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 ON BEHALF OF THE OFFICE OF SMALL BUSINESS ADVOCATE ON THE PROPOSED RULEMAKING

I. BACKGROUND

The Electricity Generation Customer Choice and Competition Act ("Competition Act"), 66 Pa.C.S. Ch. 28, provides that, after the recovery of stranded costs, generation rates are to be determined through market forces rather than through traditional rate base/rate of return/energy clause regulation. To that end, each Electric Distribution Company ("EDC"), or a Commission-approved alternative default service provider, is to acquire electric energy "at prevailing market prices" to serve those customers who do not choose an Electric Generation Supplier ("EGS") or whose EGS fails to deliver. See 66 Pa.C.S. § 2807(e)(3).

Section 2807(e)(2) requires the Commission to promulgate regulations to define the EDC's obligation under Section 2807(e)(3). To assist in the rulemaking process, the Commission convened the Provider of Last Resort ("POLR") Roundtable at Docket No. M-00041792 and sought written and oral comments from interested parties. The Office of Small Business Advocate ("OSBA") provided written comments and reply comments and made an oral presentation as part of the POLR Roundtable.

By Order entered December 16, 2004, the Commission closed the docket at M-00041792 and initiated a proposed rulemaking at Docket No. L-00040169. By Ordering Paragraph 5, the Commission invited comments on the proposed rulemaking within 60 days of publication in the Pennsylvania Bulletin and reply comments 30 days after the close of the initial comment period. The proposed rulemaking was published on February 26, 2005, at Pennsylvania Bulletin, 35 Pa.B. 1421.

On April 27, 2005, the OSBA and numerous other interested parties filed initial comments.[1]

By Notice published on May 28, 2005, at Pennsylvania Bulletin, 35 Pa.B. 3146, the Commission extended the deadline for reply comments from May 27, 2005, to June 27, 2005.

Set forth below are the OSBA's reply comments.

II. REPLY COMMENTS

In an effort to simplify these reply comments, the OSBA will place each response under the topic heading in the "Discussion" section of the proposed rulemaking which is most implicated by the particular comment of the party to which the OSBA is

[1] Other parties filing comments included the Office of Consumer Advocate ("OCA"); the Pennsylvania Department of Environmental Protection ("DEP"); the Allegheny Conference on Community Development ("Allegheny Conference"); the Energy Association of Pennsylvania ("EAPA"); the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance (collectively "IECPA"); PECO Energy Company ("PECO"); PPL Electric Utilities Corporation and PPL EnergyPlus, Inc. (collectively "PPL"); Pike County Light & Power Company ("Pike"); UGI Utilities, Inc.-Electric Division ("UGI"); Citizens' Electric Company and Wellsboro Electric Company ("Citizens' and Wellsboro"); Allegheny Power ("Allegheny"); Duquesne Light Company ("Duquesne"); Metroplitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (collectively "MetEd/Penelec/Penn Power"); PJM Interconnection, LLC ("PJM"); FirstEnergy Solutions Corp. ("First Energy"); Morgan Stanley Capital Group, Inc. ("Morgan Stanley"); Amerada Hess Corporation ("Hess"); Constellation Energy Commodities Group, Inc and Constellation NewEnergy, Inc. (collectively "Constellation"); Dominion Retail, Inc. ("Dominion"); Direct Energy Services, LLC ("Direct"); Mid-Atlantic Power Supply Association ("MAPSA"); National Energy Marketers Association ("NEM"); Richards Energy Group ("Richards"); TBG Consulting ("TBG"); and Reliant Energy, Inc. ("Reliant").

responding. However, the OSBA's reply to each particular comment should be deemed to cover all provisions of the proposed rulemaking related to that comment.

Preamble

The OSBA rests on its initial comments under the preamble to the "Discussion" section of the proposed rulemaking.

A. Purpose

The OSBA rests on its initial comments under the "Purpose" subsection of the proposed rulemaking.

B. Definitions

The OSBA rests on its initial comments under the "Definitions" subsection of the proposed rulemaking. However, the OSBA notes that some comments of other parties to which the OSBA will respond under other topic headings included conforming amendments to the definitions.

