OSBA Comments at 11.

5 66 Pa. C.S. § 2811(d).

6 66 Pa. C.S. §§ 2802(3), 2802(5); *See also* RESA Comments at 4-12.

approve default service plans which stimulate retail competition.[7] There is no support for OCA's claims that Act 129 places an "affirmative obligation" on the default service provider ("DSP") to "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."[8] Notably, OCA's comments never address how its proposals would stimulate *retail* competition or ensure that consumers would realize the promise of the Choice Act – lower prices resulting from a fully functional competitive retail marketplace. On the contrary, OCA's "actively managed portfolio" whereby DSPs are "empowered" to "time the market" will produce the very opposite result from what OCA desires. In the end, default service customers will be stuck with artificially priced default service rates because there will be no competitive alternatives. The default service rate will bear no relation to the market because consumers, not the DSPs, will be the ones forced to pay for the mistakes and misjudgments of DSPs that are neither equipped nor in favor of being held responsible for making such market timing judgments.

Finally, the OCA and OSBA proposals to simply replace all references in the regulations to "prevailing market prices " with "least cost over time" should be rejected. Ensuring that default service rates to customers reflect "the least cost over time" is just one of the requirements that the Commission must evaluate when reviewing a default service plan. The others are: (1) ensuring adequate and reliable service; (2) ensuring that the supply contracts are competitively procured; (3) that the supply contracts consist of a "prudent mix"; and (4) that the default service plan is appropriately structured to stimulate the development of the competitive retail market.

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7 RESA Comments at 15-21.

8 OCA Comments at 6 (emphasis added).

For these reasons, the Commission should reject the proposals of OCA and OSBA for the wholesale replacement in the regulations of "prevailing market prices" with "least cost over time."

II. REPLY COMMENTS

A. Act 129 Does Not Render Retail Competition Irrelevant And The Commission Has Not "Turned Away" From Promoting Retail Competition

OSBA correctly states that Act 129 made changes to the Choice Act. OSBA then asserts that "*some* of those changes are inconsistent with *some* of the decisions made, and preferences expressed, by the Commission prior to the enactment of Act 129."[9] According to OSBA, the Commission's "commitment to retail competition" "may have to change" because of Act 129.[10] RESA respectfully disagrees with OSBA and submits that the language of Act 129 as well as the Commission's decisions following enactment of Act 129 do not justify a change in the Commission's mandate to develop policies that will foster the development of a robust and functional retail electricity competitive market.

Act 129 did not make any changes to numerous sections clearly stating the purpose of the Choice Act to foster a competitive retail electricity market to give consumers the benefit of least cost generation. All of the below listed pre-Act 129 statutory language evidence this purpose and, importantly, none of these sections were altered or deleted by Act 129:

- 66 Pa. C.S. § 2802(3): ". . . it is now in public interest to permit retail customers to obtain direct access to a competitive generation market. . ."
- 66 Pa. C.S. § 2802(5): "Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."

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9 OSBA Comments at 10 (emphasis added).

10 OSBA Comments at 11.

- 66 Pa.C.S. § 2802(7): "This Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers. . . "

- 66 Pa.C.S. § 2802(8): "In moving toward greater competition in the electricity generation market . . . "

- 66 Pa.C.S. § 2802(11): ". . . utilities shall consider the experience and expertise of their work force in moving towards competition."

- 66 Pa.C.S. § 2802(12): "The purpose of this chapter is to. . . establish standards and procedures in order to create direct access by retail customers to the competitive market for the generation of electricity . . . "

- 66 Pa.C.S. § 2802(13): "The procedures established under this chapter provide for a fair and orderly transition from the current regulated structure to a structure under which retail customers will have direct access to a competitive market for the generation and sale or purchase of electricity."

- 66 Pa.C.S. § 2802(14): "This chapter requires electric utilities . . . to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth."

- 66 Pa.C.S. § 2802(15): "In establishing the standards for the transition to and creation of a competitive electric market. . . "

- 66 Pa.C.S. § 2802(16): "There are certain changes to a utility which will create transition costs to accomplish the move to a competitive market. . . "

- 66 Pa. C.S. § 2804(2): ". . . the commission shall allow customers to choose among electric generation suppliers in a competitive generation market through direct access. Customers should be able to choose among alternatives. . . "

- 66 Pa. C.S. § 2804(12): ". . . the commission shall conduct milestone reviews of the transition to retail electric generation competition to assure a technically workable and equitable transition period."

