BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Provider Of Last Resort (POLR)	:	
Roundtable	:	**Docket No. M-00041792**
	:	

COMMENTS OF
EXELON GENERATION COMPANY, LLC

I. INTRODUCTION

Exelon Generation Company, LLC ("Exelon") submits these comments in response to the Commission's March 18, 2004 Secretarial Letter establishing a Provider of Last Resort ("POLR") Roundtable to address issues concerning POLR service to be provided at the conclusion of the transition periods for Electric Distribution Companies ("EDCs").

Exelon is actively involved in wholesale market transactions across the eastern interconnect and Electric Reliability Council of Texas. Either through direct ownership or long term contract, Exelon controls in excess of 35,000 MWs of generation and serves over 26,000 MWs of load through contracts with its affiliates, PECO Energy ("PECO") and Commonwealth Edison Company and other load obligations Exelon has obtained through various competitive processes. Exelon is very active in the regulatory and legislative processes throughout the Northeast, Midwest and Texas.

Exelon's view is that the Commission should focus on establishing a robust process for the submission, evaluation and approval of EDC-specific POLR plans that would include some minimum required criteria for the procurement model or models applied. The Commission should not, however, dictate in its forthcoming rulemaking a specific procurement model that must be used by all EDCs to manage their POLR supply obligation. Unlike in other States, where EDCs enter the post transition period at the same time, in Pennsylvania, EDC rate cap expiration dates are staggered over more than seven years. In its role as a generator and wholesale marketer operating in numerous states, Exelon has seen and participated in several procurement models applied over the past few years. As the experiences from the past few years amply demonstrate, the wholesale generation markets are likely to continue to evolve in potentially dramatic ways, and further changes in market structure, rules and participants can be expected both in the near term and over the much longer period leading up to the expiration of all of the Pennsylvania EDC rate caps at the end of 2010.[1] Accordingly, instead of prescribing one model, the Commission should focus on developing an over-arching process, including an agreed set of criteria to guide EDC's POLR Plans. To establish the agreed set of criteria, Exelon believes that now is the time to discuss and obtain consensus on establishing common principles to which all such plans should adhere. Exelon suggests the following common POLR plan principles:

a. There Is No Free Call Option On An EDC Affiliate's Generation Supply
b. Wholesale POLR Generation Supplies Should Be Acquired At Market-Determined Prices That Include All of The Services That Comprise POLR Service
c. Wholesale POLR Supply Agreements Must Align With The PJM Planning Year

[1] For approximately 75% of all Pennsylvania customers, the post-transition period will not begin until 2009 or later. For Exelon's affiliate, PECO, the post-transition period will not begin until 2011.

d. The Interval Between A Wholesale Price Offer And Definitive Agreement Must Be Limited To A Few Days

e. Switching Rules Are Necessary To Help Mitigate Volumetric and Seasonal Price Risk And Their Associated Supply Costs

In Section II of these comments, Exelon details its views as to these key guiding principles.

Exelon also supports the concept of competitive wholesale procurement. With that and the guiding principles in mind, in Section III Exelon discusses in detail some of the POLR wholesale procurement models that other States with competitive retail markets are using. Finally, in Section IV Exelon proposes a two-stage process for the development, review, approval and implementation of EDC-specific POLR plans.

II. COMMON PRINCIPLES FOR POLR PLANS

Exelon offers the following as common principles that should be observed in developing EDC-specific POLR plans as EDCs' rate caps expire over the next several years.

