COMMENTS OF

CHARLES J. KRUFT

ON BEHALF OF WEST PENN POWER COMPANY

D/B/A ALLEGHENY POWER

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

PROVIDER OF LAST RESORT ROUNDTABLE

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INTRODUCTION

NAME AND AFFILIATION.

My name is Charles J. Kruft and I serve as Manager, Rates for Allegheny Power. In that capacity, I participated in the recent Maryland Case No. 8908 that established the framework for the continuation of Provider of Last Resort service by Allegheny Power in Maryland.

West Penn Power Company, doing business as Allegheny Power (AP), appreciates this opportunity to participate in this Provider of Last Resort (POLR) Roundtable established by the Pennsylvania Public Utility Commission. AP believes that its experience in Maryland and Ohio procuring market-based POLR service can provide valuable information to this Commission as it addresses the future of default service in the Commonwealth of Pennsylvania. The Maryland default provider framework is described by Gregory V. Carmean, Executive Director of the Maryland Public Service Commission, in his comments provided on April 8, 2004 in this proceeding.

SCOPE OF COMMENTS

My Comments will identify what AP perceives to be the current significant policy and technical implementation issues associated with the continuation of POLR service, followed by AP's specific recommendations for continuation of POLR in its service territory.

SUMMARY

SUMMARY OF AP'S PROPOSAL REGARDING POLR SERVICE IN PENNSYLVANIA.

AP believes that the continuation of a default service offering in Pennsylvania after its generation rate caps expire is essential to ensure continued electric service to customers who choose not to, purchase or are unable to purchase, from an alternative retail supplier. POLR service must be carefully balanced with the overall electric restructuring goal of creating a competitive retail market. With the Commission adopting appropriate protections and with full cost recovery, AP is ready to continue to serve as the POLR provider in its service territory after its generation rate caps expire.

Because existing generation rate caps of electric distribution companies do not expire for a number of years, and also expire at varying times, AP recommends that the overall process in Pennsylvania remain flexible, and not necessarily adopt a "one size fits all" approach, nor become "etched in stone" at this juncture. AP recommends that the Commission obtain input from all interested stakeholders, including utilities, consumer groups (residential, commercial and industrial), wholesale and retail electric suppliers, Commission Staff, the Office of Consumer Advocate and the Office of Small Business Advocate. The Commission should establish a definite timeline in the hopes of reaching consensus and universal settlement for further consideration by the Commission. Such a process would allow for the presentation and open discussion of diverse interests in attempting to reach a proposed settlement on policy issues. Once the policy issues are decided, a second roundtable process, again involving all interested stakeholders, would focus on the technical implementation issues and the development of the electric supply procurement process.

AP proposes the use of a competitive bid process to procure wholesale electric supply to satisfy its POLR load.

POLICY ISSUES

POLICY ISSUES REGARDING THE PROVISION OF POLR SERVICE.

The establishment of default or safety net electric supply options for customers who elect not to choose an alternative retail supplier and for customers who are unable to select an alternative retail supplier must be carefully balanced with the restructuring goal of developing a competitive electric retail market. A retail electric market can only function if the barriers to competition, notably AP's below-market generation rates currently reflected in its capped rates, are removed. In developing a POLR option, a level playing field for both the POLR provider and the competing retail electric suppliers must be obtained. There should not be a price advantage for customers remaining on utility-provided POLR service.

AP SUPPORTS THE ELECTRIC DISTRIBUTION COMPANIES SERVING AS POLR PROVIDER.

Upon the Commission's adoption of appropriate cost protections and allowing full cost recovery, AP is ready to serve as the POLR provider in its service territory after its capped generation period expires. Selecting the EDCs as the POLR providers will eliminate the issue of the Commission's regulation of a non-utility POLR provider, while also recognizing the Commission's jurisdiction over the utility's POLR service offerings. AP envisions a competitive procurement of electric supply to satisfy its POLR load, with a full pass through to customers of market-priced wholesale power supply costs, transmission costs, administrative charges and applicable taxes.

