

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**POLR of Last Resort Roundtable**

**Docket No. M-00041792**

**Reply Comments**

**On behalf of Metropolitan Edison Company, Pennsylvania Electric Company and**

**Pennsylvania Power Company –**

**The FirstEnergy Operating Companies**

**June 17, 2004**

## **INTRODUCTION AND SUMMARY OF REPLY COMMENTS**

Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (“the FE Operating Companies”) commend the Pennsylvania Public Utility Commission (“Commission”) for its thorough and efficient review of POLR issues through the Roundtable process. Not unexpectedly, diverse viewpoints have been shown to exist on virtually every issue associated with POLR service.

The Roundtable highlights the need for the Commission to promulgate regulations in the near term that will provide a measure of guidance to all stakeholders in the POLR process on several basic issues. Immediate action is necessary because the post-transition POLR period has already commenced for EDCs such as Duquesne Light. At the same time however, the Commission’s POLR regulations must retain the flexibility needed to address differences among EDCs and allow an evolutionary approach to certain POLR service issues as EDCs come off their rate caps at different times.

Consistent with this general framework, the FE Operating Companies agree with those Commentators that urge Commission promulgation of regulations that resolve several basic issues in the following manner:

- The regulations should confirm that EDCs shall be the POLR service providers and continue in that capacity until it is determined in an on the record proceeding that POLR service may be provided by some other entity;

- The regulations should provide a basic definition of POLR service consistent with Section 2807(e)(3) of the Public Utility Code;
- The regulations should approve an auction process as an acceptable means, which would be a “safe harbor”, of acquiring electricity for POLR service at prevailing market prices while allowing POLR service providers the option of pursuing, in whole or in part, alternative acquisition methods; and
- The regulations should provide a limited reconciliation for POLR costs and confirm that hourly market prices are appropriate for large customers.

Other POLR issues such as auction details, cost allocations, rate design, credit provisions and switching policies are better addressed through annual POLR proceedings, coordinated with the auction process, that allow a flexible, evolutionary approach to these important issues. Therefore in addition:

- The regulations should establish an annual procedural process through which each EDC would submit a POLR proposal which the Commission would review prior to implementation.

In summary, the Commission’s regulations should make several important initial policy decisions but retain, through use of annual POLR process, the flexibility to adjust acquisition methods, rate design, credit rules and other factors as more experience is gained in the post-transition period.

### **The EDC as POLR Provider**

Although a few POLR Roundtable participants have urged the Commission to retain long-term flexibility on the issue of who may be the POLR service provider,<sup>1</sup> (a proposition with which the FE Operating Companies cannot disagree), the

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<sup>1</sup> The National Energy Marketers Association, Comments p.5 (Metering and customer care are competitive functions that should be provided by the competitive marketplace); Centrica, Presentation Slide 9 (The Commission should not assume the EDC must be the POLR provider); PPL EnergyPlus, LLC, Comments

preponderance of opinion in this Roundtable is that the EDC should continue in its role as the POLR service provider at the end of the transition period. The POLR regulations should confirm that, post-transition, the EDC shall continue its role as POLR until otherwise directed by the Commission.<sup>2</sup> In support of this position, the Commission may properly point to the intrinsic linkage of customer care, Chapter 56 requirements and the role of the EDC as owner and operator of the energy delivery system.

This stance by the Commission would not deny any other entity the opportunity to propose, in on the record proceeding, the assumption of POLR responsibilities.

### **The Commission Should Establish the Definition of POLR Service**

The general parameters of POLR service is defined by statute. Section 2807(e)(3) of the Public Utility Code, 66 Pa. C.S. §2807(e)(3), states that the EDC is to acquire electric energy at prevailing market prices to serve customers whose “electronic energy...is not delivered” or a customer who “does not choose an alternative electric generation supplier...”. While virtually all presenters acknowledge this role for POLR service providers, there are indications that in the minds of some parties, the POLR role is viewed not as a backstop, but as a service that effectively is in competition with EGSs. For example, the OCA asserts that “a customer does not have to leave his or her retail electric distribution company (EDC) in order to get access to the competitive generation market.”<sup>3</sup> If POLR service was intended to be the equivalent of competitive service, it

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p. 4 (Metering, billing, customer care and reconciliation functions should be unbundled and provided by the entity most efficient and effective at providing these services); and Calpine Corporation, Comments p. 3 (The Commission should not close the door forever to some entity other than the EDC being the POLR provider).

<sup>2</sup> The Commission is specifically authorized by law to select an alternative POLR service provider. 66 Pa.C.S. §2807(e)(3).