C. Default Service Provider

The OSBA rests on its initial comments under the "Default Service Provider" subsection of the proposed rulemaking.

D. Default Service Provider Obligations

The OSBA rests on its initial comments under the "Default Service Provider Obligations" subsection of the proposed rulemaking.

E. Default Service Implementation Plans and Terms of Service

- A fundamental principle of the proposed rulemaking is that the default service provider should acquire energy through an open and transparent competitive auction or Request for Proposals ("RFP"). The OSBA strongly supports this principle, in

large part because a competitive procurement process by rate class would offer the best opportunity to eliminate the subsidies which are reflected in current generation rates.

Although the Commission states in the "Definitions" subsection of the proposed rulemaking that "different procurement mechanisms may be appropriate in different territories or terms of service," the Commission acknowledges in the "Default Service Implementation Plans and Terms of Service" subsection that a statewide procurement process may be appropriate in the future.

In its initial comments, the OSBA recommended that the Commission mandate the use of a uniform statewide plan for the acquisition of electricity for default service providers for 2011 and thereafter. In contrast, several commentators not only opposed the use of a uniform statewide plan but also recommended the elimination of the Commission's authority to order such a plan at any time.[2]

Although these commentators identified the need for possible exceptions to a statewide process, they did not demonstrate that it is necessary to eliminate even the possibility of a statewide plan.

First, the OSBA recognizes that not all EDCs are members of PJM. Although that fact may justify exempting Penn Power and Pike from a statewide procurement process, every other Pennsylvania EDC does belong to PJM.[3] Furthermore, more than 95% of the load served by Pennsylvania EDCs is delivered to customers located in service territories of EDCs which belong to PJM.

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[2] See EAPA Comments at 3-6; OCA Comments at 2, 27, 33, and 35; Exelon Comments at 4 and 12; and Pike Comments at 1-2.

[3] Penn Power is in the control area of the Midwest Independent System Operator. Pike is a subsidiary of a system which is principally located in the control area of the New York Independent System Operator.

Second, the OSBA acknowledges that Pike, Citizens', Wellsboro, and UGI may be too small to acquire electricity through the tranches used by the statewide plans in New Jersey and Maryland. Although that fact may justify exempting those four EDCs from a statewide plan, the remaining Pennsylvania EDCs are large enough to assemble the tranches used in New Jersey and Maryland. Furthermore, Citizens' and Wellsboro already use an RFP process to acquire electricity.[4] Therefore, even if all four of these small EDCs must be exempted from a statewide process, Pike and UGI should at least be required to utilize an RFP process similar to those employed by Citizens' and Wellsboro.

Third, the OSBA recognizes that most of the major EDCs will not be providing default service pursuant to the proposed regulations until 2009, 2010, or 2011, when those EDCs' rate caps have finally expired. Although that fact may affect the date on which EDCs can begin utilizing a uniform statewide procurement plan, it does not justify depriving the Commission of the authority to order the use of a statewide plan. Specifically, the fact that EDC rate caps expire on a staggered schedule would not prevent the implementation of a statewide plan for acquiring electricity for 2011 and beyond.

Fourth, allowing each EDC to propose its own default service plan in perpetuity would make it more difficult to achieve the Competition Act's goal of eliminating territorial differences in generation rates.[5]

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[4] See Citizens' and Wellsboro Comments at 2-4.

[5] The General Assembly approved the Competition Act because "[r]ates for electricity in this Commonwealth are on average higher than the national average, and significant differences exist among the rates of Pennsylvania electric utilities" and because "[t]he cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth." See 66 Pa.C.S. § 2802(4) and (6), respectively.

In essence, the General Assembly concluded that differences in generation rates should not be a critical factor in determining the EDC service territory in which a business locates or expands and should not give a business located in one EDC service territory a significant advantage over competitors located in other EDC service territories. Unfortunately, the proposal to delete the authority to order a statewide procurement plan would deprive the Commission of its most effective remedy if the individual plans failed to eliminate, or substantially reduce, the disparity in generation rates across the Commonwealth.