A. There Is No Free Call Option On An EDC Affiliate's Generation Supply

Every day, Exelon makes decisions regarding commitment of its portfolio of generating resources. To ensure that Exelon's resources are optimally applied, Exelon attempts to deploy its resources in markets that provide the Company with the best opportunities given its risk profile. Similarly, as to PECO's post transition period beginning in 2011, Exelon will be required to make assumptions about the extent to which it will dedicate a portion of its portfolio to PECO's POLR supply. Without an affiliate contract for PECO's POLR supply, Exelon will need to deploy its generation sources to pursue the best opportunities in the market. If a Wholesale POLR Provider defaults, Exelon's generation therefore will likely be unavailable to PECO. Thus, the post transition POLR plan the Commission adopts for EDCs with generation affiliates should not assume that the affiliate can provide the EDC with supply if other providers default on their obligations. The POLR plan must include a process for replacement of supplies in the event of a default and enable the EDC to recover from POLR customers any resulting increased costs regardless of how that supply was obtained (e.g. PJM spot market, RFP, auction, or bilateral agreement). Adopting such a process is not only fair, it is also good public policy, as it will result in the most efficient allocation of generation resources to the benefit of all market participants.

B. Wholesale POLR Generation Supplies Should Be Acquired At Market-Determined Prices That Include All of The Services That Comprise POLR Service

Section 2807(e)(3) of the Electricity Generation Customer Choice and Competition Act (the "Competition Act") provides that generation to serve POLR customers shall be acquired "at prevailing market prices." Generation to serve POLR load is not a single product but rather comprises a number of products and services that need to be incorporated into the definition of "prevailing market prices." To meet their customers' needs and manage generation supply risks, Wholesale POLR Providers will need to acquire a portfolio of various electricity products, distinguished by type and duration of supply, such as base load energy, load following energy, peaking energy, risk management products such as call and put options, capacity and ancillary services. In doing so, Wholesale POLR Providers must fully address congestion and losses. Consequently, "prevailing market prices" should not be narrowly defined as, for example, the price in the PJM day-ahead market, the "spot" price or the price resulting from the outcome of any one particular procurement model. Rather, "prevailing market prices" must refer to the specific products being provided, for example, full requirements load following service for a specific time period, along with the required risk management products expressed in hourly, monthly, annual, or multi-year price terms.

C. Wholesale POLR Supply Agreements Must Align With The PJM Planning Year

Most, if not all, current POLR supply agreements are calendar year based. Therefore, the next POLR procurement process EDCs will enter into will begin on a January 1. This does not, however, synchronize with the PJM Planning Year, which is from June 1 through May 31. Aligning with the PJM Planning Year will enhance the pricing efficiency of any POLR procurement model. For example, the annual Auction Revenue Rights/Fixed Transmission Rights process allows suppliers with load obligations an opportunity to hedge their congestion risk between the load obligation and sources of generation they may own or have access to. If, however, the POLR procurement process is not aligned with the PJM Planning Year, wholesale suppliers will incur some unhedged congestion risks, which they would likely pass on to end users through higher offers to the EDCs during their procurement processes. As a result, Exelon suggests that an EDC could align with the PJM Planning period by executing initial contracts of up to seventeen months.

D. The Interval Between A Wholesale Price Offer And Definitive Agreement Must Be Limited To A Few Days

Under any procurement model, the review, approval, and implementation process must ensure that the interval between a Wholesale POLR Provider's price offer and legally binding acceptance of that offer is limited to only a few days or even less. If a POLR procurement process, such as an auction or RFP, requires prospective Wholesale POLR Providers to hold their offers open for weeks or months before the execution of a definitive agreement, the likely result will be higher priced offers, and ultimately fewer participating suppliers. Prospective Wholesale POLR Providers will make offers assuming market conditions at the time of their offers and generally will not hedge a particular transaction until a definitive agreement has been executed. As the supplier is at risk for any price movement above the offered price, the supplier will either avoid the risk entirely and not participate or will add a price movement risk premium to its offer: the longer the time, the greater the premium. Therefore, limiting the time between price offering and contract execution should allow more suppliers to participate and result in more favorable prices, an outcome which clearly benefits both the prospective Wholesale POLR Providers and the customers whose load they seek to serve.

