BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. § 2807(e)(2)	))))))	**Docket No. L-00040169**

REPLY COMMENTS OF DUQUESNE LIGHT COMPANY

Pursuant to the Commission's December 16, 2004 Proposed Rulemaking Order issued in the above-captioned docket, and the Commission's May 16, 2005 notice extending the date for submitting reply comments, Duquesne Light Company ("Duquesne") submits the following comments in response to those submitted by other participants in this proceeding on April 27, 2005 regarding the proposed rules governing the obligation of electric distribution companies ("EDCs") to serve retail customers at the conclusion of their respective transition periods. Duquesne's primary comment on the Commission's proposed rules – that they should include flexibility and assessment of alternative programs, particularly in the period prior to 2011 when all EDCs in the Commonwealth will complete their transition periods – finds considerable support in the comments received by the Commission on April 27. Based on its extensive experience with post-transition period provider of last resort ("POLR") service, Duquesne believes the Commission should maintain flexibility in its default service regulations and encourage the industry to seek areas where uniformity can be

incorporated into the regulations for the state-wide post-transition period (beginning in 2011).

I. FLEXIBILITY IN THE DEFAULT SERVICE REGULATIONS, PARTICULARLY PRIOR TO STATE-WIDE COMPLETION OF TRANSITION, WILL SERVE THE GOALS OF THE COMPETITION ACT

As Duquesne described in its initial comments, there are several primary areas in which flexibility is needed in the development of default service regulations for the period prior to state-wide completion of the transition period. First, the Commission should discard its proposal that the *only* way to procure power for POLR customers is through a wholesale competitive solicitation. Though Duquesne agrees that a competitive solicitation process is *one* reasonable way to procure power, it is not necessarily the *most* reasonable method for all utilities under all market conditions. Indeed, in Duquesne's POLR III proceeding, the Commission explicitly recognized that "a competitive procurement process is not the exclusive method to arrive at a prevailing market price." Reconsideration Order at 26. Second, Duquesne suggested several modifications to the supplier gaming provisions that will allow EDCs the flexibility to propose reasonable protections that balance the desire to allow customers to freely switch suppliers with the protections needed to ensure that default service can be provided at a reasonable cost. These modifications are necessary to ensure that EDCs are not subsidizing competition.

The flexibility recommended by Duquesne is supported by the circumstances presented by the current retail choice marketplace. EDC service areas are not similar in

size or location, and may not be compatible with a competitive procurement process. As many parties have noted, transition periods terminate at different times, making it difficult to even discuss uniform terms and conditions of procurement in the short term. EDCs are located in different markets and their rate designs and customer bases vary considerably. Some EDCs have generating affiliates that will participate in a procurement process while others do not. Hourly pricing is practical for some EDCs but not others. Some EDCs are willing to accept the risks associated with non-reconcilable generation charges, while others are not. Moreover, the Commission must balance competing objectives sought by the different participants in this proceeding. For example, certain parties emphasize rate stability and the continued role of the EDC as the default service provider. OCA at 1-2; OSBA at 3-4 (noting the Competition Act's goal of reducing rates rather than promoting retail competition). Others argue that retail switching levels are the sole benchmark of retail competition's success. Dominion at 8-10; SEL at 2 (expressing its goal for all consumers eventually to be served by a competitive supplier). Still others believe default service customers, while opting not to participate in retail competition, should benefit from competitive market forces at the wholesale level. Const. at 2. These varied circumstances and competing goals color the recommendations received by the Commission, and they should be kept in mind as final regulations are developed.

Notwithstanding the variety in circumstances and opinion of the EDCs, customer groups, and other market participants, Duquesne acknowledges the value in standardizing certain aspects of default service. There will undoubtedly be less

confusion, lower transaction costs, and increased fairness to customers, suppliers, and EDCs if there are some uniform practices and protocols within Pennsylvania. The question, however, is whether a single approach to default service is advisable now, even though most customers in Pennsylvania will not be subject to that approach until 2010 or 2011. In the intervening five or six years, many events may influence the development of the retail marketplace and therefore the development of regulations that are best suited to Pennsylvania's electric consumers. As described by Duquesne, a number of other default service models in other states are being developed, and the results from those jurisdictions will be available to the Commission. *See* DLC at 18-20. Retail and wholesale markets will continue to evolve, and new rules, regulations and laws will be enacted. But most importantly, with the Commission's assistance in the intervening period, a consensus could be reached among EDC, consumer and supplier groups that will result in standard rules and protocols in the areas in which the parties currently disagree.