Fifth, in addition to opposing a statewide plan, several commentators proposed that each EDC be permitted to acquire electricity for default service customers by means other than an open and transparent competitive procurement process.[6] However, even if the Commission were to eliminate the explicit requirement to acquire energy through a competitive procurement process, an EDC would continue to be bound by Section 2807(e)(3) to acquire electricity "at prevailing market prices." Except for linking default service rates to an index, the use of a competitive procurement process would be the easiest way to assure an EDC's compliance with that statutory mandate.[7]

- Numerous commentators urged the Commission to draw a distinction between the permissible length of the procurement plan and the frequency of the actual

[6] See UGI Comments at 7; Duquesne Comments at 5-8 and 13-19; Allegheny Conference Comments at 3; TBG Comments at 1-2; and Reliant Comments at 35-36 and 60-61.

[7] Primarily because of rate volatility, the OSBA is opposed to linking default service rates to an index. The OSBA is also concerned about the potential difficulty in selecting an index which would consistently, and accurately, reflect prevailing market prices for electricity to serve small business customers.

acquisition of electricity.[8] The OSBA agrees with that suggestion. After the initial review and approval of a procurement plan, it should not be necessary to review and approve the plan prior to each acquisition unless amendments to the plan have been proposed or circumstances have changed significantly.

- Because the generation rate caps expire at different times, it will be necessary to review and approve "interim" plans for some EDCs while other EDCs remain subject to caps. In addition, it may be necessary for the Commission to review and approve "interim" plans for some EDCs before the proposed regulations have been finalized. However, all of these "interim" plans must comply with the requirement under Section 2807(e)(3) to acquire electricity "at prevailing market prices." Therefore, all "interim" plans should comply with the proposed regulations as closely as possible. At a minimum, each EDC which proposes an "interim" plan should be required to acquire electric energy through a process which is both competitive and transparent.

In its initial comments, Duquesne suggested that its "interim" plan (for 2008-2010) might simply be a request for approval of the second three-year period of its previously litigated six-year POLR III Plan. As Duquesne pointed out, the Commission approved only the first three years of that six-year plan but stated that the second three years might ultimately be approved. See Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service, Docket No. P-00032071 (Order entered August 23, 2004), at 17-18.[9]

[8] See Exelon Comments at 7; OCA Comments at 14-15; and Citizens' and Wellsboro Comments at 12. For example, the same procurement plan could be in place for a five-year term, but the auction or RFP could be conducted annually.

[9] See Duquesne Comments at 4.

Unfortunately, Duquesne did not make clear whether it would submit the same plan for 2008-2010 that was part of its final plan in the POLR III litigation or whether it would submit an entirely new three-year plan. If the latter is Duquesne's intent, the OSBA believes that Duquesne should be required to adhere to an open and transparent competitive procurement process for small business customers.

F. Default Service Supply Procurement

The OSBA rests on its initial comments under the "Default Service Supply Procurement" subsection of the proposed rulemaking.

G. Default Service Rates and the Recovery of Reasonable Costs

- As indicated previously, numerous commentators urged the Commission to allow each EDC to submit its own procurement plan. Unfortunately, that approach would invite an EDC to acquire electricity at a systemwide wholesale generation price and then allocate that systemwide price among the rate classes on the basis of the EDC's last approved "bundled" cost-of-service study or on the basis of an across-the-board adjustment to existing class generation rates.

None of these commentators proposed a way to eliminate interclass subsidies embedded in existing generation rates. Therefore, if the Commission were to adopt their position, the Commission should also require each EDC to eliminate those subsidies—whether by acquiring energy through separate bids for residential customers, small commercial and industrial customers, and large commercial and industrial customers or by developing an explicit process (similar to what is used in New Jersey) to translate a systemwide wholesale price into retail rates on a rate class by rate class basis. To do

otherwise would be inconsistent with the requirement of Section 2807(e)(3) to acquire electricity "at prevailing market prices."

- In its initial comments, the OSBA supported the Commission's decision to guarantee a fixed rate option for small business customers with a load of 500 kW or less. The OSBA took no position on whether the threshold for hourly pricing should be set at a higher load than 500 kW and on whether hourly pricing should be the only option for customers with a load higher than 500 kW.

