111 Market Place
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Constellation Energy

June 14, 2004

Hon. James McNulty
Secretary
Pennsylvania Public Utilities Commission
400 North Street
Harrisburg, PA 17120

Dear Secretary McNulty:

Attached are written comments that accompany the presentations made by Constellation NewEnergy, Inc. and Constellation Power Source, Inc. during the POLR Roundtable discussions for posting on the POLR Roundtable website. These written comments supplement those presentations by presenting responses to each of the questions raised in the POLR Issues List.

Please let us know if you have any questions. Constellation expects to file another document on or prior to June 17 with specific Reply Comments to the presentations and comments by other parties, which we will direct to your attention.

Thank you. Please let us know if you have any questions.

Sincerely,

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Provider of Last Resort (POLR) Roundtable) Docket No. M-00041792

RESPONSE OF CONSTELLATION POWER SOURCE, INC. AND CONSTELLATION NEWENERGY, INC. TO THE POLR ROUNDTABLE ISSUES LIST

Dated: June 14, 2004

1. INTRODUCTION

Constellation Power Source, Inc. ("CPS") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") appreciate this opportunity to submit written comments to the Pennsylvania Public Utility Commission ("Commission") that directly address each of the issues contained in the Provider of Last Resort ("POLR") Roundtable Issues List issued by the Commission on March 19, 2004 ("Issues List"). Constellation is willing and able to serve customers in the Commonwealth of Pennsylvania and applauds the Commission's efforts to explore best practices in the industry today for providing POLR service, and adopt such practices in Pennsylvania.

CPS and CNE are affiliates within the Constellation Energy Group, Inc. ("Constellation Energy") family of companies. Constellation Energy is a Baltimore-based Fortune 500 company that traces its history through almost two centuries. Besides CPS and CNE, the Constellation Energy companies include (1) Constellation Generation Group, LLC ("CGG"), with responsibility for over 12,000 MW of generation; and (2) Baltimore Gas and Electric Company ("BGE"), a regulated energy delivery company in Central Maryland.

CPS is responsible for selling the output of affiliated and unaffiliated generation companies and managing the associated market-hedgeable risk. CPS focuses on serving wholesale customers (distribution utilities, co-ops, municipalities, power marketers, large companies and other large, load serving entities) that operate in deregulated energy markets. CPS also provides fuel-related products and services. CPS provides POLR supply (or Standard Offer Service supply) in Maryland, New Jersey, and in several New England States.

CNE is an electric generation supplier ("EGS") that provides customized energy solutions and comprehensive energy services to commercial and industrial customers. CNE's local management allows for tailor-made service geared towards lowering electricity costs and hedging price volatility based on the exigencies of individual markets. Founded in 1995, CNE was one of the first independent energy providers in the nation, buying electricity for its customers and achieving savings through energy efficiency, load management, and other specialized services. CNE is a licensed Pennsylvania EGS that has served customers in the Duquesne, Penn Power, PECO, Penelec, Metropolitan Edison, and PPL service territories. Nationwide, CNE has over 8,000MW of load under contract with over 5,000 retail customers. CNE is licensed as a competitive supplier in 19 states and two Canadian provinces, and operates out of 10 regional offices. CNE is also a licensed natural gas supplier, and when combined with its affiliate Constellation NewEnergy, Gas Division L.L.C., has over 8,000 large commercial and industrial customers in North America (electricity and natural gas) - many with multiple locations. CNE provides specialized energy products and services that help customers effectively manage and control energy costs and usage based on their unique business requirements.

CGG currently owns or controls 12,000 MW of generating capacity nationwide, including several generating stations located in Pennsylvania. Generating plants located in Pennsylvania in which CGG or an affiliated entity has an ownership interest include the Colver, Keystone, Conemaugh, Handsome Lake, Panther Creek and Safe Harbor plants.

BGE delivers energy to more than 1.1 million electric customers and 600,000 gas customers throughout Central Maryland. BGE operates in the PJM Interconnection, L.L.C. ("PJM"), maintains 21,500 miles of distribution lines and almost 1,300 circuit miles of transmission lines in a 2,300-square-mile service territory. BGE provides unbundled, open access delivery service, and is a provider of last resort for customers that do not opt for alternative energy providers under BGE's retail customer choice program.

Thus, the Constellation Energy family consists of companies that have a diverse set of interests in the issues associated with POLR service design. As such, Constellation has analyzed all aspects of the POLR service design issues. While there may be multiple models of POLR service design, the best ones are those that have achieved a balance between providing fair, reasonably priced service to POLR customers and promoting competitive wholesale and retail markets that allows customers to make energy choices. The comments below in response to the Issues List reflect what Constellation believes to be the ***right balance*** to meet these objectives.

2. SUMMARY

In determining the best POLR model for Pennsylvania, the first question that must be answered is whether POLR service will be provided by the incumbent electric distribution company ("EDC") or by unregulated competitive entities. Constellation believes that the EDC should serve as the POLR Provider at this time. When the POLR Provider is the incumbent EDC, the next determination is how the EDC will procure the energy services necessary to meet its POLR obligations. Constellation believes that these services should be procured via a competitive solicitation open to all qualified suppliers. Constellation refers to this model – when the EDC is the POLR Provider and procures wholesale energy services via a competitive procurement process – as the Wholesale Model. Under a Wholesale Model, the EDC retains the obligation to provide electricity supply service to the retail customers in its franchise territory and retains the obligation to provide all the related customer care functions associated with the POLR service. Within the PJM territory and indeed throughout the country where retail access has begun, the Wholesale Model has been the prevalent POLR service design model. Alternatively, under a true Retail Model, the EDC retains no obligations to serve electricity supply to customers in its franchise territory, nor does the EDC retain any customer care obligations associated with electricity supply. The EDC's obligations are limited to those associated only with distribution service, and all the customers in the territory must select an alternative generation supply provider or all the customer accounts are bid out in some fashion to competitive electricity supply providers.