COST SAFEGUARDS MUST BE IN PLACE FOR AP TO PROPERLY PROCURE AND SUPPLY POLR SERVICE.

Consistent with its obligation to provide POLR service, AP believes adequate cost protection against the risk of customer migration back to POLR service, electric supplier default, and prudency challenges to the wholesale power procurement result is required for AP to provide of this service.

ADMINISTRATIVE CHARGE

CONCEPT AND PURPOSE OF THE ADMINISTRATIVE CHARGE.

The use of an appropriate administrative charge or adder is essential to the establishment of a POLR price that is comparable to competing retail electric suppliers. An administrative charge must allow for full cost recovery of a utility's incremental costs and a reasonable return in exchange for the obligation to purchase and supply power to POLR customers. Without such a charge, a competing retail electric supplier would suffer a price disadvantage in comparison to the POLR provider and would be viewed negatively by prospective customers.

SPECIFC COMPONENTS OF AP'S PROPOSED ADMINSTRATIVE CHARGE.

In addition to a return for shareholders and the recovery of incremental costs directly related to the provision of POLR service, the administrative charge should also include an allowance replicating retail electric suppliers' costs for marketing and "back office" costs. By including that allowance, along with the return and incremental costs of the utility, the POLR price will be comparable to the price offered by alternative retail electric suppliers.

AP emphasizes that the administrative charge would be collected only when it provides electricity supply to POLR customers. To the extent that a customer chooses to shop, the administrative charge would not apply, and the utility would not earn a return associated with that electricity purchase.

RATIONALE FOR INCLUDING A RETURN COMPONENT IN THE ADMINISTRATIVE CHARGE.

The return portion of the administrative charge is necessary to compensate shareholders of the POLR provider for real and perceived risks of managing the POLR process and services. Such risks require that shareholders be compensated through a reasonable return. Under traditional rate base/rate of return ratemaking, utility shareholders were compensated for investing in the utility through a return on the utility's plant investment in a capital-intensive industry. However, the provision of POLR service will require minimal, if any, capital investment by the utility, thereby generating no return under traditional ratemaking. Shareholders and the capital markets cannot be expected to invest in and lend funds to an entity that manages the procurement of hundreds of millions of dollars annually in power supply contracts without adequate compensation for their investment in such a company. Potential investors and creditors can be expected to react negatively, in terms of expected return and credit costs, if they cannot be assured that the POLR provider is being granted a reasonable return for this continued POLR service obligation. AP notes that it procured over $700 million in purchased power for its default service in Pennsylvania in 2002.

Regulatory risk is another area of risk, whether perceived or real, that investors are mindful of and therefore expect a return for investing in a regulated entity. Any perception on the part of investors that full cost recovery is questionable may lead to higher return expectations by investors.

AMOUNTS COLLECTED THROUGH THE ADMINISTRATIVE CHARGE.

Amounts collected from POLR customers pursuant to the administrative charge are disbursed in the following manner: first, the utility's return component is computed; next, the utility receives recovery of incremental costs incurred to serve POLR load; and finally, any remaining amount collected refunded to all distribution customers. An example of this mechanism follows:

Administrative Charge Example

	POLR Customer (cents/kwh)	Shopping Customer-A (cents/kwh)	Shopping Customer-B (cents/kwh)
Alternative Retail Electric Offer		5.00	5.22
Wholesale Electric Cost	5.00	-	-
Administrative Charge	0.40	0	0
Price to Customer	5.40	5.00	5.22
Distribution Credit to All Customers	0.18	0.18	0.18
Net Price to Customer	5.22	4.82	5.04

Assumptions:

- 100,000 total kwh load
- 90,000 kwh POLR load
- Administrative Charge, net of incremental costs and return, equals 0.20 cents/kwh
- Distribution Credit = ($0.002 * 90,000 kwh) / 100,000

Crediting this amount collected from customers of a specific POLR type to all customers eligible (but not necessarily taking POLR service) in a specific POLR type renders the credit competitively neutral from the customer's perspective.

