STATE OF PENNSYLVANIA
PUBLIC UTILITIES COMMISSION

Docket Number M-00041792 – Provider of Last Resort Roundtable

Comments of Amerada Hess Corporation

Rickey Joe
Regulatory Affairs Specialist
Amerada Hess Corporation
One Hess Plaza
Woodbridge, NJ 07095
Phone: (732) 750-7037
Fax: (732) 750-6670
rjoe@hess.com

May 19, 2004

Executive Summary

Amerada Hess Corporation (“Hess”) appreciates the opportunity to participate in this Provider of Last Resort (“POLR”) working group in Pennsylvania. Policy decisions on POLR service provisions that promote competitive markets are crucial for development of a robust environment in which to conduct business in Pennsylvania. We acknowledge that there are a large number of policy issues to address but we believe that POLR rules can be designed to meet any regulatory concerns while opening the State’s electric market with market-based pricing.

In order to facilitate a robust market, Hess submits the following comments on the scope of POLR service, provider requirements, a proposal for designing the POLR model, and recommendations for implementing this model.

Overview of Amerada Hess Corporation

Amerada Hess Corporation is a leading total retail energy provider in the Eastern United States providing retail energy service to more than 24,000 large commercial and industrial customer locations. Hess employs approximately 11,500 employees and is the largest supplier of fuel oil to commercial and industrial customers and a major supplier of natural gas and electricity to large industrial, commercial and institutional end-users in the North East region. Hess is also a major wholesale supplier of natural gas to a large number of LDCs in the North East and Mid-Atlantic regions, and operates retail gasoline stations all along the East Coast.

Hess began providing electric supply services in 1999, and has previously served retail electric customers in Pennsylvania primarily in the Pennsylvania Electric Company (“PenElec”), PECO Energy Company (“PECO”), Metropolitan Edison Company (“MetEd”) and Pennsylvania Power and Light Electric Utilities Corporation (“PP&L”) regions. Hess currently provides retail electric supply in Maryland, New Jersey, and New York, and is exploring market conditions in other surrounding states.

Hess has also provided electric wholesale supply through New Jersey's bidding process for Basic Generation Service.

POLR Service Defined

Pursuant to 66 Pa. C.S. §2807(e)(3), POLR service is applicable "if a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier." As in New Jersey and Maryland, the POLR provision represents the default or backstop option for customers. POLR service should consist of only one pricing option. If more than one pricing option were available to a POLR customer, then the POLR provider would in effect be competing against electric generation suppliers and therefore would not be serving as a true POLR. Moreover, POLR providers should not actively market any of the POLR services, since this would potentially confuse customers in comparing supply options. More than one POLR pricing option is anti-competitive.

POLR Service Design

POLR service must be market based and procured through some competitive process. Whether the POLR obligation is handled through an auction or RFP process, to the extent possible, the POLR rates must provide accurate pricing signals in line with wholesale market conditions. POLR rates for commercial and industrial customers must be hourly priced to reflect wholesale market prices and should be switched to hourly pricing at the expiration of their Electric Distribution Company's ("EDC") generation rate caps. Hourly pricing allows customers to experience real-time markets and alleviates concerns on setting retail rates that accurately reflect wholesale market prices. When POLR generation rates are set hourly, there is less incentive for customers to game the system such as moving from POLR to Electric Generation Suppliers ("EGS") service prior to peak periods only to return during off peak periods. Additionally, hourly pricing, in exposing customers to real-time pricing, will provide customer incentives to consider conservation measures to reduce peak period usage.

From a policy perspective, POLR rules will need to balance the objectives of minimizing price volatility with promoting pricing options that reflect wholesale market conditions. Residential and small commercial customers may arguably have less expertise than larger customers to make educated decisions on energy procurement options. Additionally, the equipment necessary (e.g., interval meters) and the economics of transitioning these smaller customers may not present significant benefits to warrant the costs. For these reasons, it may be reasonable to consider fixed price options for the residential and small commercial customer classes.