Constellation believes that a Wholesale Model for Pennsylvania is the best next step in Pennsylvania's transition to competitive electricity supply markets. Having the EDC in the role of the POLR Provider requires that there be additional elements of the POLR design that allows customers to migrate to the competitive market without impediments such as exit fees and minimum stays, and that POLR pricing reflect the full wholesale and retail costs associated with providing POLR service to retail customers. Adoption of a properly designed Wholesale Model, as described by Constellation and others during the Roundtable discussion and in these comments, will pave the way in Pennsylvania for increased, robust competition at both the wholesale and retail levels. In the future, as wholesale and retail competition increase and customers become familiar with and comfortable with the rules, risks and benefits of competitive shopping, the role of the EDC in providing POLR service will naturally decline over time and whether that role can or should continue can be re-evaluated.

Implementation of a Retail Model, on the other hand, carries with it several complex issues that are more easily addressed when large numbers of customers have become familiar with competitive markets and shopping. These complex issues include (i) which entity has the ultimate obligation to serve, (ii) customer account information ownership, and (iii) code of conduct rules associated with competitive entities providing both POLR service and competitive supply.

Thus, the objectives of a Wholesale Model POLR design are to accomplish the following:

- Provide all customer classes a fairly priced electricity service that is market responsive.
- Support robust wholesale competition as a necessary component for achieving reasonable POLR prices and promoting retail competition.
- Promote retail competition by providing accurate price signals to all customer classes and preserving customer choice.

In order to achieve these objectives, a Wholesale Model POLR Design must adhere to the following principles when the regulated, incumbent utility is the POLR service provider:

- POLR service should be a basic service offering for customers who cannot or do not elect competitive service. The same level of POLR service should be offered to all customers in a specific rate class and the incumbent utility should not be allowed to offer different levels of service or multiple products to customers within a rate class.
- Customers must be free to choose between POLR service and competitive retail service. Switching restrictions that limit a customer's ability to choose freely between POLR and competitive service should be eliminated in favor of seasonal rates and other customer migration risk mitigation methodologies that do not deter competition.
- POLR service rates should be reasonably reflective of current market rates for electricity, so as not to create unreasonable gaps between POLR prices and competitive market prices. The duration of POLR pricing for each customer class should reflect a balance between the need to minimize these price differentials, and the need to ensure that customers have the ability to obtain reasonably priced, stable POLR rates if they cannot procure this price stability from the competitive market.
- POLR service rate components should be clearly stated, and should reflect the full cost of wholesale full requirements service, transmission service, an amount that reflects the administrative costs associated with serving POLR customers (including a reasonable margin for the POLR provider commensurate with the risk assumed by the POLR provider), and taxes.
- The POLR provider's acquisition of the wholesale full requirements supply should result from a competitive wholesale bidding process.

- This competitive procurement process for the wholesale full requirements supply should be fully developed before procurement begins, including the development of a Request for Proposals ("RFP") or auction process that (i) articulates the procurement structure, bid process, contract periods, bid block sizes, and bid timetables, (ii) provides for the availability of detailed customer load data, and (iii) includes the wholesale contract to be executed between winning suppliers and the utility containing the terms and conditions of the full service requirements for POLR supply.
- The contract between the winning suppliers and the utility should provide for industry standard, comprehensive, bilateral credit and collateral provisions.

Prior to addressing the specific nature and scope of POLR service design, Constellation offers the following definitions of terms used throughout our response:

1. POLR service: The retail commodity service that a non-choosing retail customer purchases.
2. POLR Provider: The entity, currently the EDC, providing retail commodity service to the retail customer who has not chosen an alternative supplier.
3. POLR Supplier: The wholesale entity, preferably chosen via a competitive process, entering into a full requirements service contract with the POLR provider.
4. Full Requirements Service: Load following energy, capacity, and ancillary services that meet the energy requirements of each customer consistent with the market rules and regulations.
5. Wholesale Model: A POLR model in which the incumbent EDC remains the POLR Provider, and solicits the Full Requirements Service needed to meet its obligations from the wholesale market via a competitive procurement process.
6. Retail Model: A POLR model in which the an entity other than the incumbent EDC is the POLR provider and takes over the customer care and account functions as well as the obligations to procure wholesale services.

3. ISSUES LIST Responses

I. Scope of POLR Service: "[T]he commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity." 66 Pa. C.S. Section 2807(e)(2) (emphasis added).

Please address the nature and scope of the POLR obligation in regards to each of the following topics. Further parties may suggest priorities and policy goals for the Commission in regards to these topics.

Connection and delivery: Including local transmission, distribution, interconnection and metering: The obligation with respect to the connection and delivery functions listed above should remain utility functions, with the exception of metering. Transmission, distribution, and interconnection functions are "wires" functions. Even if the EDC petitions to exit the merchant and/or POLR function, these functions should still remain with the utility.

Metering, particularly advanced metering technology, is a function that can be served by the competitive market. As the retail market matures, the Commission should continue to monitor the need to develop further competitive metering in Pennsylvania jurisdictions that do not already have competitive metering provisions in their tariffs or settlements based on the specific inquiries of Competitive Metering Providers and customers.

Generation Acquisition/Supply Obligation: The acquisition of generation in order to supply POLR load should be a responsibility of the POLR Provider; however, that acquisition should be conducted via a competitive procurement process, such as an auction or RFP. It is critical that POLR customers not be burdened with paying for supply that is procured without the benefit of competitive pressure on the wholesale price for that supply.

The POLR Provider should administer such a competitive procurement process with Commission involvement and oversight. Please see our discussion in Section III below concerning the wholesale procurement process used successfully in neighboring states.

Reliability: There are two aspects of reliability in the POLR context. The first is the EDC's responsibility for maintaining reliable distribution and transmission service as the system operator. This is done in conjunction with and pursuant to the reliability rules established by the governing NERC entity and/or the Regional Transmission Organization ("RTO") in whose footprint the EDC resides and under the traditional oversight of the Commission. The second aspect of reliability is the reliability of the wholesale supply contracted for by the EDC pursuant to the competitive procurement process. The POLR Supplier(s), must deliver the Full Requirements Service (energy, capacity, and ancillary services products) in compliance with a contract between the POLR Supplier and the POLR Provider EDC, and that contract should in turn, require the supplier to meet all applicable reliability criteria established by the RTO and meet all financial security requirements of the contract.

