

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Provider of Last Resort (POLR) Roundtable)

Docket No. M-00041792

**COMMENTS OF
THE NATIONAL ENERGY MARKETERS ASSOCIATION
ON POLR ROUNDTABLE ISSUES LIST**

The National Energy Marketers Association (NEM)¹ appreciates this opportunity to offer suggestions on the most equitable, efficient and cost-effective manner in which to structure and implement POLR services and cost recoveries consistent with the intent of The Electricity Generation Customer Choice and Competition Act (EGCA). Pennsylvania's leadership has established PJM as a model for restructuring regional wholesale electricity markets. Consequently, Pennsylvania is particularly well-suited to design and implement a competitive retail market that leverages and extends the success of its liquid wholesale market into a price and technology competitive retail energy market as well.

To be clear, it is the timing, market design and default commodity pricing ("price to beat") plus the certainty of the date after which utilities will fully exit the merchant function that will determine whether private risk capital may competitively absorb all of the commodity-related costs and risks that are currently borne by public utilities on behalf of captive ratepayers, often unknowingly. It is the utility's complete exit from the commodity business by a date certain that: (1) creates an important opportunity to design and implement a progressive, value-driven, consumer-focused, price-and-technology-competitive retail energy market, and (2) supports the PUC's conversion of the Obligation to Serve into an obligation to "promptly connect, efficiently and safely maintain and reliably deliver electricity."²

¹ NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the U.K. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, electronic trading exchanges and price reporting services, advanced metering, demand side management and load management firms, billing, back office, customer service and related information technology providers. NEM members also include energy, risk management, financial trading and settlement related software developers as well as companies that are developing advanced power line technologies to enhance grid reliability as well as to deliver information and content over power lines.

This regionally diverse, broad-based coalition of energy, financial service and advanced technology firms has come together under NEM's auspices to help federal and state lawmakers and regulators to implement a consumer-focused, value-driven transition to an orderly, reliable and competitive retail marketplace for energy and related products, services, information and technologies.

² See "The Public Interest in a 21st Century Global Economy," March 2004, available at [http://www.energymarketers.com/Documents/\\$aapubli__interest_article.pdf](http://www.energymarketers.com/Documents/$aapubli__interest_article.pdf) (a copy of which is attached hereto).

I. The Scope of No Notice, Last Resort Service

A. The Electricity Generation Customer Choice and Competition Act (EGCA) Anticipated a Complete Exit from the Merchant Function

The Pennsylvania Public Utility Commission has correctly identified the structure, timing and pricing of high cost, high risk 24/7/365 emergency, last resort, no notice, retail commodity service as the single most important element of a competitive retail market design.³

The nature and scope of POLR service is critical to the design and implementation of a successful competitive retail market. NEM submits that the primary public interests that a utility, and only a utility, can and must have an "obligation to serve" was, is and for the foreseeable future will be "to promptly, efficiently and safely connect, operate, maintain and reliably deliver" electricity.⁴ Accordingly, once a reasonable transition period is provided, a utility's "obligation to serve" should no longer obligate it to negotiate, buy, sell, trade, hedge, swap, finance or risk manage electricity as a commodity or any related competitive functions. At the end of a properly designed transition period, POLR customers should be served by competitive providers and LDCs should have fully restructured their operations so that all of their financial resources and credit are available and focused on operating, maintaining and enhancing both reliability and service quality. The EGCA gives the Commission explicit authority to convert the utilities traditional obligation to serve into an obligation to connect, maintain and reliably deliver. NEM urges the Commission to initiate a rulemaking that establishes a date certain by which 100% of the Commonwealth's customers have chosen an alternative supplier, prior to which a utility has a "full obligation to serve," and after which a utility has fully exited the merchant function.

Section 2807(e) discusses the utilities obligation to serve as follows,

An electric distribution company's obligation to provide electric service following implementation of restructuring and the choice of alternative generation by a customer is revised as follows:

1. while an electric distribution company collects either a competitive transition charge or an intangible transition charge or

³ No other commodity requires a regulatory mandate to be available to the public if needed on a 24/7/365 retail basis. Seven-Eleven and many other retail convenience stores are open twenty-four hours a day, seven days a week without a mandate and when compared to Sam's Warehouses their prices normally reflect the cost of being open 24/7/365 without any guarantee that customers will patronize the store during these hours. However, it is also clear that consumers understand this default market and pricing structure for food and other necessities provided by these establishments and shop accordingly.