The majority of customers above 200 kW are sophisticated enough and possess the metering equipment to warrant inclusion in the hourly pricing model. Commercial and industrial customers with loads at 200 KW and above are capable of fully understanding several energy options and to avail themselves of the benefits associated with those options. Therefore, Hess proposes an initial threshold to distinguish commercial customers eligible for hourly pricing as those with loads equal to or greater than 200 kW including aggregated load amounts. Subsequently, the Commission should explore expanding the hourly priced customer group to below this threshold as it becomes feasible to provide the telemetry necessary to allow for hourly pricing..

In order to properly reflect wholesale market prices, the retail rate needs to move according to market conditions. If a POLR fixed price option is offered to small commercial (under 200 kW) or residential customers, the POLR rates should, at the minimum include seasonally-differentiated bid prices to reflect the on/off peak season differences. By differentiating the summer and non-summer periods, customers are better aware of electric market conditions. A monthly priced option would better reflect market prices, but Hess acknowledges that the Commission must consider concerns on price certainty, especially for these types of customers.

For a more robust competitive environment, POLR pricing must represent the actual cost for providing that service. In addition to the recommendations that POLR service be based on market rates and reflect market conditions, the costs for providing POLR service must be fully allocated. The POLR price must reflect the cost to provide that service. If an EDC serves as the POLR provider and the costs for POLR service are not fully allocated, then cross subsidies would occur. Such costs include but are not limited to administrative, customer care, and generation procurement. Administrative costs would include assignment and general costs, while customer care would include all customer service and uncollectible functions. Generation procurement would include (in addition to energy, capacity, and ancillary) charges for working capital, scheduling, administration and pass through of transmission costs. New Jersey and Maryland have adopted the concept of an administrative charge, which is applied to POLR prices, to recover these types of costs only from those customers that are still receiving POLR service. Hess supports such an administrative charge to properly reflect the costs to provide POLR service and would emphasize that the administrative charge should result in a reduction of distribution rates for any portions related to provision of these services. Customers who switch to a competitive supplier should not pay for these costs in their distribution rates.

Procurement of the energy obligations for fixed price POLR service for residential and small commercial customers should be done through a competitive process. Hess believes that a wholesale auction process similar to that used in New Jersey with some modifications can attain the goal of market-based prices that accurately reflect a wholesale market. The New Jersey auction bids the price for estimated load obligations (broken down into tranches) through a descending clock auction held online. Generally, suppliers bid on prices in a reverse fashion where the auction prices are reduced every round. As the auction progresses, prices decrease until the auction bids cover the amount of load in the auction. This process provides a fair, market-based price for fixed price residential and small commercial customers. The competitive bid process used in Maryland for fixed price POLR service is an alternative way to procure market-based supply for residential and small commercial POLR customers.

Regarding switching restrictions, true competition is premised on the ability to choose from a number of competitors, and to switch freely. Since POLR is the default or backstop option, customers should have the liberty to make decisions without the hindrance of being locked into the default service by any means. Provided the POLR service is properly priced to minimize gaming incentives, customers must have the freedom to enter and exit POLR service without penalties while shopping to meet electric supply needs. Restrictions such as minimum stay provisions or exit fees are not appropriate in a truly competitive market.

POLR Provider

Hess supports the incumbent EDC as the POLR provider provided that (as discussed above): (1) POLR rates are properly priced, and (2) all POLR-related costs are separately and properly allocated to the retail rate. Assignment of the POLR function to the EDC would alleviate concerns on jurisdiction over the POLR provider and would be more efficient to administer in both the initial transition to POLR service and for revisions to the POLR design if subsequent changes are warranted. Additionally, customers familiarity would help alleviate the transition to POLR service.