Retail Market Support Functions: All activities currently required of electric distribution companies to support the function of competitive markets, including Demand Side Response and the maintenance of customer lists: The activities that the EDC's perform to support retail markets are "wires" functions and as such, should remain with the utility. The costs for these functions, such as enrollment, maintenance and distribution of customer lists, EGS assistance, customer assistance, EDC functions, should all be reflected in the distribution charge. All costs associated with providing the POLR service should be fully reflected in the retail POLR rate.

If the POLR model is designed properly with market responsive pricing, retail markets in Pennsylvania will flourish as EGS's participate in the market. As the retail market is re-established, demand side programs will once again become a competitive function. We have seen this development in New Jersey and in Maryland, where CNE is very active in the retail market and offers demand side products. Our view is that these demand side programs, while currently properly offered by the EDCs in the absence of a robust competitive market, should eventually be a competitive function.

Customer Care Functions: All retail customer care obligations currently assigned to electric distribution companies, including those found at Chapter 56 of the regulations: Retail customer care obligations of EDCs providing POLR service should remain a part of POLR service regardless of the identity of the provider – EDC or alternative. It is critical that the costs for these functions be fully reflected in the retail POLR rate.

At some point during this transition period, to the extent that competitive retail markets develop for residential customers, the Commission may wish to evaluate the appropriateness and relevance of the existing Chapter 56 regulations. However, at this stage of market development, it is our view that the Chapter 56 protections are an important and necessary responsibility for the POLR provider. Nevertheless, Constellation has begun a review of the existing Chapter 56 Regulations in order to provide the Commission with its views on which of the Regulations may need to be reconsidered as POLR service evolves over time, and will share those views upon the conclusion of its review.

Environmental and Conservation: Including any potential Renewable Portfolio Standard requirements and Demand Side Response: To the extent that Pennsylvania establishes Renewable Portfolio Standards ("RPS"), the standards should apply equally to all entities that serve retail customers – both the POLR Provider and those that provide competitive EGS service. POLR Providers will meet this obligation by securing the renewable requirements through their wholesale Full Requirements Service contracts. The RPS energy and compliance costs for POLR service should be included in the POLR rates, not the distribution rates. In addition to the requirement to meet any RPS requirements, competitive suppliers should be allowed to distinguish themselves with verifiable claims of environmental products and services. As is the case with Demand Side Management, Constellation's view is that the competitive market is the best provider of these non-standard renewable products or services that exceed any minimum RPS requirements. However, our view is tempered by the realities of the slow pace of market development, particularly in the small commercial and residential classes.

Customer Participation: Does POLR service extend to all customer classes?: Yes. As competitive markets develop, POLR service will be a necessity for fewer and fewer customers, and at some point, it may become inefficient to retain a service for which there are few subscribers. This, in fact, is what has occurred with respect to industrial gas customers in the upstate New York gas market, for example, where the natural gas utility provides only distribution service.

Pennsylvania has not reached that level of competitive market development and therefore POLR service for all customer classes in Pennsylvania is appropriate at this time. Nevertheless, POLR service should not inhibit the development of competitive markets by offering multiple products and services. POLR service should be a basic service with one POLR product offered to all customers in a customer class. Note, however, that as explained further below, while all customers should have access to POLR service, that does not mean that POLR product will necessarily be the same for each of the customer classes.

EDC's Participation: Should the nature of POLR service be uniform for all existing EDC's?:

POLR ***obligation*** should not vary from EDC to EDC in the interest of customer comfort with and trust in electricity markets in the Commonwealth. In our mobile society, POLR obligations that vary by EDC would be a recipe for customer confusion and dissatisfaction.

Ideally, POLR ***service*** should also be uniform across the Commonwealth, in order to maximize wholesale and retail market participation. From the wholesale perspective, the use of similar process and rules by each EDC to procure the POLR supply leads to economies of scope and scale for wholesale bidders, and in theory, this would translate into lower prices to consumers.

For retail market participants, the same POLR service design throughout the Commonwealth would also generate economies of scope and scale in terms of modeling and pricing, marketing and billing. This again would facilitate lower prices to consumers.

The fact that the Pennsylvania utilities will not reach the post-rate cap period at the same time, need not be a major concern in developing uniform procurement processes across the Commonwealth. In Maryland, rate freeze service ends at different times for different EDCs and for different customer classes within each EDC, but that has not created a barrier to uniform rules and programs. However, there are some features of POLR service that may differ among the EDCs. For instance, different EDCs have different rate classes which may necessitate the use of slightly different customer group classifications for different EDC. Nonetheless, the Commission should avoid radically different POLR programs among the Commonwealth EDCs and should adopt processes and procedures that are as uniform as possible given the structure of existing rate classes. Most importantly, the Commission should include in its POLR regulations a process that is flexible enough to be able to incorporate improvements in the POLR design to take advantage of lessons learned along the way.

II. Qualifications for POLR: A POLR may be either an "electric distribution company or commission-approved alternative supplier." 66 Pa. C.S. Section 2807(e)(3)

Please address the financial and other qualification standards for the POLR provider:

A. Reserved for Incumbent EDC

What should the requirement be for an EDC to qualify as a POLR provider? EDCs have been providing POLR service for many years, and have the systems and customer service resources in place to continue this role as the Pennsylvania market moves from the transition period of retail choice to the post transition period. There is very little need for additional requirements, except to ensure that an EDC's role as the POLR Provider does not impede the continued development of the competitive market. Along these lines, if the EDC remains the POLR Provider, it should not be permitted to market POLR service. Furthermore, the EDCs' procurement of Full Requirements Service to meet its POLR obligations should be conducted in an open, competitive process that maximizes wholesale competition. Finally, the EDCs' role as a POLR provider should not result in any degradation of the EDC's ability to provide reliable distribution and transmission service.