⁴ See "The Public Interest in a 21st Century Global Economy," March 2004, available at [http://www.energymarketers.com/Documents/\\$aapubli__interest_article.pdf](http://www.energymarketers.com/Documents/$aapubli__interest_article.pdf) (a copy of which is attached hereto).

until 100% of its customers have choice, whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric energy and the production or acquisition of electric energy for customers.

2. at the end of the transition period, the commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period.

3. if a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.

4. if a customer that chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy services.
66 Pa. C.S. § 2807(e).

The EGCA clearly authorizes and requires the Commission to define the timing, cost recoveries and the residual obligations of a utility once it has properly restructured its operations around connection and delivery services and outsourced the high cost and high risk commodity functions to the competitive marketplace.

The EGCA clearly anticipated a transition period during which the utilities would have the full obligation to serve. The legislature also clearly authorized and guided the Commission with the authority to require utilities to stop buying, selling, swapping, hedging, financing, production, and/or generation with ratepayer dollars. Given this context, the word "acquire" as used in Section 2807(e)(2) of the statute should more properly be viewed as a delivery-related function in the sense of an electricity scheduler that is functioning to support and/or to coordinate the delivery function but does not take title to the electricity. However, it must be clear at the end of the transition period, utilities should no longer be able to engage in the high cost and high risks of the commodity business with ratepayers absorbing any of the losses.

The legislature also intended the Commission to exercise its authority and provide a time certain within which utilities would fully recover transition costs. Cost recovery should be permitted during the transition period as part of the utility's commodity price to beat. Upon reaching the date certain by which the utilities shall exit the merchant function, utilities in compliance should be permitted to recover remaining costs that were not previously collected due to exigent circumstances or unforeseen events, and only if the Commission finds the costs were prudently incurred and aggressively mitigated and recovered during the transition period. If a utility remains

in the merchant function after the date certain ending the transition period, the utility should be fully at risk for any costs associated therewith. If a consumer wishes to pay a utility to perform a non-utility function, the full costs of that request for service should be borne by the customer requesting it.

It is clear that effective January 2002 the legislature expects the Commission to define the terms of a transition period during which utilities shall "exit the merchant" function and thereafter be obligated solely to connect, maintain and reliably deliver. The legislature also expects the Commission to define the "acquisition" of energy within this context (i.e. as part of an obligation to connect, maintain and reliably deliver) but not to generate or resell. Within this context, NEM urges the Commission to: 1) define a time certain for the transition; 2) define "acquire" and deliver to be nearly synonymous, i.e. "acquire" means the duty to schedule delivery and ensuring interconnection to permit delivery and is part of the obligation to connect, maintain and reliably deliver; 3) the definition of acquisition and acquisition costs should not force utilities to maintain commodity acquisition departments. Indeed the entire point of the transition period is to restructure utilities to no longer perform commodity related competitive service functions.

Modification of the utilities full obligation to serve is further supported by the language of Section 2806, which states that, "[t]he generation of electricity shall no longer be regulated as a public utility service or function except as otherwise provided for in this chapter at the conclusion of a transition and phase-in period beginning on the effective date of this chapter and ending, consistent with the commission's discretion under this section, January 1, 2001." 66 Pa. C.S. § 2806(a). The statute clearly states that generation is not to be utility service. And we urge the Commission to enforce a full exit from these activities. However, if the Commission declines and permits merchant function activities by utilities after the end date, NEM urges the Commission to monitor and enforce any commingling of funds or services between and among utility and non-utility sources of revenues and cost centers.

Furthermore Section 2807 pertaining to "Duties of the electric distribution companies" explicitly states that, "[e]ach electric distribution company shall maintain the integrity of the distribution system at least in conformity with the national electric safety code and such other standards practiced by the industry in a manner sufficient to provide safe and reliable service to all customers connected to the system consistent with this title and the commission's regulations." 66 Pa. C.S. § 2807(a). However, the statute does not set forth a similar duty with respect to a utility obligation to procure commodity. This omission makes clear that the utility's "obligation to serve" has been converted to an "obligation to deliver."

B. Billing, Metering and Customer Care Functions Can Be Provided by the Competitive Marketplace

The EGCA authorized the Commission to properly structure the POLR function so that the competitive supplier POLR would not only provide commodity but would also provide all forms of commodity-related products, services, information and technologies including billing, metering and customer care. With respect to billing, Section 2807 provides that, "[s]ubject to the right of an end-use customer to choose to receive separate bills from its electric generation supplier, the electric distribution company may be responsible for billing customers for all electric services, consistent with the regulations of the commission, regardless of the identity of the provider of those services." 66 Pa. C.S. § 2807(c). The use of the discretionary word "may," rather than the use of the mandatory term "shall," indicates that billing is not intended to be a monopoly-only function. NEM urges the Commission to encourage competition in this space so that at the end state utility legacy systems can be replaced and upgraded with a rate base and full costs and risks absorbed by the marketplace.