Rather than attempting to craft a resolution of all the issues now, Duquesne recommends that the Commission explore areas in which consensus may be reached in an open, state-wide process on several key topics. These could include standard supply contract terms and conditions, the types of service to be offered, the term of such services, and switching rules. If a consensus resolution is not reached, the Commission could mandate an approach at a time that is closer to the date of implementation of state-wide default service plans. In the interim, as Duquesne has suggested, a tailored approach should be adopted for default service plans that are ripe for Commission

resolution before the remainder of the state completes transition ("interim default service plans").

Critical to Duquesne's recommendation, however, is a Commission acknowledgement that each interim default service plan will stand on its own. It will be difficult, if not impossible, for interim default service plans to navigate the administrative process if every commentor in this proceeding participates under the impression that such interim plans will be used to set precedents for the entire Commonwealth. Citizens' Electric and Wellsboro Electric, which also expect to submit interim default service plans, share this concern. Citizens' and Wellsboro at 11. Duquesne therefore urges the Commission to state that default service plans addressed prior to the adoption of final regulations will not bind parties that later litigate plans offered by other EDCs.

II. Specific Comments

In the preceding section, Duquesne proposed a comprehensive set of regulations that will allow flexibility in the short term, while working toward a consensus resolution of state-wide protocols in the long term. In this section, Duquesne highlights a number of critical issues raised by commentors on the current proposed regulations. Duquesne offers its view on several such key issues below. Duquesne has reviewed all of the comments received, however, and is willing to participate in further Commission

proceedings to craft a consensus resolution to the broad range of additional issues raised in the comments on the Commission's initial proposal.[1]

A. Prevailing Market Price

1. Competitive Solicitations Should Not Be Mandatory

Duquesne devoted much of its initial comments to its view that mandatory competitive solicitations should not be the sole method of determining prevailing market prices. Ignoring other available methods for discerning the prices that prevail in a given market exposes the Commission and the Commonwealth's consumers to processes that (1) are not always successful in stimulating retail competition, (2) do not always produce acceptable results, and (3) can be hampered by lack of creditworthy entities. Many participants in this proceeding recognized the potential pitfalls in mandatory competitive solicitations, and therefore voiced support for a proposal that would allow supply acquisition strategies that do not necessarily include one. Importantly, the Office of Consumer Advocate ("OCA") recommends that EDCs be permitted to acquire supply using RFPs, auctions or bilateral negotiations with non-affiliates (at 2-3, 37). The OCA also encourages the Commission not to discourage long

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[1] Duquesne disagrees, however, with the attempt of some participants to broaden this proceeding to include any and all issues relating to the provision of competitive service in the Commonwealth. *See, e.g.*, Direct Energy at 14 (requesting that the Commission order competitive metering by the end of each EDC's transition period); MAPSA at 7-8 (requesting that its comments in the customer usage information docket be incorporated and "resolved" in this docket as well); Nat'l Energy Marketers at 5-6 (requesting conditions on EDC transmission and distribution rate cases); SEL at 20 (seeking new process for selecting suppliers); MAPSA at 10-11 (addressing New Jersey standards for affiliate relations, accounting and reporting requirements). These efforts should be rejected.

term planning by requiring short term only purchases (at 6-7). The EAPA supports additional flexibility in the supply acquisition regulations (at 4-5), as does the Allegheny Conference on Community Development (at 2), and Reliant (at 33-35). *See also* Direct Energy at 10-11 (noting that competitive solicitations have not fostered a competitive retail market for small customers). PPL also advocates leaving open the possibility that bilateral contract negotiations might be a better option depending on the circumstances (at 8-9), as does UGI (at 8). For the reasons set forth in its initial comments, Duquesne agrees with these opinions and urges the Commission to follow them.