What are the risks and benefits of reserving this role to the incumbent? If the EDC takes on the role as POLR Provider, there is the risk that the EDC may impose barriers to the right of consumers to migrate to the competitive market. In order to ensure the continued development of a successful retail choice program in Pennsylvania, it is vital that the Commission ensure that unnecessary restrictions on the ability of consumers to migrate to the competitive market are not imposed on consumers. There must also be a clear code of conduct that ensures that the EDC provides the same level of service to competitive retail suppliers as it does to its affiliate, if it has a retail affiliate. Furthermore, if the EDC still owns generation, either directly or through an affiliate, that generation should be required to compete on a level playing field to supply the wholesale Full Requirements Service supply obligations of the EDC in order to ensure the consumers benefit from the competitive wholesale markets

The main benefit of reserving the POLR Provider role for the EDC is that the EDCs are the regulated entities with the obligation to serve. An unregulated entity does not have the same level of obligation as the EDC in this regard, and therefore a model that calls for an entity other than the EDC to be the POLR Provider must address issues associated with a default by the non-regulated entity and determine how service will be provided to customers if that should occur. Furthermore, if a non-EDC is the POLR Provider, the Commission has to consider whether the affiliate codes of conduct must be re-worked to ensure that the competitive POLR Provider does not use its access to customer information in a way that favors any of its affiliates or that unfairly inhibits the ability of other competitive suppliers to compete to serve those customers. Finally, a POLR design that has the EDC as the POLR Provider - required to conduct a competitive procurement process to secure the Full Requirements Service necessary to meet its POLR obligations - will foster the development of robust wholesale competition in the region, which in turn will support competitive retail markets.

Do any EDCs wish to be relieved from the obligation? Constellation defers to the EDCs on this question.

B. Alternative Suppliers that may serve as POLR

What should the requirements be for a non-EDC be to qualify as a POLR provider? As noted in the first section of these comments, Constellation does not believe that it is advisable that an entity other than the EDC should serve as the POLR provider at this stage of competitive transition in Pennsylvania. Rather, as each EDC completes its stranded cost recovery, it should provide POLR service to customers in its service territory who are unable to find or do not choose an alternative electric generation supplier or whose electric generation supplier fails to deliver. If, however, the Commission determines that non-EDC entities should serve as the POLR Provider, any such non-EDC POLR Provider must generally meet the qualifications outlined in the next section.

What should the process be for an alternative supplier to qualify? If market development is sufficiently advanced and an EDC petitions to be relieved of POLR responsibilities or the level of POLR service from the EDC has been reduced to a very low level that it is not economically efficient for the EDC to continue in the role of a POLR Provider, the process for the designation of an alternate POLR should involve:

- Demonstrating financial fitness by meeting credit and collateral requirements appropriate to that role.
- Agreement to abide by consumer protections contained in chapter 56 or its equivalent at the time the designation is made.
- Demonstrate operational fitness to handle all billing, collection, customer care and supply functions.
- Development of a competitive bid process, and a full requirements retail contract for serving the load.

Are there unreasonable barriers to this role, regulatory or otherwise, that the Commission should address? There are a number of issues that currently provide barriers to retail POLR service, including:

- Obligation to serve
- Access to customer load data
- Access to low income customer funds
- Priority of payment issues
- Service disconnection policies

Constellation is not recommending that non-EDC entities serve as the POLR Provider at this time in the Commonwealth and therefore does not believe that these issues need to be discussed at this time. Constellation encourages the Commission to periodically examine all elements of POLR service, in order to assess the competitiveness of the market place and determine whether any changes are corrections are required.

III. POLR Service Models

Please comment upon the form that POLR Service should take. Please consider the following models and issues:

A. Direct Assignment to EDC or Alternative Supplier – The Commission selects the POLR from applications of one or more EDCs and/or alternative suppliers

What process should be used for reviewing assignment proposals? If the Commission were to consider direct assignment to an Alternate Supplier, such an assignment could only be done on the basis of a competitive evaluation that assesses the ability of the non-EDC entity to perform the retail functions and secure the wholesale supply necessary to meet the POLR obligation. As noted throughout these comments, Constellation recommends that the POLR Provider obligation should remain with the incumbent EDCs at this time. Thus, the remaining questions in this section of the Issues List with respect to establishing prevailing market price and competitiveness of the wholesale procurement strategy and its impact on retail competitive and customer choice are addressed elsewhere in these comments, specifically in the sections that described Other POLR Models (Section III.C) and the Terms and Conditions of POLR Service (Section IV).

B. Competitive Assignment – the POLR is determined as the result of a competitive process which is open to incumbent EDCs and/or alternative suppliers.

While Constellation believes that a Wholesale Model at this time, as as the markets mature, and customers seek service from alternate providers, it may be appropriate to consider a Retail Model. If, however, the Commission determines that a competitive process should be conducted to determine whether the incumbent EDC or an Alternate Supplier is the POLR Provider, such a process should designed in accordance with same principles that apply to a competitive wholesale procurement process, with the difference being that the Full Requirements Service includes not only the generation supply, but would necessarily include all the retail services as well. In other words, a competitive process to determine who would serve as the POLR Provider(s) should be an open, transparent process in which all qualified suppliers participate on a level playing field.

C. Other POLR Service Models

- ***Please discuss existing models in states with similar regulatory frameworks that have been successful, with emphasis on rates, reliability, consumer protections, and administrative efficiency***
- ***Please identify any relevant POLR service models that have not been attempted that are worthy of consideration***
- ***Please identify any models that you deem a failure, and why?***

Constellation recommends a POLR service model that complies with the principles outlined in the first section of these comments, and that has the following features:

- Initially, the POLR provider is the incumbent EDC, as discussed fully elsewhere in these comments.
- The POLR provider procures supply to serve POLR load in a competitive procurement process administered by the EDC, with oversight by the PUC.
- All retail POLR costs are recognized in the retail rate charged to POLR customers.