With respect to metering and customer care, Section 2807 provides that, "[t]he electric distribution company shall continue to provide customer service functions consistent with the regulations of the commission, including meter reading, complaint resolution and collections." 66 Pa. C.S. § 2807(d). NEM submits that consistent with the foregoing language, the utilities will continue to perform certain functions that support its ability to bill customers for the delivery function, as it would retain the ability to resolve disputes and collect monies associated with the use of the distribution system. However, the utility's performance of these functions in support of the delivery function should be coincident with a competitive supplier POLR performing customer care functions as is necessary to support provision of commodity to POLR customers. It is NEM's contention that metering (including ownership, installation, servicing of equipment, maintenance, testing, reading, data management, validation, editing, estimations, pulse output transmission via Internet) and customer care are competitive functions that should be provided by the competitive marketplace.

C. Renewable Portfolio Requirements Should Be Imposed at the RTO/ISO Level and Only After Performance of a Cost-Benefit Analysis

The POLR provider should not be charged with meeting renewable portfolio standard requirements. If there is a need to procure additional renewable resources to meet a statewide target, it is essential to conduct a quantitatively accurate cost/benefit study to identify the best means of achieving the target. If there is a need for additional resources, the Commission should evaluate different options for acquiring additional renewable resources including the purchase of 100% renewable power at state-owned facilities, conducting a state-wide wholesale procurement of renewable energy, and providing incentives to marketers that achieve renewable targets and determining if the contemplated benefits will significantly exceed the added costs. The study should

determine the public demand and benefits derived from a specific portfolio standard for renewable fuels and the increased costs that competitive suppliers will incur by complying with a regulatory mandate versus more market-based approaches.

NEM also recommends that PJM implement any potential RPS requirements if the benefits have been proven to outweigh the costs. PJM can more easily and efficiently comply with any potential RPS mandate, saving competitive suppliers and consumers from significant cost duplication, complexity and business risk. However, if the Commission does impose a RPS mandate on the POLR, it is imperative that POLR pricing fully reflect the costs of generating or procuring renewables.

D. Customer Eligibility for POLR Service

The transition period should be used to transition utilities out of the merchant function and the provision of related competitive products, services, information and technologies and to help the marketplace to achieve the liquidity and depth necessary to competitively provide this function and to reduce the costs and risks on the utility shareholders. Therefore, it is vital to structure POLR terms and rate design to be a last resort service and not a standard service option. It should be used in emergency or special circumstances. Customers should be eligible, not required, to receive POLR service when they are no longer being served by a competitive provider, i.e., if the customer's provider stopped doing business in the state.

POLR service should be structured to encourage minimum stays not mandated minimum terms. POLR service should be structured to be 24 hour/7days a week/365 days a year retail full risk, no notice service. There should be no incentive for any class of customer to use the POLR option as a long-term standard service option. In fact, if structured properly the cost of such last resort service should reflect the associated high costs and high risks of emergency, no notice retail service. Accordingly, it is important to prohibit the POLR entity from mandating that a customer enroll for a minimum term as a condition of service in the competitive market. If customers are required to enroll for minimum service terms, the customers will be unable to shop for other competitively priced services or switch to take advantage of other types of services.

Furthermore, the costs of providing POLR service vary by customer class and service prices should be structured to reflect those differences. Additionally, it is vital that the full costs and risks associated with each class of service be included in the POLR commodity price. (see Sections IV and V below).

E. Transitional Market Design Considerations

In the interim between the current state of the market design and the end of the transition period when utilities are out of the merchant function and POLR customers are served by competitive providers, NEM recommends a number of transitional

market design recommendations to facilitate the development of the competitive market. First, utility pricing of commodity to large commercial and industrial customers who can be billed hourly should be based on an hourly, time of day rate. Additionally, as long as a utility is providing commodity-related services to small commercial and residential customers, the commodity component of the "price to beat" should start with a monthly-adjusted, market-based rate to which should be added a utility's fully allocated embedded and projected stranded costs associated with providing all of the otherwise competitive commodity related products, services, information and technologies currently bundled in full service rates. By reflecting a utility's embedded and stranded costs of providing competitive services, consumers will quickly find that it is no longer in their interest to purchase competitive products and services from a utility that is designed to connect, maintain and reliably deliver. Additionally, marketers who cannot beat a "full cost" "price to beat" are not likely to be competitive.