Though a number of parties support the use of a competitive procurement process,[2] implementation of a mandatory competitive wholesale procurement process may result in a significant step backward in retail competition in Duquesne's service territory. Duquesne has the highest level of customer shopping in the Commonwealth, with over 40 percent of its customer load receiving service from an EGS. The default service regulations should enhance this development while balancing the needs of customers. Duquesne's POLR plans have demonstrated that default service customers can receive the price protection they need while retail competition is promoted. The Commission should not tie Duquesne's hands after it has achieved such superior results.

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[2] *See* OSBA at 6; Allegheny at 2; Morgan Stanley at 2-3; Exelon at 3-4; Constellation at 6-7; Amerada Hess at 16; Dominion at 3.

2. State-Wide Procurement Processes

The Commission received considerable commentary on whether a state-wide procurement process might be beneficial once the state completes its transition. The participants appear evenly split between those who believe a state-wide procurement process, or at least one involving the larger EDCs, should be adopted, and those who oppose state-wide supply procurement. For example, the OSBA believes a state-wide process should be required when all EDCs complete the transition period. OSBA at 7; Direct Energy at 12; see also Constellation at 7 (supporting proposed regulation); SEL at 4-5 (suggesting the PUC explore state-wide procurement processes). Taking the contrary view is the OCA, which argues that the Commission should not have the authority to order joint procurement plans. OCA at 35; *see also* UGI at 7-8; Exelon at 4; IECPA at 5; Citizens and Wellsboro at 8-9; Allegheny at 4; Reliant at 33-35 (favoring discretion for supply procurement).

Duquesne agrees with the position articulated by the EAPA, which contends that a multi-service territory plan should only occur at initiation of affected EDCs. EAPA at 5-6. If the affected EDCs believe a joint procurement process will result in greater participation and more competitive results, and if the engineering and operational considerations between the EDCs and their regional transmission organizations permit one, they should have the flexibility to choose such a process. But unless the affected EDCs agree, the Commission should not impose such a requirement on EDCs. The assessment of whether such a process is appropriate under the circumstances is best performed, in the first instance, by the affected EDCs. Section 54.185(e) should be

amended accordingly by eliminating the first sentence and the first clause of the second sentence.

3. Commission Review of the Solicitation Results

The Commission's review of the results of a competitive solicitation also received considerable attention in the comments. Duquesne agrees with the prevalent sentiment that the Commission should review a proposed solicitation process in detail when it is filed, but that the Commission's review of the *results* of that solicitation process should be limited to whether it was implemented properly.

Though the Commission's proposed rules indicate that it intends to devote a minimum of three days to its review of the results of a competitive solicitation, Duquesne agrees with most commentors who oppose the recitation of a minimum, rather than a maximum review period. For the reasons articulated by those participants, chiefly related to the interest of wholesale suppliers in limiting the "life" of their bids, Duquesne recommends that the Commission complete its review in three days. *See* EAPA at 11; OSBA at 21; PPL at 18; *see also* Const. at 8 (seeking a maximum of 2 days); *accord* Morgan Stanley (at 9). As the Commission is aware, the Commission thoroughly evaluated the protocols designed by Duquesne to implement the competitive solicitation conducted as part of its POLR III plan in 2004. When the results of the solicitation were presented to the Commission, the Commission's review was limited to Duquesne's compliance with the approved protocols, and accordingly was completed within a three business day period. Based on the feedback received from the wholesale suppliers that participated in its POLR III solicitation, Duquesne believes that the

procedure following by the Commission in that proceeding was critical to the suppliers' participation, and therefore recommends that the Commission adhere to that procedure.