- 66 Pa.C.S. § 2805(b)(1): "In order to make the benefits of competition in the generation and sale of electricity as widely available as possible to retail customers"

- 66 Pa.C.S. § 2806(a): "The ultimate choice of the electric generation supplier is to rest with the customer."

- 66 Pa. C.S. § 2811(a): "The commission shall monitor the market for the supply and distribution of electricity to retail customers and take steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power."

- 66 Pa.C.S. § 2811(e)(1): ". . . the commission shall consider whether the proposed merger. . . is likely to result in . . conduct . . which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market."

If, as suggested by OSBA, the legislature intended the Commission to "change its focus" on developing retail competition based on the enactment of Act 129, then all of the above sections would have been either amended or repealed. Because they were not, the Commission remains charged by the Choice Act with implementing policies and procedures that will foster the development of a properly functioning and workable competitive retail electricity market.

Moreover, aside from not deleting or changing the pre-Act 129 "pro-competition" language of the Choice Act, the language added by Act 129 affirms the statutory requirement of the Commission to develop a properly functioning and workable competitive retail electricity market. For example, the newly added language in Section 2807(e)(3.1) states:

> Following the expiration of an electric distribution company'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 *pursuant to a commission-approved competitive procurement plan.* The power shall be *procured through competitive procurement processes* . . . .[11]

As explained in RESA's initial comments, this newly added language makes clear that the competitive market remains the preferred choice for electricity supply, over default service, as under the prior "prevailing market prices" standard.[12] Notably, Act 129 did not replace the prior Section 2807(e)(3) reference to "prevailing market prices" with any other "standards" language.

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11 66 Pa. C.S. § 2807(e)(3.1) (emphasis added).

12 RESA Comments at 7-13.

Rather, as well explained by Constellation, Act 129 set forth requirements for the default service plan, and one of two sub-requirements is to ensure that the default service plan will lead to default service rates that are "the least cost to customers over time."[13] If the legislature had intended the Commission to no longer focus on developing retail competition, then it would have clearly stated that directive. If the Commission had intended the Commission to focus on only "least cost over time" without any regard to competition, then it would have clearly stated that directive. Act 129 does none of these things and, on the contrary, implements new language consistent with and confirming the already stated goals in the Choice Act. Thus, Act 129 does not give the Commission statutory authority to "change" its focus on implementing policies designed to foster development of a robust and functional competitive market, but requires the Commission to "stay the course."

Moreover, the Commission's decisions to permit Allegheny Power to accelerate its default service supply procurement in 2009 do not support the argument that ensuring "least cost [default service] to customers over time" is more important than promoting retail competition.[14] Rather, these decisions confirm that expecting or requiring DSPs to try to time the market to acquire default service supply at "least cost to customers over time" does not guarantee that result, and that procurement of default service supply to produce market-responsive and market-reflective rates does. As OSBA correctly points out, the market price expectations of those who supported Allegheny Power's acceleration of scheduled procurements from later in 2009 and in 2010 to earlier in 2009 proved to be incorrect: (1) wholesale auction prices in the June 2009 auction were lower, not higher, than the prices in the accelerated April 2009 auction; (2)

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13 Constellation Comments at 4-5.

14 OSBA Comments at 11.

wholesale auction prices in the October 2009 auction were lower, not higher, than the prices in the June 2009 auction; and, (3) wholesale auction prices in the January 2010 and May 2010 auctions were lower, not higher, than any of the prices in the 2009 auctions.[15] Clearly, Allegheny Power would have acquired default service supply at "least cost to customers over time" by sticking to its procurements designed under the "prevailing market prices" requirement to produce market-responsive and market-reflective rates instead of trying to time the market to take "advantage" of wholesale electric power prices based upon market conditions "which we may never see again."[16]

Indeed, the OSBA's comments are consistent with and support RESA's position the "least cost to customers over time" requirement is just one of the requirements Act 129 and the Choice Act require the Commission to consider when reviewing and approving a default service plan. For example, OSBA acknowledges that the requirement for competitive procurement applies to all default service supply acquisition "regardless of the specific product being acquired."[17] OSBA's comments are also consistent with and support RESA's position that Act 129 does not divorce default service procurement from prevailing market prices but ensures that default service procurement will result in rates that are as close as possible to the market price of energy available for default service customers. OSBA's assertion that the Commission's substantive reasoning permitting Allegheny Power to accelerate default service procurements was consistent with the Act 129 "least cost to customers over time" requirement – even though Allegheny Power's procurements were established under a "prevailing market prices"

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15 OSBA Comments at 14, n. 18.