TECHNICAL IMPLEMENTATION ISSUES

TECHNICAL ISSUES RELATED TO THE IMPLEMENTATION OF POLR SERVICE AND PROCESS FOR CONSIDERATION.

Once the Commission renders its decision on policy issues, the highly technical implementation issues can be addressed. These areas include the following:

- Design of the wholesale power competitive procurement process
- Level of Commission oversight in the competitive procurement process
- Participation of utility affiliates in the competitive procurement process

- Qualifications of acceptable wholesale power suppliers
- Remedies for wholesale supplier default
- Translation of wholesale bids into retail rates

COMPETITIVE PROCUREMENT PROCESS.

AP proposes to use a competitive bid process to procure the market-based fixed rate POLR service. Although other states such as New Jersey have used an auction process to successfully procure wholesale electric supply for POLR load, AP prefers to use a competitive bid process. AP is familiar with, and has conducted such POLR supply bids, in both Maryland and Ohio. AP believes that the competitive bid process is the most cost-effective approach with the utility conducting the bid while being fully open to review and monitoring by the Commission. AP has successfully conducted similar competitive bids through a Request for Proposals approach, wherein clear and specific criteria are established before the actual bidding is conducted to insure comparable bids from qualified bidders. AP believes that this approach will provide highly competitive prices for electric supply that is reflective of market conditions.

QUALIFICATIONS FOR POTENTIAL BIDDERS IN THE PROCUREMENT PROCESS.

First, all qualified bidders, including non-regulated utility affiliates, should be eligible to participate in the bid process. The intent is to allow all wholesale electric suppliers who meet the eligibility requirements to participate. These requirements should include credit, FERC authorization and RTO membership requirements.

POTENTIAL REMEDIES FOR WHOLESALE SUPPLIER DEFAULT.

The issue of supplier default and its possible remedies should be resolved in designing the responsibilities of the utility acting as the POLR provider and the responsibilities of the wholesale electric supplier. AP believes that this issue was admirably settled after intense negotiations in the recent Maryland Standard Offer Service case, and, therefore, AP proposes that those remedies be adopted in Pennsylvania. The settling parties in Maryland agreed to a three-step process to remedy any supplier defaults, with all default recovery and applicable costs being passed on to customers. First, the POLR default load would be offered to the other wholesale POLR suppliers at the same terms, conditions and pricing as the defaulted agreement. Should all the POLR defaulted load not be placed, the utility would supply the defaulted load by purchasing through the PJM market on a temporary basis. Finally, and as soon as practicable after determining load was unserved, the utility would competitively bid the remaining term of the defaulting supplier's contract.

PRICING POLR SERVICES TO CUSTOMERS.

AP believes that a full cost pass through of market-priced wholesale power supply, transmission costs, administrative adders and applicable taxes to POLR customers is appropriate. Specifically, AP proposes the full cost recovery of the following items:

- All awarded electric supply bid prices,
- Transmission charges,
- Other PJM charges and costs incurred by AP related to its POLR load obligation,
- An administrative charge that includes a return to AP for retention by its shareholders, any incremental costs associated with providing POLR, and an administrative adjustment intended to replicate a retail electric suppliers' costs for marketing and "back office" costs, and
- Applicable taxes.

Full cost recovery of these items from POLR customers will ensure that POLR service is paid for by POLR customers and is not subsidized by or offered below market by AP. As part of its full cost recovery mechanism, periodic reconciliation would be performed and any under/over recovery would be surcharged/credited to customers to insure a dollar for dollar recovery.

Once the new prices are developed, prices will be posted at least two months prior to their effective date to provide customers with adequate time to compare offers from alternative retail electricity suppliers to POLR.

This concludes AP's pre-filed Comments in this proceeding.