

COMMONWEALTH OF PENNSYLVANIA



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The Office of Small Business Advocate (“OSBA”) offers the following reply comments to testimony presented, and questions raised, at the June 2, 2004, session of the POLR Roundtable.

I. Funding of Universal Service Programs

Speaking on behalf of the Pennsylvania Utility Law Project, Attorney Harry Geller recommended that the POLR Regulations promulgated by the Public Utility Commission (“Commission”) include a requirement that all customer classes contribute toward the cost of universal service programs. In response to a question from Commissioner Pizzingrilli, Mr. Geller cited PGW as a potential model for implementing his recommendation.

The OSBA is opposed to Mr. Geller’s recommendation for the following reasons:

1. Funding universal service programs through utility rates (rather than through taxes) is similar to the concept of insurance: ratepayers pay “premiums” when they can afford to do so in exchange for “benefits” to help them pay their utility bills when their individual economic circumstances require. Because all residential ratepayers theoretically could need such assistance, there is a logic to making all residential ratepayers contribute toward the program’s costs. However, small commercial and industrial customers are ineligible for assistance through gas and electric universal service programs. Because they can not share in the financial

assistance, it would be unfair to divert small business ratepayer dollars to cover the cost of universal service programs. Except for PGW, the Commission has recognized that inequity and has not required small business ratepayers to pay for universal service programs.¹

2. Implicit in Mr. Geller's recommendation is the notion that there is a "societal good" or an "economic self-interest" justification for making small business ratepayers contribute to the cost of universal service programs. Both of those "justifications" ignore the fact that small business ratepayers are already subsidizing residential ratepayers in a major way. Specifically, viewed from a cost-of-service basis, the small commercial and industrial electric customer classes are paying rates which generally provide a rate of return well above the system average. In contrast, residential electric customers are paying rates which usually provide a rate of return well below the system average.

3. Even if the Commission were to require small business ratepayers to contribute to the cost of universal service programs, PGW should not be the model. On June 2, 2004, the Commission entered an order initiating an investigation of PGW's poor performance in collecting bills owed by the utility's customers. In launching that investigation, the Commission pointed out that PGW's universal service programs cost more than all of the other gas universal service programs in Pennsylvania combined. *See, Investigation into Financial and Collections Issues Regarding the Philadelphia Gas Works*, P-00042090, R-00049157, M-00021612, and P-00032061, Order entered June 2, 2004, pp. 5-6. Using the burdensome PGW universal service programs as a model would risk causing PGW-type financial problems for other utilities.

¹ Even in the case of PGW, however, the universal service funding model was *inherited* by the Commission, i.e., the funding program was approved by the Philadelphia Gas Commission.

II. Designing Seasonal Rates

Both Chairman Fitzpatrick and Commissioner Thomas raised questions regarding the use of seasonal rate differentials.

Although numerous participants in the POLR Roundtable advocated seasonal rates as a replacement for switching restrictions, none of the proponents adequately described how seasonal rates should be incorporated into a POLR rate structure. The OSBA has previously cautioned that while seasonal usage is *one* factor to be considered in POLR rate design, in no event should seasonal rates be implemented in isolation, solely as a vehicle to abolish existing switching restrictions.

Furthermore, before it adopts seasonal rates, the Commission needs to consider the appropriate size of the differential between winter and summer rates. In order to mitigate the adverse effect on small business customers which can not significantly reduce consumption on a seasonal basis, the differential should be based on cost-of-service factors and not simply set administratively at whatever level is deemed to be necessary to discourage gaming.

The Commission should also take account of the fact that only one EDC in New Jersey (Public Service Electric and Gas) imposes a demand charge for small commercial and industrial customers and that demand charge is minimal in comparison to the demand charges imposed by numerous Pennsylvania EDCs. (See Table 1 below.) The absence of a demand charge, or the imposition of only a minimal demand charge, works to mitigate the adverse impact of seasonal rates on small business customers in New Jersey.

If the Commission decides to implement seasonal rates, the Commission must first identify the valid cost-of-service determinants to be considered when designing POLR rates.

The Commission must also decide how seasonal usage should properly figure into the rate design mix.

In an attempt to fill some of the gaps in the record with regard to these important details, the OSBA offers the following simplified discussion of the POLR rate design methodology currently in use in New Jersey.² The discussion is presented only as an illustration; the OSBA is not advocating that the Commission adopt the New Jersey approach at this time.

A. The New Jersey Approach

Prior to the wholesale auction to procure POLR supply, each EDC estimates the cost of obtaining 100% of its POLR requirements in the PJM market. The purpose of this exercise is *not* to determine the actual price of POLR supply, for that will be determined via the auction. Rather, the purpose is to determine the *relative* cost of supplying each of the rate classes which will be eligible for fixed-price POLR service. These relative cost measures are then utilized in conjunction with the wholesale winning bid price to design POLR rates, by rate class.

As a first step, the EDC prepares various data or inputs for each of its fixed-price classes. Such information includes, but is not necessarily limited to, the following: a) an updated monthly load forecast, assuming all customers in a given class will require POLR service; b) the percentage of on- and off-peak period usage, by rate class; c) the percentage of summer versus non-summer usage, by rate class; d) class loss factors; and e) PJM generation capacity obligations, by rate class, based on the above load forecast. It should be noted that seasonal usage information (Item c) is just *one* of five factors which will be reflected in the final POLR rate design.