16 *Petition of West Penn Power Company d/b/a Allegheny Power for Acceleration of its Competitive Procurement Plan and Request for Expedited Consideration* ("*West Penn II*"), Docket No. P-00072342, Order entered March 20, 2009, at 15.

requirement – shows that the "prevailing market prices" and "least cost to customers over time" requirements are compatible and not mutually exclusive.

B. Act 129 Does Not Require The Commission To Only Approve Default Service Plans That Use An Actively Managed Portfolio Approach

OCA "submits that the ultimate purpose of the Act is to achieve 'least cost to customers over time.'"[18] This is the prism through which all of OCA's comments are focused. However, exclusive reliance on this ideal is not consistent with the Choice Act nor has OCA offered any convincing evidence that it can even be achieved by adopting OCA's actively managed portfolio recommendation.

As discussed above, the Choice Act requires the Commission to foster the development of the competitive market through the policies it adopts and the default service plans it approves. Despite this, OCA never once addresses how its proposals will impact the development of the competitive market – it simply chooses to ignore this statutorily mandated analysis altogether. By doing so, OCA avoids offering any explanation as to how its preferred actively managed portfolio approach will stimulate competition claiming instead that the approach "is more likely to produce lower rates over time."[19]

Even if the effect on competition could be ignored (which it cannot), OCA focuses only on trying to ensure that the default service plan will provide the "least cost over time." However, as Citizen Power aptly stated "a DSP cannot literally ensure the least cost to customers without the help of a crystal ball given the unpredictability of energy markets."[20] Therefore, OCA's

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17 OSBA Comments at 4.

18 OCA Comments at 25.

19 OCA Comments at 19.

20 Citizen Power at 1.

reliance on one product – the default service plan – to produce the "least cost over time" for all consumers is doomed to fail. Rather, consumers will be saddled with rates at artificial levels that could very well be above the true market price for energy. The way to avoid this quagmire is to remain true to the goals of the Choice Act and ensure that all consumers have the benefit of the least cost generation service over time by developing the competitive market wherein "many suppliers will be competing to serve the same customers and their presence will – over the long term – drive prices as low as possible."[21]

Other commentors also make very clear that there is no guarantee that OCA's preferred actively managed portfolio approach will in fact lead to default service rates that are the "least cost over time." First, under an actively managed portfolio approach, default service customers pay all the costs of the portfolio manager. Since actively managing portfolios is not a "core business" function of an EDC, this means that default service customers will be required to pay all the costs the EDC incurs to develop the infrastructure necessary to perform the function.[22] This is in stark contrast to the function of the wholesale supplier pursuant to a full requirements approach whose business is to actively manage portfolios and who may employ hundreds of people to provide this service across the country.[23]

Second, the fact that all the costs of developing infrastructure would be recovered from the default service customer removes any economic incentive for the EDC to drive down its costs.[24] Wholesale suppliers, on the other hand, compete against each other to win a supply

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21 RESA Comments at 10.

22 PPL Electric at 9; PECO Comments at 13 (Suppliers of full requirements products typically have risk management expertise and are supported by sophisticated trading and portfolio management operations across market regions.); First Energy Comments at 7;

23 Constellation Comments at 25.

24 Constellation Comments at 27.

contract and the winning supplier will be the one with the lowest bid. Thus, wholesale suppliers have a significant economic incentive to drive down their costs so that they can price their product as low as possible.[25] This insulates consumers from being forced to pay over inflated or unreasonable costs to the wholesale suppliers in performing their core business function pursuant to a full requirements supply approach.

Third, OCA fails to address how default service customers are benefited when they are forced to pay the full costs of unforeseen risks under an actively managed portfolio approach. An actively managed portfolio does not include a built-in amount as "insurance" for future risk. Rather, if the future risk occurs, the default service customers will be expected to pay for the full amount of the risk. In contrast, contracts pursuant to a full requirements approach include an amount that is built into the supply contract as "insurance" for future risk. If the future risk occurs, the consumer is not required to pay "more," rather the wholesale supplier absorbs whatever cost was not covered in the amount allocated for the risk. OCA's comments do not address why a "no insurance" approach should be favored over an "insurance" approach. In fact, OCA seems to be asking the Commission to take the gamble that there will never be market price movements that vary far from expectations. However, as OSBA eloquently states:

> It is perilous to assume that there will be no major market surprises. For example, no surprises means that there will be no major changes in market prices due to fuel cost changes, no changes in transmission rates or RTO demand charges, and no changes in load due to economic activity (*e.g.*, the "Great Recession") or weather (*e.g.* Hurricane Katrina). No surprises also means that there will be no significant changes in shopping, either as a result of customers' choosing to shop or customers' choosing to return to

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25 Constellation Comments at 29-30. The comment of Citizens' and Wellsboro that wholesale suppliers may have incentive to "front load" their bids is unsubstantiated and should be rejected. Citizens' and Wellsboro Comments at 6. Notably Citizens' and Wellsboro offer nothing as evidence to prove that their assertion exists in fact. Further, as explained above, an effective and properly structured competitive bid process will guard against such tactics.

> default service. It is the absorption of all of these risks by the wholesale supplier that causes wholesale full-requirements contracts to include a price premium above forward market prices. Significantly, **the portfolio approach does not avoid these risks; it simply shifts them to the ratepayers.**[26]

RESA submits that a full requirements approach, consisting of competitively procured contracts based on the lowest bid, is the best way to manage inevitable market risks without overburdening consumers.

Finally, OCA offers nothing to explain why EDCs, as DSPs, are best positioned to be active portfolio managers. As explained above, this is not a core business function of EDCs. This is in contrast to wholesale suppliers who bid on full requirements contracts. As explained by Constellation:

> Wholesale suppliers are specialists in the area of portfolio management, and have greater resources, expertise and ability to appropriately utilize this data to manage portfolios of supply at the least possible cost, by allocating the costs for their operations over much larger load obligations throughout the country. Moreover, such suppliers are able to draw from their substantial experience through PJM and in other jurisdictions to develop proprietary models of customer behavior and switching patters, to refine these models, and to better analyze the local data provided by EDCs. These wholesale suppliers pass on the efficiencies they achieve due to their sophisticated risk management skills and experience in the form of more competitive bids for Default Service FR Products in a DSP's competitive procurements. Wholesale suppliers have already invested in, and continue to make significant investment in acquiring, experts in each specific type of market which makes up full requirements Default Service supply.[27]

While most of the commentors appropriately recognize that the terms "managed portfolio approach" and "full requirements approach" are broad and can refer to a wide spectrum of possible plans and the Commission should maintain flexibility in judging each default service

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26 OSBA Comments at 20 (emphasis added).

27 Constellation Comments at 24.

plan, OCA seems to be advocating that the Commission should require default service plans to employ an actively managed portfolio approach in all cases. However, OCA has provided nothing convincing to show why this should be the preferred approach or how it would even result in providing default service customers the "least cost over time." Therefore, RESA recommends that the Commission reject OCA's position.

C. Comments on Parties' Proposed Regulatory Changes

1. Section 54.181. Purpose

Both OCA and OSBA propose to replace the "prevailing market prices" language with "least cost over time" so that the second sentence of this section would read 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 at the least cost over time ~~prevailing market prices~~.

For all the reasons set forth in RESA's comments, this change is unnecessary as default service rates priced at the "prevailing market" are consistent with the mandates of Act 129 and the Choice Act because they are the product of default service plans appropriately structured to stimulate retail competition. Even if, however, the Commission is inclined to delete the reference to "prevailing market prices" since that language was deleted by Act 129 from previous Section 2807(e)(3), then it should not be replaced with the language offered by OCA and OBSA for the following two reasons.

First, Section 54.181 was consistent with the now deleted Section 2807(e)(3) which provided that the default service provider "shall acquire electric energy at prevailing market prices." Upon deleting – not repealing – Section 2807(e)(3), the legislature chose to replace it with Section 2807(e)(3.1) which states, in relevant part, that "the default service provider shall provide electric generation supply service . . . pursuant to a commission-approved competitive

procurement plan."[28] Importantly, Section 2807(e)(3.1) did not simply replace the "prevailing market prices" language with "least cost over time" to support the change proposed here by OCA and OSBA.

The second reason why OCA and OSBA's proposed change should not be adopted is because, as explained above and in RESA's comments, the "least cost standard" is not the exclusive standard upon which the Commission must judge a default service plan.[29] Rather, as explained by Constellation, a default service plan must include: (1) power acquired through competitive procurement processes; (2) a prudent mix of varying supply contracts; and, (3) contracts designed to ensure adequate and reliable service, the least cost to customers over time and competitive procurement.[30] Thus, and consistent with Section 2807(e)(3.1), the purpose of the Commission's default service regulations should be to provide customers who do not shop, or for whom energy is not delivered, access to default service consistent with a Commission-approved competitive procurement plan that meets all the requirements of the Choice Act. As the OCA and OSBA proposed language change incorporates only one of the Act's requirements – one that is not even stated in the statutory section upon which the regulation section is based – it should not be adopted.