B. Switching Rules

Similar to Duquesne's comments with respect to competitive solicitations, Duquesne requested that the Commission preserve the flexibility to approve default service implementation plans that include reasonable mechanisms designed to prevent gaming of default service and protect the default service provider from subsidizing competition. CITE. The Commission received comments reflecting significant support for greater flexibility in the adoption of switching rules that are tailored to an EDC's experience with customer migration. For example, Citizens and Wellsboro request that the Commission allow the imposition of a "reasonable service term of one-year for any yearly fixed-price retail service option" (at 25). Exelon proposes that default service providers should be permitted to impose 12-month stay or other appropriate mechanisms (at 19), and PPL requests that the Commission establish state-wide rules to prohibit seasonal gaming, including switching fees, seasonal pricing and minimum stays (at 17). EAPA and UGI likewise seek greater flexibility to propose switching rules such as minimum stays. EAPA at 10; UGI at 14-15. The OSBA recognizes that rates may be higher without switching rules and recommends that the Commission consider prohibiting an EGS from entering contracts that terminate within one month of the EDC's peak season (at 16).

Several parties counter that the switching rules proposed by the Commission are too strict. Direct Energy contends that the Commission's proposed competitive

safeguards permit too many grounds for an EDC to refuse to accept a returning customer. Rather, Direct Energy argues that an EDC should be able to refuse only on the grounds it could refuse a new applicant, *e.g.*, bad credit (at 14). Several suppliers chastise the Commission for implying that minimum stays or switching fees may be appropriate at some later time. Amerada Hess at 12; *accord* MAPSA at 12.

The divergence of opinion on this sensitive issue is not surprising. Rather than attempting to prescribe rules in this environment, Duquesne would support a state-wide effort to establish uniform switching rules and protocols, as suggested by PPL. Duquesne suggests using an open and collaborative process in which all market participants would participate. If such effort fails to develop an acceptable set of rules as viewed by participants and the Commission, Duquesne reiterates its comments in support of allowing EDCs to propose switching rules that are appropriate to each service territory.

One additional issue bears discussion. While Duquesne supports the proposal in the regulations that would allow EDCs to propose seasonal rates as a method of addressing customer migration, Duquesne recommends that the Commission reject the OCA's preference for *optional* seasonal rates. OCA at 22-23, 28-29, 47 (commenting that seasonal pricing should be an option, not a basic default service rate, which should be fixed rates). Seasonal rates are designed to recover the same cost of supply as fixed rates, but to allocate the costs between the seasons to discourage customers from returning to default service only during high cost periods. If an EDC is required to offer a fixed rate in addition to a seasonal rate, the EDC (or its wholesale supplier) will not

recover its supply costs because customers with different load profiles will choose the rate that is most advantageous. For example, an elementary school customer will choose a seasonal rate because it will not experience the higher summer rate, while a customer operating a summer camp will choose the fixed yearly rate. In both cases, the EDC will fail to collect its supply costs. Further another layer of complexity would be added to the switching rules. In the absence of switching rules, default service customers would switch between fixed and seasonal default rates of the EDC to minimize their cost. The OCA's primary concern – of the impact of varying electric bills on fixed-income and elderly customers – can be addressed through the use of budget billing. *See* OCA at 22-23. The regulations should not be amended to make the use of seasonal rates optional for EDCs that do not already have standard seasonal rates.

C. Customer Charge

Duquesne's initial comments reflect its confusion regarding the intent behind and the precise scope of the Commission's proposal to include customer care costs within the proposed customer charge, and to create a "modified customer charge" that would only recover customer care costs provided to shopping customers. Because it appeared that this rate structure would require the unbundling of all these functions, and because these functions are not currently provided by entities other than EDCs, Duquesne opposed the proposed customer charge. DLC at 26-28. Even if it was appropriate to unbundle the customer care functions, Duquesne explained why it is far from clear that it can be done accurately without lengthy, contentious, and cumbersome litigation. Id. at 28-30.

The majority of participants in this proceeding agree on this point. For example, the OCA suggests eliminating the customer charge because it includes costs that are not solely generation-related, costs that are not avoided by the default service provider when a customer shops, and costs that "are not even for services provided by the alternative generation supplier." OCA at 18-19, 42-44. The OSBA rejects shifting customer care costs until interclass subsidies have been eliminated, and then only for such costs that the EDC actually would avoid. OSBA at 10-11. A number of other participants advocate striking this charge, or at a minimum only including such costs that are actually avoided by the EDC. *See* PPL (at 9-10); UGI (at 9-13); Citizens and Wellsboro (at 18-19); EAPA (at 8-9); FirstEnergy Operating Companies (at 6-7); Exelon (at 5); IECPA (at 19-20). The Commission should adhere to this near-universal opinion and strike section 54.187(a)(2)(i) of the customer charge.