However, the Commission must require that the incumbent EDC file for approval its plan for providing POLR service. The filing should include all the intricacies for performing this service, and specifically, provide detailed analyses on how the EDC's POLR plan will ensure that, among other criteria, cross subsidies do not occur. To prove that cross subsidies do not occur, the EDC must substantiate that the costs for providing the POLR service are properly allocated to the POLR rate and/or POLR administrative charge. As discussed above, all costs for providing POLR service must be fully allocated to address cross-subsidy issues.

Uniformity of POLR Service

While the market environments and demographics can vary greatly among the EDCs, Hess believes that uniform POLR rules should apply across all EDCs' territories, with some flexibility to address certain EDC-specific issues. Uniform policies would include the overall design of the POLR model with a standardized schedule that would define the major objectives of implementation in each POLR service territory. Utilizing a standard POLR model across the state would create a more efficient administrative and implementation process. Each EDC would implement the same POLR plan at the time of its rate cap expiration. The plan would outline implementation milestones including: establishing a working group to identify key issues on the standard POLR model, designing a generation procurement process, planning consumer education meetings, etc. Working groups would allow the parties to discuss the details for implementing the standard POLR model including any areas that may require customization to accommodate EDC-specific issues. During the generation procurement phase, the Commission would either administer the process or contract with a third party to act as administrator, but would itself approve the process for generation procurement, upholding a fair, market-based process. Consumer education meetings would allow the commission to ensure that messages are being communicated appropriately by EDCs and EGSs and all customers are afforded accurate and usable information. It is imperative that clear and achievable goals are defined in the planning process.

Understandably, the Commission may consider flexibility to customize certain aspects of the POLR service. The Commission should make a determination on flexibility only after a proving that certain aspects of the standard POLR model must not apply. Implementation start dates for POLR on a staggered schedule would allow an opportunity to focus on any territory-specific issues that may arise, as well as any improvements that could be made to the overall POLR model. Nevertheless, any alterations to the model should be made in all EDC territories to maintain uniformity, an essential element of an efficient competitive market. One other concern that may warrant flexibility include the differences in the Regional Transmission Organizations ("RTO") on which an EDC operates. The specifics of the differences need to be discussed further so that generation procurement processes can be tailored to meet the different characteristics of the RTO. Moreover, once a standard POLR model is implemented state wide, the Commission must have the flexibility to revise it going forward based on any learning experiences that can be applied. Any further areas on flexibility must be presented to the Commission for consideration and approved only after good cause is shown.

POLR Implementation

Prior to switching customers to POLR service, customers need to be educated on pricing options, supplier contracts, and the general concept of Provider of Last Resort. Hess strongly believes that an integral part of the phase-in period must include consumer education initiatives. Statewide efforts coordinated through the Commission are required to help educate consumers about the transition process. Marketing efforts such as updates provided on websites, radio and television advertisements and consumer education meetings would help customers make informed decisions. Hess has recently participated in customer education conferences in both New Jersey and Maryland, which have been highly effective in ensuring a uniform message and providing comprehensive information to a large number of customers. At those conferences, representatives from Staff, PJM, the EDCs and marketers worked together to present an overview of the industry, how the newly opened markets could benefit them and answer any questions. Furthermore, customers who attended the New Jersey meetings were able to hear presentations from customers that had already switched. These customer testimonials provided insightful discussion from the customers' perspective and were well received by prospective customers.

As part of a standardized schedule to implement POLR service, there should be a forum to review the status of the POLR process. The forum would allow interested parties to discuss the prospective milestones and provide opportunities to alter the process as needed to address any issues that may arise. Parties will also be able to share their views on the progress of POLR service implementation and recommend policy or operational changes. By conducting periodic discussions on the POLR process, parties can also present any developments in the market such as short-term disparities between POLR prices and wholesale (spot and forward) electric prices. The forum could then determine a recommended course of action for the Commission to consider.

Closing

In order to develop a robust competitive electric market, electric pricing POLR service must provide accurate pricing signals to reflect market conditions while ensuring that POLR service acts only as the default service as intended. Hess looks forward to working with the Commission and industry participants to craft a POLR model that will promote competition while providing default service to those that require default service.