Numerous commentators suggested that the threshold should be set higher or lower than 500 kW or that each EDC should have the option of setting the threshold at any load, presumably including a load less than 500 kW.[10] As Hess pointed out, the Commission has already set the threshold at 300 kW in the Duquesne service territory. Although small business customers usually do not have loads higher than 300 kW, the proposals to lower the threshold to 25 kW or 50 kW would impact customers in what have typically been considered to be small business rate classes. As the Commission has recognized, many small business customers can not readily shave their electricity use to respond to hourly fluctuations in market prices. Instead, they must consume energy to accommodate their own customers. That is especially true for restaurants and retail businesses.

- Section 3(a)(3) of the act of November 30, 2004 (P. L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act ("Alternative Energy Act"), provides that costs incurred by an EDC for the purchase of electricity from alternative

[10] See, e.g., Exelon Comments at 17; EAPA Comments at 9; UGI Comments at 12; Allegheny Comments at 9-10; Hess Comments at 4-5, Dominion Comments at 12; Direct Comments at 13; DEP Comments at 3-4; and Reliant Comments at 9, 17, and 26.

energy sources and costs for the purchase of alternative energy credits shall be recovered "pursuant to an automatic energy adjustment clause under 66 Pa.C.S. § 1307 as a cost of generation supply under 66 Pa.C.S. § 2807."

In its initial comments, the OSBA proposed that the Commission allow an EDC to waive recovery under a Section 1307 surcharge if that EDC is acquiring electricity from alternative and non-alternative energy sources on a combined basis through a single RFP or auction and if that EDC is recovering the costs of that electricity through "blended" rates.

The OCA commented that if a waiver of recovery of alternative energy costs under a Section 1307 surcharge is not legally sustainable, it would be reasonable to use a Section 1307 surcharge to recover the costs of all electricity acquired for default service customers. Furthermore, PPL commented that a Section 1307 surcharge could be used to recover both alternative energy and non-alternative energy costs.[11] The OSBA disagrees, on both legal and policy grounds.

First, the OSBA recognizes that Section 1307 has been used in the past for the recovery of fuel costs and purchased power costs. However, the legislature explicitly provided in Act 213 for recovery of alternative energy costs under a Section 1307 surcharge but neither stated nor implied in the Competition Act that any default service costs may be recovered through such a surcharge. If the legislature had thought that the Competition Act already permitted recovery of default service costs through a Section 1307 surcharge, there would have been no need to use explicit language in Act 213 to

[11] See OCA Comments at 4-5, 20-21, and 45-46; and PPL Comments at 3, 7-8, and 10-11.

authorize a Section 1307 surcharge to recover the alternative energy portion of default service generation costs.

The Commonwealth Court recently rejected the Commission's attempt to authorize wastewater utilities to collect certain investments in collection systems through a Section 1307 surcharge. Critical to the Court's holding was the fact that the General Assembly had explicitly authorized the use of a surcharge for the collection of water distribution system improvements but had not done so with regard to wastewater collection system improvements. See Pennsylvania Public Utility Commission v. Popowsky, 869 A.2d 1144 (Pa. Cmwlth. 2005). In view of that holding, the OSBA questions whether the Commission has the legal authority to permit recovery of non-alternative energy costs through a Section 1307 surcharge.

Second, although the OSBA believes that allowing the combined purchase of alternative and non-alternative energy could lead to lower overall rates than if the two were acquired separately, that potential benefit may be more than offset by the negative effects of allowing the use of a Section 1307 surcharge for the recovery of non-alternative energy costs. For example, if each EDC were permitted to design its own procurement plan, the guarantee of recovery under Section 1307 would undermine the EDC's incentive to obtain the best price for consumers. In addition, reconciliation through a Section 1307 surcharge would further disconnect the "price to compare" from "prevailing market prices."