Second, as long as utilities are permitted to incur and recover costs associated with billing and customer care they should be required to offer to purchase the receivables associated with a utility bundled bill. This is a low cost solution that could aid in the promotion of choice to residential customers, as witnessed in the O&R program in New York which has achieved a 30+% customer migration. Third, tax or regulatory incentives should be tied to the timing and degree of customer migration. Finally, utilities should actively support and cooperate to ensure the success of the transition.

II. Qualifications for POLR - Suppliers

A. Competitive Suppliers Should Not Be Subject to Utility-Like Regulations

When the POLR function is outsourced to the competitive marketplace all of the political or social requirements that are necessary to be a POLR should be commoditized within an RFP process. Competitive suppliers are already subject to utility-like regulatory structures imposed by the licensing requirements in the state, and there should be no additional utility-type regulatory, operational and consumer protection regulations for POLR providers.

Unreasonable creditworthiness standards should not be adopted for a competitive POLR provider as this would constitute an artificial barrier to competition. Companies with certain S&P or Moody ratings should already meet reasonable standards. Others should be able to meet a creditworthiness standard with a reasonable bonding requirement. Excessive creditworthiness requirements will increase the costs associated with energy delivery and limit competition.

With respect to the issue of unreasonable barriers to the POLR role for competitive suppliers, the wholesale auction approach can effectively prevent retail suppliers from entering the mass market because retailers cannot bear the large initial customer

acquisition cost investment required for market entry due to the uncertainty of maintaining a known volume of customers for a sustained period of time.

III. POLR Service Models

A number of POLR service models have been implemented and/or are being considered as Pennsylvania and other states define the end-state of the transition period. Among them include the wholesale auction approach utilized in New Jersey and Maryland, the retail auction approach used in Maine, the Atlanta Gas Light approach of assignment based on market share, and the transfer of POLR customers to an affiliated provider as utilized in Texas. Without endorsing any of these models, NEM would like to offer a few observations.

One issue that has retarded the development of a competitive retail market in New Jersey is the three-year duration of the wholesale BGS supply contracts. This structure is likely to lead to higher supply prices due to the lack of liquidity to hedge supply in the last half of the contract as well as increased counterparty credit requirements. The three-year duration also insulates a retail "Fixed Price" from market movements inasmuch as 2/3 of supply will always be locked in. As a result, a retail boom is created when the forward market drops below the "locked in" BGS rate and a retail bust is created when the forward market increases above the "locked in" BGS rate. This contributes to the general lack of mass market customer switching in New Jersey. This could be improved by staggering BGS supply in 1 and 2 year contracts. By comparison, the large commercial and industrial customers that are exposed to market-based, hourly pricing on BGS have migrated in sizable numbers to competitive suppliers.

The Atlanta Gas Light assignment model, while subject to initial difficulties associated with customer billing because of the "flash cut" to competition in an abbreviated period, has proven to be an effective and workable national model in the long term. Even the initial billing issues that took approximately ten months to resolve have ultimately led to many benefits for the consumer. The time and cash crunch associated with a lack of data and competitive billing infrastructure has led to very efficient and technologically advanced world-class companies now offering competitive billing, metering, customer care and predictive settlement, and risk mitigation products, services and technologies. While once upon a time only the utility meter reader would perform this function, we now have multi-billion dollar international companies equally competing on price and technology to fill these needs.

Likewise, the Texas approach of assignment of customers to the affiliated REP has stimulated competition in the relatively brief period since the market opened in 2002. Recent statistics indicate that in Texas competitive suppliers serve approximately 14% of residential customers, representing over 15% of residential load, about 19% of secondary energy market customers (most commercial and some small industrial

customers), representing 42% of load and approximately 35% of primary or transmission customers, representing over 60% of the large industrial load.⁵

IV. and V. Terms and Conditions of Service and Full But Immediate Recovery of Reasonable Costs

A. POLR Cost Categories

Utilities must remove all costs related to commodity sales from delivery service charges and place them in their commodity price. Costs should follow causation, e.g., all costs associated with POLR service should be in the commodity component of POLR rates and/or fully bundled sales rates. These costs include transmission charges, scheduling and control area services, distribution line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, metering, billing, collections, bad debt, information exchange, regulatory compliance, and customer care. These costs are incurred by energy marketers and are included in energy marketer pricing. To date, approximations in the form of an adder to a wholesale auction rate have proven inadequate. Properly structured adders to wholesale market auctions could be an efficient way to jump start a competitive transition. However, the lack of inclusion of retail costs in the adders has been a problem that has distorted restructuring timing and economics. These same costs are also included in utility pricing resulting in a double payment of these costs if they remain in utility delivery service pricing.