In addition to the above class load-profile data, the EDC gathers projected PJM on- and off-peak energy prices (by month) and projected PJM capacity prices (by season). These energy

² The New Jersey methodology described herein applies to fixed-price POLR service only.

and capacity *prices* are then multiplied by class *usage* to determine the total cost of each class's POLR requirements. Dividing total cost by kWh supplied then produces an average cost per kWh, by rate class.³ At the same time, the hypothetical system average POLR cost per kWh is determined using all classes eligible for fixed-price service.

In a final step, the EDC divides each class's average POLR cost per kWh by the system average to determine the relative cost of serving each fixed-price POLR service rate schedule. Depending on the nature of a class's load profile, as summarized via the above inputs, and the relative market price of on- and off-peak energy, etc., a given class may have a relative POLR cost ratio above or below the system average. Whatever relative cost ratio a class earns via the above exercise, *the EDC will assign the same multiple to the subsequent winning auction bid price to determine the class's actual POLR rates.*⁴ In other words, the goal of the New Jersey rate design methodology is to develop market-oriented POLR rates for each rate class, i.e., rates which are generally reflective of relative market prices rather than rates which are derived from the results of a previously approved embedded cost-of-service study.

B. Actual June 1, 2004, New Jersey POLR Prices

Table 1 summarizes the POLR rates applicable to small commercial customers in New Jersey, beginning June 1, 2004. It should be noted that these charges include all generation- and transmission-related services, including ancillary services, as well as applicable taxes. It should also be noted that the actual charges reflect the *blended* results of two separate auctions.

³ For simplicity, this discussion ignores the cost of transmission and ancillary services which are included in the New Jersey methodology to determine an "all-in" (rather than generation-only) class average cost per kWh.

⁴ For example, if a given class exhibits a relative cost ratio of 1.10 times (or 110% of) the system average, this same class will be assigned an actual POLR price equal to 110% of the winning wholesale auction price.

Table 1

<i>EDC Rate Schedule</i>	<i>Summer Energy \$/kWh</i>	<i>Winter Energy \$/kWh</i>	<i>Summer Demand \$/kW</i>	<i>Winter Demand \$/kW</i>
Conectiv MGS-Secondary Jersey Central GS	\$0.074419	\$0.052284	None	None
Public Service GLP Rockland Rate Sch. 2-ND	\$0.069922	\$0.051170	\$1.1321	\$0.5470
	\$0.063880	\$0.046930	None	None

In essence, these fixed-price POLR rates were established by applying the multipliers obtained from the above-described rate design exercise of each EDC by the actual winning auction price for a slice of that EDC's system. Importantly, the resulting seasonal rates reflect only the average expected difference in seasonal market prices. No attempt is made to time-differentiate rates within a given season.⁵ As such, customers are charged the average summer rate for all usage, whether or not such usage falls within PJM's actual on-peak hours.

III. Definition of Small Business

During questioning of Keith Dorman (KLE Management Group) and Cliff Shannon (SMC Business Councils), the Commission staff sought guidance regarding where to draw the line between those businesses which should have the benefit of POLR prices fixed for at least one year and those businesses which might be exposed to some form of real-time pricing. Mr. Dorman suggested that the line should be drawn somewhere within the range of a 300 kW to 1,000 kW load. Mr. Shannon agreed that that range could be a starting point; but he cautioned that the appropriate definition of small commercial customers is murky, at best.

⁵ Indeed, none of the fixed-price POLR rate classes possesses the interval metering capability necessary to implement time-of-day pricing.

If the Commission decides that POLR rates for higher load customers should be based on real-time pricing, the Commission should take account of the infrastructure costs associated with such pricing. Infrastructure costs fall into two primary categories: 1) the cost of interval meters (including installation); and 2) the cost of billing system upgrades necessary to process hourly data. Although some Pennsylvania customers already have interval meters, their load sizes vary widely across EDCs. For example, Duquesne Light Company has installed meters capable of real-time pricing for customers with loads of 300 kW or greater. In contrast, PPL does not install such meters for any customer class below Rate LP-4; Rate LP-4 has average customer loads of approximately 1 MW. Accordingly, the currently installed interval meter base in Pennsylvania does not provide a clean point at which to draw the real-time pricing line.⁶ An alternative, i.e., requiring all EDCs to provide interval metering capability for all customers of a given (or greater) size, would be costly. Installing such meters for small business customers would also probably be unproductive because the additional monthly metering cost would be likely to outweigh any energy cost savings which might result from the customer's limited ability to shift load in response to peak period prices.

Finally, interval metering alone does not translate into real-time pricing capability. The EDC's billing system must be able to process the tremendous amount of additional data which is needed to properly bill a real-time pricing customer. Even if the EDC currently provides a real-time pricing option, that does not mean that the EDC's incremental billing system costs would be negligible. There is another variable: the number of customers for which such billing is provided. It is, for example, one thing to bill on a real-time basis for a handful of customers on an experimental tariff; it is quite another to process the same information for hundreds, if not thousands, of new real-time pricing customers.

⁶ In New Jersey, the line is currently drawn at 1,500 kW; i.e., all customers with loads of 1,500 kW or greater are *ineligible* for fixed-price POLR service.

For all of the above reasons, the OSBA recommends that the Commission tread carefully in the area of mandating that certain size customers on POLR service be subject to hourly pricing.