Third, if a waiver of alternative energy costs under a Section 1307 surcharge is not legally sustainable or if an EDC chooses not to waive recovery under such a surcharge, the default service provider should be required to utilize a competitive

procurement process for acquiring electricity, or associated credits, from alternative energy sources. Under Section 2807(e)(3), an EDC "shall acquire electric energy at prevailing market prices . . . and shall recover fully all reasonable costs." (emphasis added) Under Section 1307(a), surcharges are intended to provide a public utility with a "just and reasonable return" on its rate base and may be revoked if rates are "unjust or unreasonable." Therefore, by linking purchases under the Alternative Energy Act to both Sections 2807 and 1307, the General Assembly implied that the test for whether rates for alternative energy are "just and reasonable" is whether those rates are based on "prevailing market prices."

- In its initial comments, the OSBA recommended deletion of the risk premiums which the proposed rulemaking would authorize for EDCs which are functioning as default service providers. Specifically, the OSBA argued that the risk of unanticipated customer migration would fall on the wholesale supplier under a load following contract and would not fall on the EDC. Similarly, the OSBA argued that the EDCs do not need a risk premium to protect them from the failure of a wholesale supplier to deliver, because the proposed regulations would allow the EDC to pass through the costs of acquiring replacement electricity.

In their initial comments, numerous commentators proposed that the Commission should reverse its prior decision and make generation supply costs reconcilable.[12] In the OSBA's view, reconcilability would be inconsistent with giving the EDC risk premiums, in that the EDC would be protected from even theoretically having to bear the risks for which it would receive the risk premiums.

[12] See, e.g., Exelon Comments at 16; PPL Comments at 6-7; EAPA Comments at 6-7; MetEd/Penelec/Penn Power Comments at 1-3; and Allegheny Comments at 7-8.

Although the commentators did not equate reconcilability with a "Section 1307 surcharge," a Section 1307 surcharge is essentially what they are proposing. As set forth above with regard to the use of a Section 1307 surcharge for the recovery of alternative energy costs, the OSBA questions whether the General Assembly intended to authorize reconciliation of non-alternative energy costs.

H. Commission Review of Default Service Implementation Plans

The OSBA rests on its initial comments under the "Commission Review of Default Service Implementation Plans" subsection of the proposed rulemaking.

I. Default Service Customers and the Standards for Transferring CustomerAccounts to Default Service Providers

Several commentators suggested that the Commission should stimulate competition by assigning a percentage of default service customers to EGSs.[13]

The OSBA believes that such an assignment is premature. Duquesne's POLR III Plan already provides a "pilot" for testing the marketers' arguments about what the Commission should do in order to stimulate shopping.

Duquesne's low load factor small commercial and industrial customers (on Rate Schedule GS/GM) are already paying from nine to eleven cents per kWh for default service generation. As the Commission recognized, generation rates in that range are well above market prices. See Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service, Docket No. P-00032071 (Order entered August 23, 2004), at 18, 21-22, and 30-31. Therefore, it is very likely that these low load factor GS/GM customers are also paying more than they would be if

[13] See, e.g., Dominion Comments at 9-10 and Direct Comments at 11-12.

generation-related customer care costs were added to the market price of generation or if their generation rates were adjusted monthly or quarterly as market prices fluctuate.

Furthermore, there is already significant competition in the Duquesne service territory. According to the OCA's "Electric Shopping Statistics" for April 1, 2005, 22.9% of Duquesne's customers are shopping and 42.4% of Duquesne's load is being served by EGSs. With that amount of shopping, the unit cost of attracting and serving more customers should be at or near the critical mass the EGSs claim to need.

Therefore, rather than assigning customers to EGSs, the OSBA recommends that the Commission track the amount of shopping among the low load factor GS/GM customers through the end of Duquesne's POLR III Plan on December 31, 2007. Such tracking would better enable the Commission to predict the likely effect before implementing proposals for monthly or quarterly rate adjustments and for shifting costs from distribution to generation. If market prices for those low load factor GS/GM customers remain below the default service rates but shopping does not increase significantly by December 31, 2007, it will be reasonable to conclude that implementing the marketers' proposals would raise rates for small business customers but would not actually induce additional shopping.

III. CONCLUSION

The OSBA respectfully requests that, prior to submitting the regulations in final form to the Independent Regulatory Review Commission and the standing committees of the General Assembly, the Commission revise the regulations in accordance with the OSBA's initial and reply comments.

Respectfully submitted,

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