While the Maryland and New Jersey POLR Service Models differ in several details, each of those models complies with the principles of POLR Service outlined in these comments and the POLR service features described above. Specifically, each of the Maryland and New Jersey models have adopted processes and procedures that require the EDC POLR Providers to conduct, with Commission and independent consultant oversight, a competitive wholesale procurement process for Full Requirements Service. In both models, the competitive procurement process for wholesale Full Requirements Supply has been fully developed before procurement begins, including:

- the development of a RFP or auction process that (i) articulates the procurement structure, bid process, contract periods, bid block sizes, and bid timetables, (ii) provides for the availability of detailed customer load data, and

- the wholesale contract to be executed between winning suppliers and the utility containing the terms and conditions of the full service requirements for POLR supply.

At the conclusion of the bidding, the confirmation by the independent consultant that the procurement process has complied with established procedures, certification by the independent consultants of the bidding results, and Commission approval all occur within two business days. The retail rates to be charged to each applicable customer group is determined based on the winning wholesale bids plus all other Commission approved fees and charges applicable to each customer group.

IV. Terms and Conditions of POLR Service: A POLR shall treat a shopping customer who returns to POLR service "exactly as it would any new applicant for energy service." 66 Pa. C.S. Section 2807(e)(4).

A. Length of POLR Service Term

Is there a recommended length? Must it be uniform across service territories? There are two separate, but inter-related, issues associated with POLR Service Term. The first issue is the length of time for which an entity should be allowed to serve as the POLR Provider. Constellation does not believe it is necessary to set a limit on the period of time for which the EDC should serve as the POLR Provider. Rather, in establishing POLR Regulations, the Commission should provide for a periodic review of the competitiveness of the market within each EDC service territory and consider whether the POLR Provider obligation should remain with the EDC, provided, however, that any change in the EDCs obligations as the POLR Provider should not impact wholesale supply contracts entered into by the EDC in carrying out is role as the POLR Provider, and further should provide for an annual review process of the wholesale procurement procedures to determine what improvements can be made to the benefit of all stakeholders and customers.

The second issue with respect to POLR service term addresses the appropriate length of contract that the POLR Provider enters into with one or more POLR Suppliers for the wholesale Full Requirements Service necessary to meet its POLR obligations. This is perhaps one of the most difficult issues to be addressed in considering POLR design, especially given the requirement of the Electric Choice Act that the POLR price reflect prevailing market prices. There is a tension embedded in this issue because longer term fixed prices for POLR customers can compromise the development of retail competition to serve that load, as has been evident in Pennsylvania given the long term fixed prices associated with the transition periods applicable to the Pennsylvania EDCs. This occurs because a long term fixed POLR price is not market responsive; when market prices go up after the fixed POLR price is established, competitive suppliers are no longer able to attract customers, whereas if market prices go lower, and customers on POLR service are allowed to switch away from POLR service, competitive suppliers are able to attract new customers and provide them with savings. However, such a structure does not present the competitive suppliers with a stable business environment upon which they can build their business – i.e., their business is "feast or famine" and it is not easy to stay and manage that instability. Likewise, wholesale suppliers who bid to provide the wholesale energy requirements to the POLR provider will also recognize that competitive suppliers will attract at least some customers away from the POLR service whenever market prices decline and will price that risk into their bids.

Nevertheless, the reality in most Pennsylvania markets is that competitive retail marketing to residential and small commercial customers has been relatively low compared to the level of marketing and service that has been offered by competitive suppliers to larger customers. Thus, it is entirely appropriate for the Commission to seek to balance these competing interests of providing stable POLR prices for residential and small customers and promoting the development of competitive markets. Pennsylvania's neighbors in Maryland and New Jersey have achieved a balance in this regard by requiring their utilities to serve residential and small commercial customers under a portfolio of contracts that vary in length from one to three years in duration, whereas POLR service for the largest customers is an hourly priced service only. Constellation considers the portfolio approach to represent an appropriate balance between the desire for fixed price service by residential and small commercial customers while not jeopardizing the development of retail competition. This portfolio approach provides for a portion of the service to be re-priced on a regular basis, serving to ensure that its remains fairly reflective of current market pricing, but at the same time provides price stability to those customer classes for which retail competition has not made significant inroads. Large Customers, on the other hand, who have demonstrated an understanding of and desire for the risks and rewards should be afforded a POLR service that provides an hourly priced service that bridges their electricity requirements when they have not chosen a competitive supplier.

Just as the role of the EDC as the POLR provider should be periodically reviewed as to its appropriateness given the level of maturity of the retail market, so should the specific contract portfolio applicable to each customer class. For example, if competitive activity for a smaller customer segment increases, it may be appropriate to shorten the length of prospective POLR contracts to make them more reflective of the prevailing market price. However, any changes that are contemplated with respect to either the portfolio of contracts or whether the EDC should continue as the POLR Provider should not interfere with existing contracts. In other words, any such changes should become effective only as existing contracts for POLR service expire.

B. Customer Migration

How should the Commission address issues surrounding customer switching, and what is the effect of the statutory language of Section 2807(4)? The statutory language that requires the POLR Provider to treat a shopping customer who returns to POLR service exactly as it would any new applicant for energy service clearly indicates that POLR design should not include any provisions that limit customer choice into and away from competitive retail service. However, all the existing POLR models have had to grapple with the difficult issue of balancing the fact that unlimited customer switching imposes significant risks on the POLR Suppliers - that causes the price of POLR service to increase - against the fact that the imposition of switching restrictions is harmful to the development of competitive markets. Both Maryland and New Jersey have avoided the imposition of customer switching restrictions while at the same time providing the POLR Suppliers with market based risk mitigation measures. The cornerstone of the market based customer switching risk mitigation measures is the implementation of seasonal rates to mitigate seasonal customer switching activity that was so problematic in Pennsylvania in the summer of 2000. Seasonal pricing, combined with other market based pricing mechanisms, should be used to provide reasonably priced POLR service while allowing customers to freely migrate into the competitive market without restrictions. Seasonal rates should initially be sufficient alone for residential and very small customers to prevent undue seasonal gaming of POLR prices. For large customers, hourly priced POLR service will ensure that POLR Suppliers are protected from undue switching risk. For moderately sized commercial customers, seasonal pricing, combined with "refreshed" POLR pricing or other volumetric pricing methodologies can provide the tools to mitigate, to a large extent, the switching risk of wholesale suppliers.