As a practical matter, such a limited interval between price offer and definitive agreement means that there cannot be a protracted period of after-the-fact review, either by the EDC or the Commission. Once the procurement process – whatever it may be – is implemented, the results must quickly be embodied in final, enforceable contracts. The two-phase adjudicatory proceeding proposed by Exelon and detailed in Section IV below, would achieve this goal by resolving all issues (including the development of master or form contracts) surrounding the procurement process as part of the first phase of the proceeding. Assuming that the procurement process was executed according to the approved plan, the PUC should then be able to quickly approve the results.

E. Switching Rules Are Necessary To Help Mitigate Volumetric and Seasonal Price Risk And Their Associated Supply Costs

POLR prices are fixed for a relatively long period of time and therefore represent an average of the POLR provider's costs over that time frame, customers could have an incentive to switch between POLR supply and competitive Electric Generation Supplier ("EGS") supply to take advantage of favorable, seasonal price differences. Even if EGS offerings for relatively short time frames are available, customers could have incentives to leave POLR service during annual non-peak periods when EGS offerings might be lower than the average POLR price, but come back to the POLR provider during annual peak periods when short-term EGS offerings are likely to be higher than the POLR price. From the Wholesale POLR Provider's perspective, however, such unrestricted switching creates significant risk that is almost impossible to hedge. Wholesale POLR Providers would still have to contract for enough supply to cover all of the load they would be responsible to serve during the entire term of their contracts, but would not collect enough revenue to cover the cost of that supply due to customer migration during the annual non-peak shoulder periods. Such unmanageable price and volumetric risk adversely affects not only Wholesale POLR Providers, but also retail customers, as the degree of risk that Wholesale POLR Providers would have to assume will cause them either to increase their prices , or to decline to participate. For this reason, any POLR plan must contain reasonable switching rules to help mitigate migration risk. The switching rules must take into account the pricing structure of the POLR offerings for the various customer classes. For example, if a residential POLR rate were available with levelized or annual pricing, a twelve (12) consecutive month "minimum stay" requirement could be appropriate to mitigate seasonal risk. If, however, hourly or monthly market-based prices were available, the seasonal risk would be “built into” this form of POLR pricing and a minimum stay requirement might not be needed.

III. WHOLESALE PROCUREMENT MODELS

Exelon supports competitive wholesale procurement and the following models that generally conform to the common principles Exelon proposes can be used.

A. Auction

The best example of the auction model is the New Jersey Basic Generation Service – Fixed Price (“BGS-FP”) process. As the Commission is aware from the Comments submitted by NJ Bureau of Public Utilities at the first Roundtable, the BGS-FP auction is a vertical, full requirements, multi-round, descending clock competition under which qualified bidders submit offers to supply vertical slices, or “tranches,” of an EDC’s load for a designated period pursuant to a Supplier Master Agreement. Each tranche is a fixed percentage share of the hourly energy requirement associated with the EDC’s residential and small commercial customers. In each round of the auction, bidders indicate how many tranches they are willing to serve at that round’s all-in price expressed in cents per kilowatt hour (“kWh”). When the volume of bids equals the necessary supply, the auction ends and establishes the single closing price for the BGS-FP load for each EDC for the designated term. The results of the auction are then reflected in the retail rates that customers pay. As the New Jersey process only procures one third of its requirements annually, the effect on consumer rates of any individual year’s auction is lessened.

For large commercial and industrial consumers, New Jersey utilizes its Basic Generation Service - ***Commercial Industrial Energy Price*** ("BGS-CIEP") process. The process is very similar in structure to the BGS-FP, however, only capacity and ancillary services are procured for consumers. The energy charge for BGS-CIEP consumers is the applicable hourly PJM Locational Marginal Price ("LMP").

A vertical, full requirements auction such as the New Jersey BGS FP declining clock auction is by its very nature an open and highly competitive process that results in transparent clearing prices. It is an objective, standardized process, and involves regulatory oversight primarily at the front end of the process. Any uncertainty to the utility, suppliers, and customers associated with after-the-fact regulatory review is, therefore, reduced. By limiting the amount for which any one supplier can bid, an auction process can also be designed to maximize the number of bidders. As opposed to an RFP process described below, the auction process can be completed relatively quickly because all non-price issues are addressed beforehand.