B. Proper POLR Rate Design is Central to a Competitive Retail Market and an Orderly, Efficient and Lower Cost Transition to a Competitive Retail Market

The proper calculation of the POLR rate is essential to long term price, service and technology competition. Consumers must be permitted to see and respond to accurate pricing signals in order to foster a competitive market. POLR pricing must reflect the full energy supply and commercial costs of serving retail load. If it does not, then consumers will receive artificially low price signals. POLR pricing mechanisms must not hide the true costs of providing retail energy services. Correct price signals are critical to both lower prices and conservation. Merely showing the "price to compare" as the wholesale cost of power is extremely misleading and a disservice to consumers. Default service customers are sent a false price signal and are still paying other costs two times to provide electric sales service in the distribution component of the bill. POLR pricing must be designed to reflect retail prices to avoid producing artificial or cross-subsidized price signals. Selling consumers a one-month adjustable rate as a thirty-year fixed rate is improper.

⁵ Texas Public Utility Commission, March 2004 Report Card on Retail Competition, available at <http://www.puc.state.tx.us/electric/projects/25645/rptcrd/mar04rptcrd.pdf>.

Additionally, as long as a utility is allowed to provide risk-free, hedged or cross-subsidized "commodity prices to beat," competition will be very difficult or impossible. Risk management is a specialized, high risk, competitive function that can and should be provided by private risk capital and not by captive ratepayer guarantees. It is not appropriate for a captive ratepayer to be forced to incur the risks and potential losses associated with commodity trading and hedging activities.

The Pennsylvania legislature has correctly identified a key problem that has since plagued the restructuring effort of numerous other states. Indeed, the utility offering what amounts to a "risk free fixed commodity price" as a "price to beat" is extremely misleading. Such nomenclature would likely be considered extremely improper in virtually any other industry. No regulator would permit a bank or mortgage company to state or advertise a one-month floating interest rate as comparable to a 30-year fixed interest rate mortgage. A "risk free fixed commodity price to beat" is equally misleading. Too often, utility provided "last resort" commodity services become price controls or thinly disguised special programs that make it impossible to open up new businesses and earn competitive rates of return on private investments. NEM strongly asserts that it is no longer in the public interest for utilities to devote enormous cash and credit and to pledge significant assets in order to engage in high risk commodity trading on behalf of small unsophisticated ratepayers.

C. Full Recovery of Reasonable Costs

Section 2807(e)(3) provides that, "if a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs." NEM submits that during the transition before the utilities full exit from the merchant function that the utilities should be made whole and permitted cost recovery that is included in the commodity price to beat. Customers returning to utility service during the transition should pay the replacement cost of energy as well as the significant additional marginal costs incurred by the utilities to serve these customers. If the utility is forced to perform the commodity function, then customers should be required to pay its full cost. If due to exigent or unforeseen circumstances, a utility has not fully recovered its costs by the date certain established for it to exit the merchant function, the utility should be permitted to recover these remaining costs in the delivery charge subject to a Commission finding that the utility has prudently incurred and aggressively mitigated these costs during the transition.

NEM also submits that when a competitive supplier is performing the POLR function, the phrase "recover fully all reasonable costs" should not be interpreted such that competitive suppliers are, in essence, converted to cost-based rate entities. With respect to competitive supplier POLRs, this phrase is more properly interpreted to

mean that the POLR price be authorized and established to reflect "fully all reasonable costs" of performing this role.

VI. Adjustment and Reconciliation of POLR Rates

A. POLR Rate Adjustment

NEM asserts that POLR pricing mechanisms must be designed to account for changing market conditions. There is a huge inherent risk for the State and the market if a "price to beat" is fixed and does not change over time in response to changes in wholesale markets. Such set prices put tremendous pressure on retail suppliers during periods of wholesale price volatility. POLR pricing mechanisms that allow prices to change over time in response to wholesale market conditions better reflect real competitive markets, provide more accurate price signals, and help consumers better manage their energy consumption decisions.

VII. Conclusion

NEM appreciates this opportunity to submit comments on the Commission's POLR Roundtable Issues List. NEM reasserts its commitment to assist the Commission and other stakeholders to develop truly price and technology competitive retail markets in the Commonwealth of Pennsylvania.

Sincerely,

Craig G. Goodman, Esq.
President,
National Energy Marketers Association
3333 K Street, NW
Suite 110
Washington, DC 20007
Tel: (202) 333-3288
Fax: (202) 333-3266
Email: cgoodman@energymarketers.com
Website-www.energymarketers.com

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