C. Customer Rate Classes and design

What should they be? Each EDC's POLR service should be designed around its existing customer rate classes. As noted in Section IV.A, the length of the POLR contract applicable to each rate class depends primarily on the extent to which customers in a rate class have demonstrated an interest in and ability to shop for their generation supply service. For rate classes that have not experienced significant levels of shopping, POLR service must balance a desire for stable, longer-term fixed prices against prices that are so long term that competitive inroads are impossible to achieve. In neighboring jurisdictions, residential and small to medium commercial customers are served pursuant to contracts that vary in length from one to three years. The largest customers in each of those jurisdictions have access to a POLR service that is (or in the case in Maryland as of 6/1/05) based on hourly prices.

For all rate classes that receive a fixed priced POLR service, the rate design should include seasonal pricing, as noted in Section IV.B

Fixed Rates – available to all, none or some? As stated above, fixed POLR rates should be available to residential and small to medium commercial customers, at least until they become more familiar with and experienced with competitive shopping. Larger commercial customers, that are sophisticated and experienced in the competitive retail markets, should be afforded a POLR service that is based on hourly prices.

Variable rates – available to all, none or some. If available, what kinds? (See discussion above.)

D. Miscellaneous

Termination – May alternative suppliers terminate service to customers for non-payment where it is acting as the POLR? As already noted in these comments, Constellation acknowledges that this issue of obligation to serve is one of the most difficult that must be addressed if the regulated EDC is not the POLR Provider. There are few jurisdictions that have adopted a true Retail POLR Model where an unregulated entity does not retain some sort of obligation to serve (and thus a default service obligation). Constellation recommends that the EDC remain the POLR Provider in Pennsylvania at this time, largely because of the complexity of the issues associated with an unregulated entity providing default service.

Information disclosure – What changes to the Commission regulations are needed? There are three important aspects to information disclosure that must be considered by the Commission in the development of a competitive wholesale procurement process. The first has to do with access to aggregate load information by potential wholesale suppliers. Specifically, the EDCs must make available to all qualified potential POLR Suppliers all existing historic hourly load data by rate class as well as all existing information about the historic levels of shopping that have occurred by rate class. The more detailed information that is made available, the more the potential POLR Suppliers will understand the load they will be serving if they are the winning bidder, and the lower their bids will be.

The second information disclosure issue has to do with the extent to which information is made publicly available about the bids submitted by potential bidders. Developing and submitting bids to serve load, especially Full Requirements Service is a highly competitive, complex, and proprietary undertaking by the bidders. It is imperative that the proprietary nature of the bids be protected by limiting their disclosure. For winning bidders, maintaining the confidentiality of bids is even more important, as the winning bidders, once determined as the winner, will seek to hedge their obligations in the market place. Such hedging activities are compromised if specific bid data is released because potential counterparties to the hedging transactions will have a competitive advantage in those negotiations. If bidders do not have assurance that their bids will be kept confidential, their hedging costs will be higher, which will translate to higher bid prices.

With respect to these two information disclosure issues, explicit information disclosure rules exist in both the New Jersey and Maryland POLR processes that should be incorporated into the Pennsylvania POLR regulations.

Finally, information disclosure requirements should ensure that competitive retail suppliers have access to all information about the competitive procurement process, including the process timeline and related documents.

Universal Service/Customer Assistance – How is this incorporated? Low income customers should not be denied the benefit of competitive markets as they develop. For this reason, all suppliers, including EGSs and POLR Providers should be granted non-discriminatory access to programs designed to assist low income consumers with their energy bills.

V. Full Recovery of Reasonable Costs: A POLR shall "recover fully all reasonable Costs" for its POLR related service. 66 Pa. C.S. Section 2807(e)(3)

POLR Cost Categories: Categories for consideration include energy, capacity, congestion, transmission, balancing, scheduling, administrative, bad debt, ancillary, POLR assignment process costs. Others?

- ***Cost Category Definitions***
- ***Standards and mechanisms for evaluating cost recovery:***

The Commission must ensure that POLR pricing reflects all reasonable costs for providing POLR service, and that the POLR Provider should be given an opportunity to collect all reasonable costs. In the Wholesale Model that Constellation recommends, in which the incumbent EDC remains the POLR Provider, the costs of POLR service fall into four categories including:

- Wholesale Supplier Costs (energy, capacity, ancillaries, losses, RPS requirements). In the Wholesale Model, all of these services are provided by the POLR Supplier pursuant to a contract between the EDC and the POLR Suppliers. The risks associated with these services and products are borne by the POLR Supplier, not the POLR Provider/EDC.
- Transmission costs (pass through of Network Integrated Transmission Costs). These are the costs imposed on all transmission customers pursuant to FERC approved tariffs (and administered by the RTO) for transmission service.
- Administrative Charge, including utility return, bad debt expense, billing and collections costs, customer account management and customer service expenses, administrative costs for transmission and wholesale supply management functions, expenses related to conducting the competitive wholesale procurement process, costs of changes to the billing system, legal/consultative, and regulatory costs related to POLR service, and a proportionate allocation of administrative and general costs. How these costs are determined and recovered is discussed in more detail immediately below.
- Taxes (Sales taxes, Gross Receipt taxes).

With the EDC as the POLR Provider, the determination of the appropriate Administrative Charge can be complex since many of the customer costs associated with providing POLR service are embedded in the distribution rates. However, when a Wholesale Model is adopted with the EDC as the POLR Provider, it is imperative that the costs that the EDC incurs to serve POLR customers be unbundled from the distribution service in order to ensure that POLR customers see an appropriate price signal against which to make competitive choices, and to ensure that POLR service from the EDC is not subsidized by the distribution rates paid by non-POLR customers.

