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June 27, 2005

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
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Harrisburg, PA 17105-3265

Re: 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

Provider of Last Resort Roundtable
Docket No. M-00041792

Dear Secretary McNulty:

Enclosed for filing are an original and fifteen (15) copies of the Reply Comments of the Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served as required by the Commission's Order and Secretarial Letter.

Sincerely,

A handwritten signature in cursive script that reads "Tanya J. McCloskey".

Tanya J. McCloskey
Senior Assistant Consumer Advocate

Enclosure
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Rulemaking Re Electric Distribution	:		
Companies' Obligation to Serve Retail	:		
Customers at the Conclusion of the	:	Docket No.	L-00040169
Transition Period Pursuant to	:		
66 Pa. C.S. §2807(e)(2)	:		
Provider of Last Resort Roundtable	:	Docket No.	M-00041792

REPLY COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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DATED: June 27, 2005

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I. INTRODUCTION

The Office of Consumer Advocate (“OCA”) offers these Reply Comments in response to the Comments submitted to the Pennsylvania Public Utility Commission (“Commission”) by interested parties in the Commission’s Proposed Rulemaking on Electric Distribution Companies’ Obligation to Serve Retail Customers at the Conclusion of the Transition Period. The Comments of the interested parties were submitted April 27, 2005, pursuant to the terms of the Commission’s Proposed Rulemaking Order, published February 26, 2005 in the Pennsylvania Bulletin. The OCA reviewed comments submitted by PECO Energy Company (“PECO”); PPL Electric Utilities (“PPL”); Allegheny Power (“Allegheny”); UGI Utilities, Inc. - Electric Division (“UGI”); Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (“Met-Ed/Penelec/Penn Power, collectively, The FirstEnergy Companies”); Duquesne Light Company (“Duquesne”); Citizens’ Electric Company and Wellsboro Electric Company (“Citizens’/Wellsboro”); Pike County Light & Power Company (“Pike”); Direct Energy Services, LLC (“Direct Energy”); Dominion Retail Inc. (“Dominion Retail”); Strategic Energy, LLC (“Strategic Energy”), Reliant Energy, Inc. (“Reliant”), National Energy Marketer Association (“NEMA”); Mid-Atlantic Power Supply Association (“MAPSA”); Morgan Stanley Capital Group, Inc. (“Morgan Stanley”); Amerada Hess Corporation (“Hess”); Office of Small Business Advocate (“OSBA”); Industrial Energy Consumers of Pennsylvania (“IECPA”); PJM Interconnection, LLC (“PJM”); Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc (“Constellation Energy”); First Energy Solution Corporation (“FES”); Richards Energy Group, Inc (“Richards”); Department of Environmental Protection (“DEP”); Energy Association of Pennsylvania (“EAPA”); David M. Boonin (“Boonin”), and Allegheny Conference on Community

Development (“Allegheny Conference”). In these Reply Comments, the OCA will not respond to all individual arguments of the parties, but will address general issues raised by the parties.

As an initial matter, the OCA would note that the Commission’s proposed Rulemaking Order, because it is establishing policy in a brand new area of law, contained many issues deserving of comment and indeed, the parties diligently and thoughtfully offered their views on this broad range of issues. What the OCA finds noteworthy, and what it urges the Commission to take special notice of, is that despite the array of issues raised by the rulemaking and the significant number of parties who commented on it, there exists substantial agreement on several of the most fundamental issues between the parties representing those who will pay for default service (OCA, OSBA and IECPA) and those who will provide that service, the electric distribution companies (“EDCs”). This convergence of interests between two of the primary groups affected by this rulemaking should be of considerable significance to the Commission as it deliberates on the design of its final-form rules.

Among the areas on which there is substantial agreement between the “payors” and “providers” of default service are the following:

- Default service should be provided by the EDCs.
- Procurement of default service supply should be accomplished through a competitive process in the wholesale market.
- Default service rates for residential customers should be characterized by stability, not volatility.