<sup>3</sup> OCA Presentation Slide 6.

would be entirely inappropriate to limit the marketing of POLR service or the number of rate design options offered by EDCs. However it is commonly asserted that these types of limitations should be placed on POLR providers.<sup>4</sup> Therefore in addition to defining what POLR service is, it is important for the Commission to be clear as to what POLR service is not. It is not a service offering that is to be compared to EGSs offerings to determine its reasonableness, nor should the EDC be subject to a POLR cost prudence review that is analogous to the kind of review a monopoly service POLR should be subjected.<sup>5</sup> While the wholesale supply for POLR service may be competitively obtained through an auction or RFP process, the retail service itself is a regulated service which must be offered to all and supplied to all who request it with full cost recovery.<sup>6</sup>

### **The Requirement of Hourly Prices to Communicate Price Signals to Large Customers Is a Necessary Policy Decision**

The use of hourly market prices for large commercial and industrial POLR customers has gained broad acceptance among the Commentators.<sup>7</sup> The industrial participants themselves however, prefer hourly prices to be merely one option among other fixed price choices large customers would have for POLR service. The position is not surprising given that EGSs cannot be compelled to provide fixed price options, which satisfy some large users interest in rate stability and budget limitations. The reality of this issue is that establishing multiple POLR rate options for customers is inconsistent

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<sup>4</sup> Amerada Hess Corporation, Presentation Slide 2 (The POLR provider should not market POLR service).

<sup>5</sup> Mirant Corporation, Comments p. 9 (“Last resort” price contrasted with “lowest possible price”).

<sup>6</sup> This is an important distinction. Even prior to restructuring, some states required vertically integrated utilities to utilize competitive bidding to obtain new power supplies. This did not change the nature of the service being provided to retail customers.

<sup>7</sup> Maryland Public Service Commission, Presentation Slide 8 (Hourly priced service only option for large C & I customers after first year); Centrica, Presentation Slide 8 (Large commercial and industrial prices should be established at hourly wholesale prices); Dominion Retail, Presentation Slide 5 (POLR service best meets the prevailing market price definition if it is a price that changes every hour); Constellation Power Source, Inc., Presentation Slide 7 (Largest customers should have spot market priced POLR service); and Amerada Hess, Presentation Slide 4 (Hourly pricing for large commercial and industrial).

with the concept of POLR service. The availability of several POLR options would pit the EDC POLR against EGSs as an additional competitive provider. This is not the function of POLR service.

Giving large customers only one POLR rate option may not meet all the needs of all large customers – however that is not the purpose of POLR service, a plain vanilla, back stop service that is acquired for the customer at prevailing market prices.<sup>8</sup>

Hourly prices provide the most accurate market signals to customers that are best positioned to react to such signals by modifying their consumption or obtaining alternative supply arrangements. Smaller users are not ready at this time for the POLR ideal of hourly prices, however this is a direction in which POLR service must head and the Commission must lead the way by establishing the proposition in its regulations that the POLR option for large customers is an hourly price regime.

**The Commission Should Confirm the Auction Process as a Reasonable Means of Acquiring Energy for POLR Customers, While Allowing POLR Providers the Option of Proposing Alternative Methods**

The Roundtable comments have demonstrated that a variety of acquisition methods may be used to obtain POLR supply at “prevailing market prices”, including auction, RFP, bi-lateral agreement and spot market purchases. The auction method however is widely supported and has particular distinction for several reasons.<sup>9</sup> First, it is

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<sup>8</sup> Constellation NewEnergy, Inc. Presentation Slide 8 (All customers in a customer class should receive the same POLR service); and PSEG Energy Resources & Trade LLC, Comments p. 10 (POLR service is a “plain vanilla” service).

<sup>9</sup> Select Energy, Inc., Presentation Slide 6 (New Jersey BGS auction has worked successfully from the NJBPU, EDCs and suppliers’ perspective); Constellation Power Source, Inc., Presentation Slide 6 (General support for a bidding process); Amerada Hess Corporation, Presentation Slide 5 (The Commission should consider a competitive bid process for generation procurement); Calpine Corporation, Comments p. 2 (a competitive RFP/competitive bidding approach provides the best assurances that appropriate POLR customers benefit from the existence of competitive wholesale electric markets); PSEG Energy Resources & Trade LLC, Comments p. 8 (The auction design used in New Jersey for the procurement of BGS offers many salutary features that should be considered by the Commission); and Office of Small Business

the method most often cited by Commentators as a preferred method of acquiring POLR energy on competitive terms and conditions. Second, it provides a process that can be readily monitored, administered and verified by the Commission to ensure non-discriminatory results. Third, multiple EDCs can easily use an auction process simultaneously over a region, to ensure that the best market prices are obtained by EDCs on a statewide basis. Finally, other states within PJM have had good experience with using a competitive auction to obtain POLR service.