This unbundling can be achieved in one of two ways. The first way is to conduct a cost-of service proceeding that separates the total retail service costs incurred by the EDC between those costs incurred to support distribution from those costs incurred to support POLR service. Such a proceeding would be complex and time consuming. Other jurisdictions have adopted an alternative process that avoids the complexity of such a proceeding, but at the same time ensures that (i) non-POLR customers do not subsidize the POLR service by paying for generation related services in their competitive supply contracts as well as in their utility distribution rates, and (ii) that the utility does not over-recover the costs associated with retail service. This is achieved by incorporating an administratively determined fee into the retail POLR Rates – this rate ranges in Maryland from 4.0 mills/kWh for residential customers to 6.5 mills/kWh for large commercial customers. This administrative charge represents an approximation of the costs that would result from a full unbundling of the EDCs' cost structure. However, because there is no automatic reduction of the distribution rates, the Maryland process requires the EDC to perform periodic true-ups that subtract the EDC margin and the incremental costs of POLR service from the total collection of administrative fees. Any excess collection is then refunded back to all distribution customers.

Universal Service and Energy Conservation costs: If these are part of POLR obligations, does the statutory language of Sections 2804(4) ad 2804(9(, regarding the mechanisms for recovery such costs, present any problems/issues? Constellation has no comment on this residential customer issue.

How can the Commission prevent the POLR rate from disrupting the competitive retail market?: By ensuring that the POLR rate includes all the costs associated with the provision of POLR service, in each of the categories described above, the Commission will ensure that the POLR design does not inhibit the growth and maturation of the retail competitive market. Specifically, a POLR retail rate that fully reflects each of those components as described above will ensure that retail competitive suppliers can compete to serve all POLR customers while at the same time ensuring that customers who are on POLR service receive the benefits of wholesale competition.

VI. Adjustment and Reconciliation of POLR Rates

A. POLR Rate Adjustment

Please address whether a POLR provider can request adjustment in its rates, and if so, the following issues:

- ***Grounds for adjustment***
- ***Frequency of requests***
- ***Procedure of requests and standard of commission review***

In a Wholesale Model, POLR Provider retail rate adjustments occur each time the competitive wholesale procurement process takes place. For example, in Maryland, residential prices are reset every year based on a portfolio of wholesale contracts of 1, 2 and 3 years. Prices for small C&I customers are based on a portfolio of 1 and 2 year contracts, whereas the larger C&I customers will receive a 1 year fixed price (customers between about 50-600kw) or an hourly priced service (customers larger than 600kw). Distribution rate credits are also adjusted each time there is a true-up of the actual costs to provide POLR service to the administrative charge, as described in Section V above. These adjustments, however, do not affect the wholesale price of POLR service. Pursuant to the wholesale contract developed in Maryland, POLR rate adjustments can be caused by changes to the transmission charges administered by the RTO (NITS charges), changes in the renewable energy requirements, or changes in the supply costs related to a large scale migration of customers back to POLR service. Upon submission to the Commission and verification of their accuracy, these rate adjustments should be incorporated into the retail rates. Adoption of these price adjustments in Pennsylvania would be consistent with the need to establish POLR prices based on prevailing market prices for these services, as required under the legislation under Section 2807 (e)(3).

The POLR design may also include other features that require periodic or occasional retail rate adjustments. For instance, in Maryland, POLR Suppliers are partially protected from customer migration risk via a "volumetric risk mitigation measure." When the POLR load in a particular rate classes increases beyond a specified bandwidth, the incremental load above the bandwidth is priced on a hourly basis and the impact of the hourly pricing is averaged in with the otherwise fixed price applicable to that rate class. The Maryland EDCs must file at least quarterly to reflect changes to the retail rates that result from this mechanism as well as the other types of adjustments described above.

B. Reconciliation of POLR rates

If the periodic adjustments noted above are implemented, there likely would be only a minimal final true-up required at the time the EDC ceased to provide the services of the POLR provider.

VII. Default of POLR Service Provider

Default Risk: What is the risk for potential default by alternative suppliers and EDCs? In addition to the two default situations that this question raises - default by the POLR Provider when the POLR Provider is not the EDC and default by the POLR Provider when the POLR Provider is the EDC – there is a third area of default that can occur and that is default by the POLR Supplier of the Full Requirements Service. With respect to default by the POLR Provider when the POLR Provider is not the EDC, as noted elsewhere in these comments, Constellation recommends that the EDC should be the POLR Provider (rather than an alternative supplier), largely because of the default complexities that have not been resolved that are created when the POLR Provider is not a regulated entity with an obligation to serve.

With respect to the potential default by the EDC POLR Provider or the POLR Supplier under Wholesale Model, from the standpoint of whether retail customers will continue to receive electricity service in the event of a default of either party, the RTO (PJM in the case of nearly all Pennsylvania EDCs) ensures that electricity continues to be delivered. Therefore, the focus of the Commission with regard to default should be on implementing measures to ensure that the retail customers are not economically harmed by a default of either party – i.e., if either the EDC POLR Provider or the wholesale POLR Supplier should default, there should be provisions in place to ensure that retail customers will continue to get the benefit of the bargain that was entered into during the wholesale competitive procurement process. This is achieved by including in the wholesale contract terms and conditions that require each party to post collateral that will keep the non-defaulting party whole in the event of the other party's default and subsequent termination of the contract. The energy industry has become highly sophisticated in this regard, and nearly all industry standard bilateral contracts include standardized provisions that require both parties to stand ready to meet specific collateral posting requirements. Unfortunately, in all existing POLR models to date, these industry standard bilateral credit provisions have been largely absent in POLR contracts. Specifically, while the wholesale POLR Suppliers are, in most cases, subject to stringent credit and collateral provisions, the EDC counterparties are not.