B. Request For Proposals ("RFP")

As addressed at the April 8th Roundtable by the Maryland Public Service Commission, Maryland has adopted an RFP approach for a full-requirements competitive procurement process. Maryland's RFP process requires that residential and non-residential load be bid separately. Full requirements contracts for one, two and three years are obtained through the process and, subject to the Maryland Commission's post-bidding review authority, fixed customer rates are established based on the results of the bidding process. These rates are reset annually.

The RFP model is a process that is familiar to most parties and is widely used for many other goods and services. The RFP model provides somewhat less price transparency than an auction because although you know the final weighted average price, you do not know the price distribution. Nevertheless, it should provide certainty in the sense that the lowest prices should be accepted and successful bidders should be paid what they offer. A full requirements RFP process can be designed to try to increase the number of potential bidders, but structurally it is not as well adapted to maximizing the number of bidders as is an auction.

C. Bilateral Agreement

A bilateral agreement with qualified suppliers also may be a source for fairly priced, reliable supply. At a minimum, it provides an alternative when either no bids are received or there are fewer bidders than required by the applicable procurement process. By its nature, bilateral negotiation involves only a few players. An EDC and potential third party suppliers, however, have the flexibility, not found in auctions and RFPs, to tailor their agreements to meet the specific needs of the EDC. Although price transparency may be limited, this issue can be addressed through application of the statutory "prevailing market prices" standard, such as through published PJM or other indices.

D. Hybrids

Pennsylvania does not have to adopt one procurement model to the exclusion of the others. The Commission could adopt several of the approaches or hybrids to the extent it determines that each is appropriate for a different component or category of POLR supply. For example, Duquesne Light Company has petitioned the Commission to approve a supply plan to set rates for residential, small commercial and small industrial customers for a six-year period by relying on an affiliate to manage a portfolio 40% of which is owned by the affiliate with the remainder to be supplied through short and long-term supply contracts entered into by the affiliate. At the same time, Duquesne proposes to procure supply for large commercial and industrial customers in the wholesale market through competitive RFPs, which would enable Duquesne to offer such customers both a one-year fixed price option and hourly-priced service.

In summary, Exelon supports wholesale competitive procurement through full requirements auctions or RFPs, but believes the Commission should also allow the use of bilateral agreements. As wholesale markets are dynamic and continue to evolve and amending regulations entails a lengthy process, the Commission should avoid prescribing one specific procurement model in its regulations. The ability to modify procurement models in a timely manner as markets evolve is critical to promoting robust wholesale markets that will continue to attract market participants and bring benefits to retail consumers.

IV. THE PROPOSED REGULATORY PROCESS

A. The Commission Should Adopt A Two-Phase Adjudicatory Process

As noted previously, rather than limiting POLR service to only one procurement model, the Commission's primary focus for its proposed rulemaking should be to establish a process that will enable it to take advantage of all available market models at the time of expiration of each EDC's rate caps. The Commission should use its authority under Sections 2807(e)(2) and (3) of the Competition Act to initiate a proposed rulemaking, which sets forth a two-stage adjudicatory process for (1) the submission, evaluation and approval of EDC-specific POLR plans; and (2) the Commission monitoring of the implementation of approved plans.

1. Phase 1 – Plan Development And The Adjudicatory Process

The Commission should establish guidelines for the contents of EDC filings for the approval of proposed POLR plans. The guidelines should identify: (1) the minimum requirements for the contents of each POLR plan; (2) issues that the EDC should address in its filing and supporting data; and (3) particular information that must be provided to assist the Commission and other parties in reviewing and evaluating the EDC's proposal.

