



# Comments and Presentation to POLR Roundtable

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Industrial Energy Consumers of Pennsylvania

Duquesne Industrial Intervenors

Met-Ed Industrial Users Group

Penelec Industrial Customer Alliance

Philadelphia Area Industrial Energy Users Group

PP&L Industrial Customer Alliance

West Penn Power Industrial Intervenors

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June 2, 2004

# **STATUTORY PRINCIPLES FOR POLR SERVICE**

- The Electricity Generation Customer Choice and Competition Act ("Competition Act") mandates the following with respect to Provider of Last Resort ("POLR") service:

## STATUTORY PRINCIPLES FOR POLR SERVICE

- 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. *66 Pa. C.S. §2807(e)(3)*.

## STATUTORY PRINCIPLES FOR POLR SERVICE

- POLR service must be provided for all customers, including large commercial and industrial customers.
  - The Competition Act does not limit the classes of customer eligible to receive POLR service.

## STATUTORY PRINCIPLES FOR POLR SERVICE

- The Competition Act is designed to create an environment where customers can choose among alternative Electric Generation Suppliers ("EGSs") and the EDC as the POLR provider.

## STATUTORY PRINCIPLES FOR POLR SERVICE

- The POLR provider must acquire energy at prevailing market prices.
  - May include hourly, month-to-month, yearly, or multi-year prices.
  - Multiple, flexible definitions of "prevailing market prices."

## STATUTORY PRINCIPLES FOR POLR SERVICE

- The POLR provider must recover all reasonable costs.
  - PUC regulations must provide guidance as to what constitutes reasonable costs.

# STATUTORY POLICY CONSIDERATIONS

- Section 2802 of the Competition Act provides the following policy considerations:
  - Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity. *66 Pa. C.S. §2802(5)*
    - ▶ Wholesale market consideration



## STATUTORY POLICY CONSIDERATIONS

- The cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth. *66 Pa. C.S. §2802(6)*
  - No point in punishing business by making POLR "ugly."

## STATUTORY POLICY CONSIDERATIONS

- This Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs. *66 Pa. C.S. §2802(7)*
  - Pricing POLR to guarantee "shopping" is inconsistent with this objective.

## STATUTORY POLICY CONSIDERATIONS

- In moving toward greater competition in the electricity generation market, the Commonwealth must resolve certain transitional issues in a manner that is fair to customers, electric utilities, investors, the employees of electric utilities, local communities, nonutility generators of electricity and other affected parties. *66 Pa. C.S. §2802(8)*
  - "Fair" does not guarantee a market position.

## STATUTORY POLICY CONSIDERATIONS

- Electric service is essential to the health and well-being of residents, to public safety and for orderly economic development, and electric service should be available to all customers on reasonable terms and conditions. *66 Pa. C.S. §2802(9)*
  - "Reasonable" does not equate to artificially inflated.

## STATUTORY POLICY CONSIDERATIONS

- Any POLR regulations must complement, not conflict with, these policy guidelines.
- Any POLR regulations must be flexible enough to account for the unique customer base in and market characteristics of Pennsylvania.
- Any POLR regulations must reflect the importance of the cost of electricity to business and industry in the Commonwealth.

## **GOALS OF POLR REGULATION**

- The Competition Act contemplates a lengthy transition period during which:
  - The wholesale market can mature;
  - Retail customers can benefit from the maturity, either through the selection of an alternate EGS or through a POLR provider.

## GOALS OF POLR REGULATION

- EDC generation rate cap expirations are staggered over seven years.
  - ▶ Generation rate cap expiration dates extend from 2004 to 2011.
  - ▶ During this time, market characteristics may significantly differ.
  - ▶ Similarly, wholesale power market rules and conditions may change.

## GOALS OF POLR REGULATION

- EDC size in Pennsylvania differs significantly.
  - The smallest EDC has approximately 3,000 customers, while the largest EDC has over 1.5 million customers.
- Customers have a need for reliability and continuity.
- Any regulations developed by the PUC must be flexible to account for these issues.



## GOALS OF POLR REGULATION

- These regulations must:
  - Comply with the Competition Act;
  - Recognize the different base of customers throughout the Commonwealth;
  - Recognize the differing characteristics of EDCs; and,
  - Recognize the need for market-based concepts, while still providing appropriate Commission oversight.

## **POLR PROVIDER REQUIREMENTS**

- During the Competition Act's transition period, the EDC must act as the POLR provider.
- At the end of the transition period, the EDC may continue to act as the POLR provider.

## POLR PROVIDER REQUIREMENTS

- In the alternative, an entity can petition the PUC for approval to act as an alternative POLR provider.
  - The POLR provider in each service territory must be either the EDC or the Commission-approved alternative POLR provider.

## POLR PROVIDER REQUIREMENTS

- The alternative POLR provider must prove its financial viability by:
  - Having the financial ability to enter into contracts for generation.
  - Providing appropriate credit assurances to cover any default risk.

## POLR PROVIDER REQUIREMENTS

- POLR regulations should address financial viability requirements.
  - POLR regulations may contain a specific credit policy.
    - ▶ These regulations should complement PJM's credit policy protections.

## **EDC AS ULTIMATE POLR PROVIDER**

- Because the POLR model enables alternative suppliers to provide a portion of wholesale requirements to EDC customers, a risk of default is possible.
- The Commission must determine whether the EDC should act as the "ultimate backstop" in event of default.