It appears that only MAPSA, SEL and NEMA advocate retaining some portion of the customer charge provision in the proposed regulations. For example, MAPSA argues that such customer care costs should be reflected in default service prices because such services "*can be* provided competitively." *See* MAPSA at 4-5 (emphasis added); *see also* NEMA at 9; SEL at 23-24. These parties do not even allege that current regulations require EGSs to perform these customer care functions identified in the proposed regulation (*e.g.*, meter reading and billing), or that EGSs are currently providing them. The Commission therefore should reject their position for the reasons provided by Duquesne and the majority of other parties.

The Commission also should reject the so-called alternative proposed by Constellation, which is based on an approach adopted after considerable negotiation in Maryland. *See* Const. at 8-9. Under the approach advocated by Constellation, the Commission would adopt an administrative charge proxy that is representative of a fully embedded cost to provide retail service, but which may be periodically trued-up against the EDC's actual incremental costs of providing default service to non-residential customers.[3] The Maryland procedures allow any excess collections (from default service customers) to be refunded to all distribution service customers (shopping and non-shopping) in a given customer group. This complex approach results in cross-subsidies between default service and shopping customers that will distort retail switching decisions.

The administrative charge developed in Maryland is composed of a utility return component, an incremental costs component, uncollectibles, and an administrative adjustment component.[4] The administrative charge is only paid by default service customers, not customers receiving service from a competitive supplier. The level of the administrative charge and its components vary across five different default service products. The utility return component is not subject to reconciliation. The incremental

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[3] The Maryland Settlement does not allow reconciliation of the administrative charge for residential customers. The Commission found that the negotiated fixed charge for residential customers promotes price certainty and stability, an important settlement and market feature for this customer class. Order No. 78400 at 93 (MD PSC Apr. 29, 2003).

[4] *Id.* at 8-9.

cost component is subject to reconciliation, but only for non-residential customers. The level of the residential administrative charge, however, is tied to customer switching levels with reductions scheduled when 35% of residential capacity peak load has switched to a competitive supplier, followed by elimination of the refundable component once 50% shopping has occurred. As described by the Maryland Commission, the administrative charge "was a heavily-negotiated issue representing compromises by the various parties" and "was the key to the compromises that made a settlement possible" in the case.[5] It would be unwise for the Commission to import a Maryland-style approach when clearly different circumstances exist that are outside the context of a settlement resolving numerous other issues.

D. Reconciliation of Costs

Most of the participants in this proceeding commented on the Commission's proposals regarding the reconciliation of supply costs. The majority opposed the provision in the proposed regulations that disallows reconciliation of the generation charge in the ordinary course. OCA at 4-5, 40-41; PPL at 7-8; Allegheny at 7; UGI at 9-14; Citizens and Wellsboro (at 17); EAPA (at 7); FirstEnergy at 2-5 (favoring quarterly adjustments to the generation charge and if necessary annual reconciliation); *accord* Pike (at 3-4); *see also* Reliant at 55 (advocating a provision that allows prices to rise if the financial integrity of the EDC is jeopardized). Duquesne agrees with Exelon, which proposes a reconcilable default service charge model that allows for default

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[5] *Id.* at 38.

service providers to propose non-reconcilable charges if they choose (at 5, 16). Such an approach allows each EDC to evaluate whether it is capable of managing the risks involved with providing default service given the risk premium permitted.[6]

The same is true of the provision allowing an automatic adjustment for renewable energy provided under the Alternative Energy Portfolio Standards Act ("AEPSA"). The parties have proposed different methods of ensuring compliance with the AEPSA within the rate design provisions proposed by the Commission. For example, Exelon suggests that EDCs may require wholesale suppliers to include energy compliant with the AEPSA and the associated costs in their supply bids, which will result in the EDC recovering such costs through the generation charge rather than a separate automatic adjustment clause. Exelon at 5; *see* OCA at 19-21; Citizens and Wellsboro at 23; OSBA at 13-14; Reliant at 27. Duquesne agrees that flexibility is necessary in this area to allow EDCs to design cost recovery mechanisms that are best suited to their supply arrangements. If they choose, EDCs should have the flexibility to waive the use of an automatic adjustment clause.