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28 As explained in RESA's comments, Act 129 did not repeal the "prevailing market prices" language or standard. RESA Comments at 8, n.22. RESA suggests that the Commission's statement to that effect in its orders initiating changes to the default service regulations and policy statement simply reflects the Commission's use of language used by some parties to describe the changes made by Act 129 rather than a reasoned Commission determination of the legal effects on statutory interpretation of a repeal.

29 RESA Comments at 14.

30 Constellation Comments at 4.

To the extent the Commission concludes there is a need to amend this section, the section should be revised as follows to make this section consistent with the relevant statutory provision and all of the mandates of the Choice Act:

> 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~~at prevailing market prices.~~

2. Section 54.184. Default service provider obligations.

In Section 54.184(c), the Commission inserts verbatim the language of Section 2807(e)(3.1). While Citizens' and Wellsboro do not object to the proposed change, they do request that the final regulations confirm that purchases in the PJM (or applicable RTO) markets and auctions are permissible. Specifically, Citizens' and Wellsboro want to be clear that a DSP can purchase products such as spot purchases, capacity, ancillary services, transmission, auction revenue rights, and financial transmission rights in the PJM markets and auctions.

No such clarification is required. The statute specifically authorizes – indeed, requires – purchases of products available in the PJM markets. There is no need to "interpret" the statute as Citizens' and Wellsboro request. Also, the confirmation Citizens' and Wellsboro request will not provide them with any additional protection afforded by compliance with the statute because it is their decisions on what constitutes a prudent mix of products available in the PJM markets – not the particular products – that are the focus of examination in their default service plan filings.

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

a. Subsection 54.186(a)

OCA proposes to replace the "at prevailing market prices" language with "at least cost over time" so that this section would read as follows:

> A DSP shall acquire electric generation supply at least cost over time ~~at prevailing market prices~~ for default service customers in a manner consistent with procurement and implementation plans approved by the Commission.

For the reasons discussed above regarding Section 54.181, RESA does not agree this change is necessary. If, however, the Commission plans to revise this section, then RESA suggest that "at prevailing market prices" simply be removed so that the section would read as follows:

> A DSP shall acquire electric generation supply ~~at prevailing market prices~~ for default service customers in a manner consistent with procurement and implementation plans approved by the Commission.

As discussed above regarding Section 54.181, OCA's proposed replacement fails to incorporate all the requirements of Act 129 that the Commission must consider and address when adjudicating a default service plan and, therefore, it should not be adopted.

b. Subsection 54.186(b)(5)

RESA supports OSBA's suggestion that this language be clear that the use of the competitive procurement processes applies to all default service electric power acquisition, regardless of the specific product being acquired and offers the following language for this purpose:

> Electric generation supply shall be ~~acquired~~ PROCURED THROUGH COMPETITIVE PROCUREMENT PROCESSES AND SHALL INCLUDE ONE OR MORE OF THE FOLLOWING: (I) AUCTIONS, (II) REQUESTS FOR PROPOSAL; AND, (III) BILATERAL AGREEMENTS. THE ELECTRIC POWER PROCURED SHALL INCLUDE A PRUDENT MIX OF ~~by competitive bid solicitation processes,~~ spot market energy purchases AND ~~,~~ short and long-term contracts~~, auctions, bilateral contracts or a combination of [both] them~~.

c. Subsection 54.186(d)

OCA proposes to replace the "prevailing market prices" language with "least cost to customers over time" so that this section would read as follows:

> 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 least cost to customers over time ~~prevailing market prices~~. 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).

OCA explains that this section enables a portfolio manager (the EDC as the DSP) to "monitor the changes in wholesale energy markets" and make decisions about procurements based on that analysis.[31] Thus, when the market looks "good," the DSP could petition the Commission to modify its plan accordingly – as Allegheny Power did in February 2009, with OCA's support. Unfortunately, OSBA's comments show how that gambit worked out. What looked like "least cost" wholesale electric power prices in early 2009 – indeed, prices described as the result of market conditions "which we may never see again"[32] – turned out not to be as "least cost" as the lower prices that followed.[33]

As explained in its comments, RESA does not support giving EDCs, as DSPs, such substantial discretion.[34] Instead, the focus should be on developing a default service plan which the Commission has ensured is reasonably likely to produce default service rates that comply with the Choice Act. Permitting EDCs, as DSPs, substantial discretion as to when and how they are going to procure energy for default service creates an opportunity for the injection of regulatory uncertainty into this process as there will be a lack of certainty regarding whether or not the approved plan will be followed. Such uncertainty will inform the decisions of EGSs in deciding whether and how to provide alternative service. With too much regulatory uncertainty

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31 OCA Comments at 36.