## EDC AS ULTIMATE POLR PROVIDER

- If the EDC acts as the ultimate backstop, POLR regulations must:
  - ▶ Allow the EDC recovery of any reasonable costs incurred; and,
  - ▶ Require the EDC to minimize and mitigate such costs.

## EDC AS ULTIMATE POLR PROVIDER

- The Commission must determine whether "customer care" functions should be unbundled.
  - Unbundling may occur if it is just and reasonable.
    - ▶ Customers should not be required to pay twice for the same service (e.g., meter reading, billing).
    - ▶ Heightened scrutiny is necessary for access to confidential information.



## POLR COSTS

- The POLR provider is permitted to recover all reasonable costs.
  - The components of these costs could include:
    - ▶ Energy,
    - ▶ Capacity,
    - ▶ Ancillary Services,
    - ▶ Taxes,
    - ▶ Actual Administrative Costs, and
    - ▶ Reasonable Return on Service.

- This design would pass-through costs to the end-use customers with little or no risk to the POLR provider.
- The development of POLR rates should include:

- A determination of the cost types related to POLR;
- A determination of the cost levels related to POLR;
- A functionalization of costs between distribution rates and POLR rates, and
- An allocation of POLR costs among the customer classes.

- This development would preclude any cross-subsidization between distribution and POLR rates.
- This development would also ensure customers are not charged twice for the same service.

- Because the Pennsylvania legislative directive is built upon a choice scenario, POLR rates cannot be artificially inflated to encourage customers to choose an EGS.
  - Such an adder would be outside the realm of reasonable costs.
  - Including such an adder would interfere with market forces.

- The POLR provider should be permitted to update its reasonable costs on a yearly basis.
  - The POLR provider should not be permitted to "true-up" any under or over recoveries from the previous year.
    - ▶ Cost-causation rules prohibit such a reconciliation.

## POLR PRICING OPTIONS

- The Competition Act provides that POLR rates should be based on prevailing market prices.
  - The PUC has discretion to allow flexible pricing options.
  - POLR pricing options do not have to be identical for all EDCs or customers.

## POLR PRICING OPTIONS

- POLR pricing options should initially include at least:
  - ▶ A no-risk option to the POLR provider that is based on an hourly pricing construct with an adder to recover the POLR's reasonable costs;
  - ▶ An annual fixed-price option without shopping restrictions; risk to the POLR provider of no shopping restrictions will increase price to level where EGSs can compete; and,



## POLR PRICING OPTIONS

- ▶ An annual fixed-price option with switching restrictions in order to assure that customers choosing POLR obtain a reasonable market price.

## POLR PRICING OPTIONS

- The menu of fixed-price options can be based on the length of commitment made by a customer.
- While a POLR provider should be permitted to offer various options, it is imperative that all customers be offered at least one fixed-price option.

- Providing only non-fixed price options is not appropriate because:
  - Arbitrary price increases are possible;
  - Load usage may be detrimentally impacted;
  - The volatile market may result in higher than expected prices;

## POLR PRICING OPTIONS

- Not all C&I customers are sophisticated enough to utilize hourly pricing;
- Budgetary constraints can occur with hourly pricing; and
- "Prevailing market price" is defined by the market more broadly than just hourly.

## POLR ENERGY PROCUREMENT

- A POLR provider must have flexibility in procuring energy at the best price possible.
- Procurement processes could include:
  - Wholesale Market Purchases;
  - Auctions;
  - Requests for Proposals;
  - Affiliate Transactions; or
  - A Portfolio Approach.

## POLR ENERGY PROCUREMENT

- Any of these procurement approaches are viable, so long as the POLR provider obtains energy at a reasonable cost.
- EDCs should be permitted flexibility in choosing the procurement option best for their customers.
- A level of regulatory scrutiny is necessary to ensure reasonable costs without any gaming.

## **SWITCHING RULES**

- The PUC cannot permit an "ugly" POLR model in order to force customers to switch to another provider.
- The Competition Act mandates POLR rates as a reasonable alternative in order to allow customers to stay on such service as long as they choose to do so.

## SWITCHING RULES

- The customer should be permitted to stay with or leave the POLR provider based on the terms of the POLR model.
- Rules must also be implemented to minimize the gaming of POLR offerings due to substantial differences in wholesale prices in summer and non-summer periods.
- Potential rules could include:



## SWITCHING RULES

- Restrictions on customers that switch from POLR service to an EGS from returning to POLR service until a full year after the switch;
- Restrictions on customers that leave POLR service from returning to that service between June 1 and August 31 of any year; or
- Allowing customers to return to POLR service, but at "refreshed" prevailing market price.

## **REGULATORY PROCESS**

- POLR customers should not be precluded from participating in any Demand Side Response programs offered by the EDC, the Regional Transmission Operator, or any other entity.
- Any regulatory process must allow for flexibility to account for the different characteristics and timing of the various EDCs transition periods.

- Regulations should allow for flexibility but also address:
  - ▶ The determination of reasonable costs;
  - ▶ The spectrum of available pricing options;
  - ▶ The spectrum of POLR procurement; and,
  - ▶ Switching Rules.

- ▶ Requirements for approval of an alternative POLR provider, including:
  - Creditworthiness;
  - Unbundling of customer care functions; and
  - Heightened scrutiny for confidential information.

## REGULATORY PROCESS

- Similar to Pennsylvania's Restructuring Process, each EDC should present an individual plan for approval by the PUC.
- This plan should include:
  - A detailed methodology for setting POLR prices and a timetable associated with the methodology;
  - An allowance for changes over time due to market evolution; and,
  - A consistency between the timing of the approval process and the PJM planning year.