This has occurred primarily because the EDCs have convinced their Commissions that due to the regulatory oversight of the Commissions on EDC activities, it is unlikely that that the

EDCs would ever default and therefore imposing credit and collateral requirements on the EDCs would simply serve to increase the EDC costs to serve POLR load. These arguments are seriously flawed. First, credit and collateral provisions protect the parties against risk of default and the resulting inability of the defaulting party to honor its contractual obligations should bankruptcy ensue. Should an EDC default and go into bankruptcy, whether or not an EDC continues to honor its contractual obligations is governed by the bankruptcy courts, not the Commission. In such a situation, there is little that the Commission can do to require the EDC to continue honoring the provisions of the contract. Therefore, the risk of non-payment in the event of default and bankruptcy is exactly the same for each of the counterparties. If the wholesale contract does not provide the wholesale POLR Supplier with any protection against the EDC's default the wholesale POLR Supplier must factor that risk into its bids. Thus, customers pay these costs in any event. Furthermore, it is likely that customers pay ***more*** when the POLR Suppliers must factor the risk into their bids when the EDC is not subject to the same bilateral credit and collateral provisions. This is the case because a creditworthy EDC would likely incur only minimal costs to post any necessary collateral and would only have to do so when the market conditions that trigger collateral requirements occur. On the other hand, if the wholesale POLR Supplier has to factor this risk into its bids, customers pay those costs on each and every MWhr that the supplier delivers for the whole term of the contract.

Preventing Default: What extra steps, if any, should be taken to avoid this, especially where the alternative provider is the POLR? The strong bilateral credit provisions as described above, are the best protection against the risk of default. In addition, there are several features of a well designed POLR model that provide important lines of defense that limit the impact of a default on retail customers:

- Bidding rules that encourage participation by multiple entities by structuring the bidding as standard trading blocks of power (50 to 100MW). This promotes supply diversity that forms a natural hedge against supplier default.
- Contract provisions that allow a wholesale POLR Supplier to assign its POLR rights and obligations to another POLR Supplier that also meets the financial and operational requirements for POLR suppliers, so that if a default is pending, the defaulting supplier may find a replacement supplier without any change to the overall POLR pricing.
- Provisions that, in the event of wholesale POLR Supplier default, allow the remaining POLR Suppliers to elect to assume the obligations of the default supplier.

Reacting to Default: What process should be followed in the event of a default to ensure continued provision of service? Who is the replacement provider and what costs may be recovered? If the POLR design includes the bilateral credit provisions referenced above, and if the bidding process is structured to encourage wide bidder participation, retail customers will be protected from the economic harm created by a default of either the POLR Provider or the wholesale POLR Supplier. With such provisions in place, experience has shown that there should be limited circumstances in which costs in excess of the contract price will ever materialize even if a default occurs.

VIII. Implementing POLR Rules/Transition Issues

Timing and Phase-in: Give the staggered schedule for the expiration of generation rate caps, should the Commission issue POLR regulations, issue interim guidelines that would be effective until the conclusion of every transition period, or address POLR plans on an EDC by EDC basis? The Commission should expeditiously issue POLR regulations, to provide guidance to each of the EDCs as their fixed rate transition periods come to an end. The Commission should not consider delaying the establishment of regulations until all Commonwealth EDCs reach the end of the transition period as such delay would be inconsistent with the requirements of Electric Generation Customer Choice & Competition Act (Section 2807(e)(2) that required the Commission to establish POLR regulations at the end of the transition period with no specification that all utilities must be at the end of the transition period before regulations should be implemented. Customers in jurisdictions that have reached the end of the transition period deserve the implementation of a well designed POLR service that brings to them the benefits of robust wholesale and retail competition. The fact that adjacent EDCs may still be in their transition period is simply no reason to deny customers the benefits of competition in jurisdictions where the transition period is over. On the contrary, EDCs that complete their stranded costs recovery should move quickly to bring the benefits of a competitive market place to its customers.

Market Power: What are the potentials for market power concentration as well as market abuse and should they be addressed by the Commission in the implementation of POLR service? The type of competitive procurement process that Constellation has described herein will limit, if not eliminate, the opportunities for market power abuse. Also, it precludes any opportunity for affiliate abuses as well as ensuring that all potential suppliers are allowed to compete on a level playing field. In addition, the processes and procedures associated with the Wholesale Model, as described herein, would be monitored by a independent consultant during the bidding process and would be regularly reviewed under Commission supervision for the purpose of implementing any necessary improvements to those processes and procedures. Finally, complementing these structural protections inherent in the Wholesale Model, the PJM market place in which nearly all of the Pennsylvania EDCs participates, functions under specific business rule and tariffs, including a tariff for market monitoring that has the authority to report and mitigate market power abuses.

Consumer Education: What efforts should the Commission or others undertake in regards to POLR prior to implementation of regulations? The Commission should encourage the POLR Provider to provide unbiased information to customers of any changes in POLR rate methodologies, rate design changes, switching restrictions, or other open access rules that are to be implemented as soon as such changes are known. EDC's should not delay release of this information to consumers. Such information should be developed, or at a minimum, reviewed by a Working Group open to all market participants such that consumers get the benefit of clear, unbiased information. The Working Group should also be charged with facilitating, with Commission oversight, customer information and education meetings. Unfortunately, our experience in other jurisdictions is that some EDCs have held unilateral and exclusive meetings particularly with large customers. These types of meetings do not help develop customer confidence in the market and they have the unfortunate and unintended effect of introducing inaccurate information into the markets.

Existing/Pending POLR Plans: How should the Commission address POLR plans that may be in operation at the time regulations go into effect? POLR regulations as developed by the Commission should be applicable to each EDC upon completion of its transition period. Until such regulations are in place, the Commission should not approve any post-transition plan that would extend well beyond the time period when these regulations will be in place.

4. CONCLUSION

Constellation appreciates this opportunity to share its experiences serving POLR load and serving retail customers with the Commission, both in these written comments and at the Roundtable discussions. Constellation urges the Commission to adopt as quickly as possible POLR regulations that will bring the benefits of wholesale and retail competition to consumers in the Commonwealth of Pennsylvania.