COMMENTS OF

J. MICHAEL LOVE

PRESIDENT & CEO

OF THE

ENERGY ASSOCIATION OF PENNSYLVANIA

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PROVIDER OF LAST RESORT (POLR)

The restructuring of Pennsylvania's electric industry has been a positive development for the State. As the caretakers of competition, each of you can take pride in your accomplishments. So, too, can your staff members who had worked with all of us in an attempt to reach the next step.

POLR is the foundation of a competitive market. We, in Pennsylvania, need to build in protections and insurance to ensure that we avoid the California example. As we know, California attempted to re-regulate through a purported deregulation effort. The old baseball adage that *"you can't get to second with one foot on first"* holds especially true for markets. Markets can't be regulated into existence. Rather, markets evolve. Our efforts should be committed to removing obstacles to the development of markets, and not creating regulations -- even well-intentioned ones. For example, while the Commission had notice requirements for those seeking to leave the market, they were never followed by either "Utility.com" or "Utility.max" This illustration only serves as a reminder that markets are governed by economics and not regulations.

Pennsylvania has enjoyed success because it chose not to be proscriptive and attempt to lock in any approach to competitive markets. States such as California have chosen proscriptive approaches and failed. The market could look quite different in 2009 than in 2006 or today. Flexibility for each EDC is essential to permit the POLR process to evolve. Settling on an auction or an RFP or other alternatives. Rather, the goal needs to be to continue to keep the options open for each EDC and the public.

We should be able to achieve through the establishment of a POLR, sufficient mechanisms to provide full cost recovery, and full compensation for the risk of securing energy and demand at very short notice. Because future conditions and market risks are difficult to predict, discretion and flexibility become POLR cornerstones.

Now we enter a brand new challenge related to the establishment of what is meant by the obligation to be the provider of last resort. (POLR). What is ultimately decided upon will either act as an encouragement of competition, or act as a drag on the marketplace. Intertwined within the concern over competitive forces remains a desire to address social issues, namely that there is some safety net from price spikes in the marketplace. The Commission's questions regarding POLR demonstrate that this issue is embedded within a larger question related to market development. As a consequence, the Association's response will embody both a response to some of the individualized questions, and expression of the overall concern as to the marketplace.

As we approach the next step, we would suggest that the various EDCs have different needs and risks, and most importantly, time frames related to POLR. As a consequence, the Commission has the authority to adopt specific EDC POLR approaches. Time can be an aide in this discussion, as it allows the Commonwealth to review the actions of other jurisdictions, changes in technology, and changes in the requirements of markets and customers. Sometimes what may appear to be an issue at one point in time dissipates over time. Clear examples of this phenomena were; (1) the lengthy good-faith process devoted to competitive meter reading, and (2) the time allocated to competitive default service, but neither one emerged as a major issue or customer concern, yet both were the subject of lengthy professional discussion at the advent of competition.

Q. The Commission asks a series of questions related to both who is qualified to be a POLR, as well as the specific aspects of this responsibility. Do you have any overall response items?

A. Yes. The theme of market development and related establishment of a POLR in each service area must be one of flexibility. Markets develop from economic factors that neither the EDCs nor the Commission can control or predict. There is nothing negative about allowing different markets to develop within the Commonwealth. The Act encouraged the development of different EDC philosophy toward generation, with some retaining all of the generation, some retaining significantly less generation, and others choosing to be without generation. While different approaches emerged, the lights stayed on, and different markets have already developed and are developing.

Q. Is there an example of an attempt to predict a market that failed?

A. Yes. During the early days of market transition, the concept of competitive meter reading was floated as a new marketplace that would develop. Considerable, well-intentioned and meaningful regulatory work went into developing policies, committees, rules and regulations, and yet the marketplace never developed. One cannot regulate a market into being, but a Commission can provide the greatest level of flexibility so as to ensure the greatest level of diversity and breadth to the market. We would encourage the

Commission to err on the side of flexibility so that markets develop naturally, and if some work better than others, then we learn from actual experience rather than projected hypothesis.

Q. What is the first point the Association wishes to raise concerning POLR?

A. While there are both social and economic aspects to POLR, it should be recognized that POLR supply involves significant risks for the provider. The first major point is that all risks associated with POLR should be <u>both</u> fully and timely compensated.

Q. Should the nature of POLR obligation be uniform for all existing EDCs?

A. No. All EDCs are not alike. There are major differences between the EDCs regarding the character of their service territories, the applicable RTO rules, differences in supply sources, customer desires, and risks. These differences were clearly a desired result of the deregulation of generation and, indeed, these differences should be embraced, and not smoothed over by tired attempts to standardize and reinstate the corresponding weaknesses of the past.

Q. Does POLR Default Service extend to all customers?

A. Yes it does, and because it does, it should be recognized that POLR Default Supply involves significant risks for the provider and all risks associated with POLR Default Supply should be fully compensated. However, EDCs should have the option of excluding large commercial and industrial customers from POLR Standard Offer Service. In the alternative, the potential supply planning costs and the additional costs related to risk, that are incurred as a result of a large commercial or industrial customer seeking POLR Default Service, would need to be reflected in both the costs and the level of margin charged such a customer.

Options under POLR design include a Standard Offer Service for residential and small commercial customers or, depending on the distribution company, all customers. Rates under Standard Offer Service may be levelized, seasonal or have real-time components depending on the distribution company. POLR Standard Offer service would be available on a fixed-term basis, as an alternative to competitive service. In such situations, the POLR pricing would reflect a risk differential unique to each EDC. The Energy Association differentiates POLR Default Service as that service that is available on no notice, and reflects the fact that, absent disconnecting the customer, electricity will continue to flow.