The guidelines should require the EDC to identify and explain the process or processes it intends to use to procure generation supply for POLR customers. In addition, the EDC should describe the procedures it would use to implement its proposed procurement method or methods. For example, if standardized contracts, standardized RFP forms or standardized bid forms would be needed for particular procurement options, the Commission's guidelines should require that they be submitted with the filing. Similarly, the guidelines should require EDCs to articulate minimum qualifications and creditworthiness standards for eligible suppliers for the proposed POLR model. The objective should be to ensure that the EDC sets forth in sufficient detail each material element of its proposal so that the Commission and all other stakeholders have a full and fair opportunity to consider, understand, and evaluate the EDC's proposed plan.

To provide sufficient lead time for review, approval and implementation, EDCs should be required to submit their POLR plans approximately 12 to18 months before the expiration of their respective rate caps. After the filing, the Commission would initiate an investigation. Interested parties would be permitted to intervene in accordance with the Commission's rules of administrative practice and procedure. The investigation would proceed in the same fashion as other adjudicatory proceedings before the Commission. A detailed procedural schedule should be adopted at the commencement of each proceeding that provides for a final order sufficiently in advance of the respective EDC's rate cap expiration to allow for the orderly implementation of the POLR plan and the associated POLR generation supply options.

The process should be designed – and all parties should be encouraged – to resolve as many issues as possible through formal or informal collaboratives that could take place in parallel with the formal procedural schedule. Given the subject matter and the likely issues, Exelon believes that many, if not all, issues can be resolved in this fashion.

2. Phase 2 – Implementation And Monitoring

The end result of the adjudicatory process would be a final Commission order approving a POLR plan for each EDC. As previously explained, the POLR plan should define a process for obtaining POLR generation supply that relies on competitive wholesale market forces to determine the price(s) for each electricity product that is a component of supplying POLR generation (i.e., base load energy, ancillaries, load-following energy, peaking energy, capacity and ancillary services). As a consequence, the Commission's role, following the adoption of its final order, would be to monitor implementation to ensure that there is no material deviation from the approved plan.

The EDC would be responsible for implementing its POLR generation supply procurement process in the manner contemplated by its pleadings as modified by the Commission in its final orders. Stakeholders should be kept informed as each stage of the approved implementation process unfolds. Their continuing interest and review, their ability to seek Commission intervention if necessary, and the resulting fundamental transparency of the procurement processes would provide the primary assurance that the EDC and participating generation suppliers are complying with the letter and spirit of the approved POLR plan.

As discussed previously, another critical factor is the need to keep the interval between a prospective Wholesale POLR Provider's commitment to a price and the execution of a final contract with the provider as short as possible. Generation suppliers should not be required to commit to the pricing of generation resources for indefinite intervals while a PUC investigation of the procurement process takes place. They must have prompt knowledge of whether their otherwise successful offering will ripen into a legally enforceable contract to supply power at the stated price. As explained earlier, the opportunity costs that would be imposed while their offer is held in limbo pending a PUC investigation would be a significant disincentive to participating in the EDC's procurement process or would require suppliers to add a potentially substantial premium to their prices to compensate for that risk.

The final result of the procurement process then would be the execution of final standard form contracts with each of the successful Wholesale POLR Providers, and their provision of the collateral required by the POLR plan's approved credit requirements.

V. CONCLUSION

Although Exelon supports competitive wholesale procurement, at this stage of the evolution of the competitive retail market in Pennsylvania, the Commission should not prescribe one specific procurement model for EDCs to obtain POLR supply. Rather, the Commission should exercise its regulatory authority by mandating a two-phase adjudicatory process for the submission, evaluation, approval and implementation of EDC-specific POLR plans that observe the common principles outlined in Section II of these comments.

Exelon thanks the Commission for providing this opportunity to express its views, as a generation supplier, on the issue of POLR service. Generation suppliers will have a central role in achieving the success of post-transition POLR service and the continuing development of the competitive retail market in Pennsylvania. Exelon looks forward to continuing to work with the Commission and other stakeholders to meet the challenges that lie ahead.