E. Default Service Model

Duquesne commends the Commission on its choice of a default service model that requires the EDC to retain its role as the default service provider, unless the EDC

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[6] If an EDC chooses not to reconcile, however, Duquesne disagrees with the OCA's request (at 50) to eliminate section 54.187(h) of the proposed regulations. Under that section, costs may be subject to review under extraordinary circumstances. Such an exception is necessary to ensure the financial viability of the default service provider and the continued provision of default service.

requests that the Commission relieve it of that obligation or the Commission decides to do so on "its own motion." *See* Section 54.183(a) & (b). The majority of participants in this proceeding advocate keeping the EDC in the default service provider role at this time. *See* Const. at 10-11; OCA at 2, 31; OSBA at 7; IECPA at 7; Exelon at 8; FirstEnergy at 6; PPL at 2-5; Allegheny at 2; UGI at 2; PJM at 4 (noting that it will not be possible to have more than one default service provider per zone). The complications in adopting a so-called retail service model were well documented by several such parties. *See* Exelon at 9 (noting the need for an EGS default service provider to functionally separate its default service and competitive operations including personnel, systems, customer interfaces, and customer information); IECPA at 7-10 (noting the need for financial fitness requirements, questions regarding the applicability of EDC rate caps, and the potential need for the separation of customer care functions); PPL at 4 (commenting that the administrative burdens associated with approving another entity as the default service provider are enormous); UGI at 2-5; OCA at 31 (citing the insufficient procedural steps, standards, and restrictions governing the replacement of the EDC as the default service provider).

Though some EGSs advocate a retail service model either on a pilot or permanent basis, *see* Direct Energy at 4-12, Dom. at 9-10, SEL at 2-3, the Commission should not attempt to force migration by requiring customers to leave EDC default service without their affirmative consent. Such assignments of retail customers have had limited success in other jurisdictions. Many EGSs in the retail auctions conducted thus far have been unable to offer prices below the EDCs' rates. Moreover, there have

been very few EGSs interested in serving mass market customers on a retail basis. Customer assignments through retail auctions also fail to protect default service customers from high unregulated prices upon the expiration of the term of the assignment. Default service customers often remain with the EGS at unregulated rates not subject to Commission review. Unlike default service rates offered by EDCs, EGSs are able to charge whatever they wish with no customer price protection or Commission oversight. This is particularly problematic for small customers that lack the ability or sophistication to exercise their right to choose an alternative supplier. Duquesne therefore agrees with Constellation, the consumer advocates, and the EDCs that the EDC should retain the role of default service provider at this stage of the market's development.

F. The Commission Should Clarify its Discussion of the Term of a Default Service Implementation Plan

The proposed regulations provide that implementation plans should include a minimum of 12-month terms. *See* Section 54.185(c). As noted by the OCA, Exelon and others, the "term" in the proposed regulation is ambiguous, and it is unclear whether it refers to the duration of the implementation plan itself (the period the plan is effective), the duration of the wholesale supply contract, or the duration of the rate applicable under the implementation plan. OCA at 15; Exelon at 3. The comments received by the Commission on this regulation evidence the confusion among the parties on this point. *See, e.g.*, OSBA at 9 (seeking safe harbor for 3-year *implementation plans*); Const. at 4 (seeking flexibility to propose *contract terms* of less than 12 months); Amerada Hess at 10-11 (seeking quarterly default service *rate terms*). Duquesne therefore requests that the Commission clarify the meaning of its proposal.

III. CONCLUSION

Duquesne appreciates this opportunity to provide reply comments regarding the proposed regulations. With the modifications suggested above and in its initial comments above, Duquesne believes the regulations will continue the Commission's responsible movement toward meaningful retail competition for all retail customers in the Commonwealth.

Respectfully submitted,

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