Q. *Please discuss generation service.*

A. It should be understood that generation service is a deregulated service that serves the basic needs of consumers. Since the Commonwealth appropriately desires to have an electric distribution company obligation defined to assure that electric service will be available for all customers, one of the options to consider is that the pricing of POLR Standard Offer Service and POLR Default Service must reflect all costs associated with providing full requirement service. Considering that generation service provided by the EDC is assured, on-demand service, with no risk to the customer, this will most likely result in pricing that is higher than competitive service.

Q. *Please discuss the risks associated with POLR.*

A. POLR service providers will incur supply risks since they must procure supplies for an unknown level of demand, which can fluctuate because of weather conditions and customer shopping. Most or all EGSs manage supply risks through customer contractual arrangements. Since the circumstances of EDC POLR service providers differ because of the availability of supply, market conditions, and ability to manage supply risks, Commission POLR rules should provide the flexibility to address supply risks in different ways, including possible reconciliation mechanisms or minimum POLR service term requirements.

Q. ***The Commission asks the question: Does an EDC need to be the POLR?***

A. We believe that the answer today is Yes. For example, PJM rules require the load-serving entity (LSE) to be responsible for providing service when an entity such as "Utility.com" defaults. Therefore, the rules by which PJM operates in Pennsylvania, as well as New Jersey and Maryland, all require the EDC to be the POLR. PJM in its testimony on April 8, 2004, confirmed that, indeed, those are the PJM rules. For the immediate future, the EDCs need the certainty of either being completely relieved of their social obligations, or to be positively identified as the POLR.

Q. ***Will POLR prices be higher than competitive service?***

A. Yes. Pricing will likely be higher than competitive service when POLR service follows the statutory requirements of the Competition Act and includes the billing of its true cost and full recovery of the social obligations.

Q. Can POLR have offerings that embody demand-side response concerns?

A. Yes. DSR could be an option embodied in POLR design. EDCs could have more than one POLR option, depending on Commission concerns. For example, POLR Standard Offer Service option could have a levelized, seasonal, or real-time price component, which would include: (1) a margin, and (2) a separate market pricing for customers who choose to leave before completion of its term. Levelized rates would have a requirement of a minimum fixed-term of twelve months; seasonal rates would have, at a minimum, a fixed-term of three months; and a real-time component would have a minimum fixed-term of one month.

Q. What is POLR Default Service?

A. POLR Default Service would be available to customers whose competitive supplier defaults, and also for customers that drop competitive service, and will include a margin.

Q. What costs are embodied in POLR Standard Offer Service and POLR Default Service?

The costs of providing POLR Standard Offer Service and POLR Default Service should include, but not be limited to: (1) all social costs, (2) the cost to acquire and schedule electricity, (3) the administrative costs related to serving POLR customers including, but not limited to: (a) risk management costs, (b) information exchange, (c) commodity acquisition and portfolio management, and (4) any costs related to or imposed by Government, including taxes, fees and surcharges. The EDC's obligation should be defined to ensure that electric service will be available to all customers at a price that reflects the total risk and costs for that service.

Q. When would POLR Default Service apply?

A. POLR Default Service pricing would apply: (1) when a customer requests such service; (2) when a customer has lost its competitive service supplier who defaults without having sold their contracts to another competitive service supplier; or (3) when a customer drops off and without notice is returned to POLR Default Service. The pricing of this service would reflect full cost-recovery plus a margin for the risk of short-term market pricing.

Q. Are there alternatives worthy of consideration?

A. Yes. An auction process, an RFP, or an affiliated transaction could be options for addressing large POLR supply, by establishing the price of providing POLR service by bid. Market prices would reflect the full cost of providing generation service plus the associated risk. The POLR load would be offered to pre-qualified bidders (i.e., suppliers) via tranches representing a fixed percentage share of the load, as determined for purposes of the auction. Suppliers bid; the auction manager announces price; suppliers bid again until prices decrease, and until sufficient supply exists to meet the load to be procured. The auction would be intended to establish clear market prices and to minimize overall procurement costs. Suppliers would be obligated to serve their share of actual load, thus the risk related to the load uncertainty would be reflected in the bid price socialized to all POLR customers.

Q. ***What concerns does the Association have regarding implementation?***

A. POLR service regulations should be implemented in a way that does not defer costs, and POLR programs which have been approved prior to the promulgation of POLR service regulations should be permitted to continue, absent evidence of significant problems. The imposition of regulations on POLR providers should have no greater impact on EDCs than other generation suppliers. POLR supply should be available on a non-discriminatory basis to similarly situated customers. A properly designed POLR service will encourage reliability and not discourage customer choice.

As I have discussed what POLR <u>should</u> be, there are also descriptions of what POLR <u>should not</u> be. Clearly, if there is a concern for developing greater competition, that concern should be reflected in not forcing an incumbent EDC's POLR rate to be more attractive than that of competing marketers. A POLR rate is not "provider of the lowest rate," but rather it should be a rate designed to fully reflect the full cost of being the POLR.

Q. Do you have any final thoughts?

A. Yes, on two subjects. The first is that EDCs need to have the financial resources to be able to take care of the wires business. POLR cannot be subsidized by the wires business for any reason. POLR service is a non-regulated service, and must be accorded that status, or the Commission runs the risk of never experiencing further market growth. Second**,** the Commission is urged to maintain the flexibility of POLR options for the EDCs. The EDCs are in different places regarding generation, but also more importantly, the EDCs roll into POLR situations at different times. None of us can predict what the market will look like in the future. As a consequence, we should refrain from locking into place rules that deny the flexibility that has beneficially guided us to date.

Q. Does this conclude your testimony?

A. Yes, it does, and I thank the Commission for the opportunity to offer comments.