32 *West Penn II*, Order entered March 20, 2009, at 15.

33 OSBA Comments at 14, n. 18.

present, competitors may not choose to enter the market. Such a result will be contrary to the established goals of the Choice Act to implement policies that will foster the development of a fully functional competitive retail electricity market. For these reasons, RESA supports OSBA's recommendation to delete this subsection.

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

a. Subsection 54.187(i)

OCA proposes changes to this section to: (1) make clear that default service rates for customer classes with a registered peak load up to 25 kW can be adjusted no more frequently than on a quarterly basis consistent with Section 2807(e)(7); and, (2) replace the "prevailing market prices" language with "least cost to customers over time."[35] OCA's proposed section would read as follows:

> 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~~.

RESA does not object to OCA's first change as it is consistent with the statute. However, consistent with the discussion above concerning Section 54.181, RESA does not support the replacement of the "prevailing market prices" language with the "least cost to customers over time." To the extent the Commission decides to remove the "prevailing market prices" language from its regulations, then RESA proposes the following change (capitalized):

> 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

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34 RESA Comments at 27-28.

35 OCA Comments at 38.

acquiring electricity CONSISTENT WITH THE DSP'S COMMISSION-APPROVED DEFAULT SERVICE PLAN~~at prevailing market prices and to reflect the seasonal cost of electricity~~.

OSBA advocates that nothing less than quarterly adjustments should be made for all "small business customers" as that customer class is defined by each EDC.[36] OSBA notes that several EDCs define "small commercial and industrial customers" as having peak loads well beyond 25 kW and as high as 500 kW (PPL Electric). According to OSBA, these customers should be recognized as "small business customers" and the restriction of Section 2807(e)(7), which prohibits less than quarterly adjustments to default service rates, should apply.

RESA does not support OSBA's position which would lock in default service rates on a quarterly basis for more customers than currently permitted by the Commission's regulations. First, the Commission's currently effective regulation adopts the appropriate "cut off" point for defining small business customers consistent with its definition of "small business customer" in its Customer Choice regulations at 52 Pa. Code § 54.2. Such consistency of treatment is reasonable and the Act 129 amendments provide no reason to change this definition for purposes of implementing Section 2807(e)(7).

Second, and for all the reasons set forth in RESA's initial comments, the ideal default service plan results in market-responsive default service rates which are regularly adjusted to reflect changes in default service costs as they occur.[37] OSBA's proposal would prohibit changes less than quarterly for business customers with peak load of more than 25 kW and up to an EDC-specified amount which could be as must as 500 kW. Pursuant to OSBA's proposal, these customers would be denied the opportunity to receive the benefit of market-reflective and

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36 OSBA Comments at 5-7.

37 RESA Comments at 17-19.

market-responsive rates because their rates could not be adjusted any more frequently than quarterly. This, over the long term, will mean that these customers will not be receiving the lowest rates for generation.

Finally, the changes suggested by OSBA are unnecessary. This is because the Commission retains its discretion in the context of each default service plan proceeding to specifically address and resolve this question. Thus, there is no need to make this change now in the context of this regulation.

b. Subsection 54.187(j), (k), and (l)

OCA recommends that the "prevailing market prices" language in these three subsections be replaced with "least cost to customers over time."[38] Consistent with the discussion above regarding Subsection 54.187(i), RESA recommends that, to the extent the Commission is inclined to change this language, it be replaced with "consistent with the DSP's Commission-approved default service plan" instead of OCA's proposed language.

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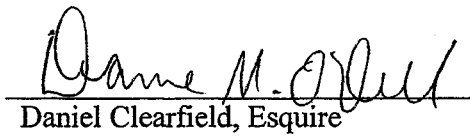
38 OCA Comments at 39.

III. CONCLUSION

For all the reasons set forth above and in its initial comments, RESA recommends that the Commission's final default service regulations be revised consistent with policies intended to develop a fully functional and workable competitive retail electricity market consistent with the Choice Act and affirmed by the Act 129 amendments.

Respectfully submitted,



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