Therefore, the Commission's regulations should confirm that an auction process will be conducted as the basic means by which EDC may acquire POLR energy at prevailing market prices. To ensure a full competitive environment all suppliers should be encouraged to participate, including the affiliates of EDCs. At the same time, the regulations should permit individual EDCs to propose for Commission review and approval, alternative methods of obtaining POLR supply, including only partial reliance on the auction method. Flexibility for EDCs on this issue is particularly important to a company such as Penn Power, which cannot be certain that its RTO, MISO, will be positioned to coordinate with a Pennsylvania auction process.

### **The Commission Stance on POLR Rate Reconciliation Should Be Established Now**

As stated above, the Commission's initial POLR regulations should clarify that EDCs shall continue as POLR providers, address the definition of POLR service and confirm auctions as reasonable means of acquiring POLR supply. In addition, the regulations should clarify the limited role a reconciliation mechanism will play in POLR rates.

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Advocate, Presentation Slide 10 (The POLR should acquire energy through an open competitive auction or RFP).

Roundtable Commentators have taken various positions on the wisdom of either freely allowing or prohibiting reconciliation of POLR rates.<sup>10</sup> Neither extreme position would be prudent. Opponents of reconciliation argue that after the fact adjustments of rates destroy market signals and prevent proper customer evaluation of alternative supply sources. However, an EDCs' recovery of its actual POLR expenses should not be unduly risky, as it would be without any recourse to reconciliation. The amounts at issue are likely to be of significance to the EDC, but not to individual customers. Without any reconciliation, an EDC will have an incentive to set high POLR rates and overall capital costs will increase. A reconciliation will help moderate rates while ensuring full cost recovery for the EDC.

Good policy falls between these positions. Reconciliation of POLR costs should be permitted but only under narrow circumstances involving reasonably unanticipated events or extraordinary events such as defaults by suppliers or other sudden losses of supply. The Commission's regulations should confirm that a reconciliation of POLR rates and costs may be requested and approved, not on a routine basis, but when warranted by that EDC's circumstances. Reconciliation has not harmed the functioning of the competitive market in New Jersey.

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<sup>10</sup> PPL Electric Utilities Corporation supported a fairly broad reconciliation process, Comments pp. 17-18; Constellation NewEnergy, Inc., Presentation Slide 10 (If no explicit cost allocation, a true up is necessary); PPL Energy Plus, LLC, Comments p. 5 (If POLR supply is based on the real time cost of providing that service, minimal adjustment or reconciliation of POLR rates is required); Calpine Corporation, Comments p. 5 (POLR rates should only be adjusted at RFP intervals. POLR rates could be fixed if the obligation were bid); and PSEG Energy Resources & Trade LLC, Comments p. 13 (It would be reasonable to allow for certain changes in the non-commodity portion of wholesale POLR service).



## **An Annual EDC Proceeding Coordinated With the Auction Process Can Resolve Many Other POLR Issues that should be Treated on an Evolutionary Rather Than a Static Basis**

An overarching issue on which the Commentators have opined is the question of which POLR policy issues should be decided now and in what detail. Some presenters have urged deferral of detailed regulations and have cited differences in thinking between the initial phases of competition and current thinking to illustrate this point. The FE Operating Companies agree that a number of the important issues discussed in the Roundtable should not be controlled in a static fashion by regulations. The regulations should provide for an annual proceeding that allows an evolution in thinking on issues such as each EDC's specific requests for auction bids, cost allocation, rate design that would incorporate the auction results, switching terms and credit requirements. The regulations should make it clear that these issues and others that may not currently be on the visible horizon are to be resolved in these annual proceedings. The annual proceedings for each EDC could be scheduled so that they were initiated and resolved sufficiently in advance of an annual auction so that the auction can be coordinated with the outcome of these proceedings.

### **CONCLUSION**

Regulations should be promulgated now that resolve certain important basic issues now such as who will be the POLR service provider, what is POLR service, the availability of an auction process, the use of reconciliation and hourly market rates for large customers. These regulations, together with regulations that allow other POLR issues to evolve on a dynamic basis, is the right combination of specific direction and flexibility that will produce good POLR service policy for Pennsylvania.

Met-Ed, Penelec and Penn Power thank the Commission for an opportunity to present these reply comments in this proceeding and look forward to continued participation as this important issue moves forward.