The EDCs and OCA are also in agreement regarding the following:

- That the proposed Generation Supply Charge should be made a reconcilable per kilowatthour charge to, among other things, facilitate compliance with the requirements of the Alternative Energy Portfolio Standards Act.

- That the proposed Generation Customer Charge should be eliminated as unnecessary, complicated and potentially confusing to customers, and that the cost items to be recovered by that charge should generally remain a part of distribution rates.

The OCA urges the Commission not to underestimate the significance of agreement in this proceeding. The issues in this rulemaking are controversial and potentially divisive. To find substantial accord on a number of critical points between those who will pay for default service and those who will provide it should, at the very least, be instructive to the Commission as it contemplates how to proceed in its final-form rules on default service. The OCA would also note that with respect to residential customers, other commenters also supported stable default service pricing as appropriate and that the prices should be understandable and easy to compare with those of competitive suppliers. See, e.g., DEP Comments at p. 1.

Where the OCA differs from a number of other commenters is in their call to expose residential customers to excessive, volatile and unreasonable prices for default service. The OCA urges rejection of all such proposals. In its Comments, the OCA proposed a method by which residential customers would be able to obtain reasonable and stably priced default service. Specifically, OCA proposed that EDCs meet their default service supply obligation by competitively procuring a portfolio of short and long term supply contracts such that only a portion of the portfolio would have to be replaced in any given year and price changes to customers (which would occur on an annual basis) would be correspondingly modest. A number of parties have argued, however, that default service prices, even for residential customers, should be tied to prices in the short-term wholesale energy market and should be adjusted on a monthly or quarterly basis. See, NEMA Comments at p.7; Direct Energy Comments at pp. 12-

13. These are the very types of proposals the OCA urges the Commission to reject. Such proposals will introduce unnecessary and unwelcome volatility into the pricing for residential customers. As the OCA has consistently maintained, use of the phrase “prevailing market prices” in the Competition Act does not demand or even suggest exclusive focus on the spot or short-term wholesale energy markets. The wholesale market provides a variety of products, both long and short term, and it is important to consider all aspects of that market, as the OCA does with its competitive portfolio approach and resultant pricing, rather than focus exclusively on the short-term energy market and use it as the sole basis for determining the price of default service.

The OCA also urges the Commission to reject all proposals that would limit or eliminate the EDCs’ role as the default service provider. Several commenters have proposed a “retail default model” under which the entire default service provider function is auctioned to one or more electric generation suppliers (“EGSs”). See, Direct Energy Comments at pp.3-9; Dominion Retail Comments at p. 10; Strategic Energy Comments at p. 2; NEMA Comments at pp. 3-5; Reliant Comments at pp. 17-19. One commenter has proposed that a date be set by which EDCs will no longer provide default service and at which point such service would be provided by EGSs. NEMA Comments at pp. 3-4. In response to these proposals the OCA first notes that under the Electric Competition Act, a customer does not have to leave his or her EDC in order to get access to competitive generation. A customer can receive such benefit when the EDC purchases generation on the customer’s behalf in the competitive wholesale market. The purpose of the Act was not to force customers to switch retail providers for the sake of switching, but to bring lower rates to customers as competitive forces lower the cost of generating electricity. The OCA would further note that no other state in the PJM region has adopted the “retail default model” proposed by the commenters. Indeed, the “wholesale default model”

advocated by all of the consumer and EDC commenters in this proceeding has now been adopted in New Jersey, Maryland, Delaware, and the District of Columbia. Finally, it should be recognized that Pennsylvania's previous attempt at pursuing this type of approach (the assignment of a portion of PECO Energy's customers to a competitive default supplier) was a decided failure.

The arguments advanced in favor of the "retail default model" – that it will bring greater value to consumers, promote reliability, and promote greater energy diversity and economic development – could all be equally true of a system that uses incumbent EDCs acquiring power in the competitive wholesale markets as the default suppliers. As noted above, the Commonwealth's EDCs have unanimously indicated their willingness to provide this service.

It is simply a reality that EDCs will continue to be called upon to step in as the "last resort" when other entities fail. Indeed, one of the proponents of the "retail default model" essentially acknowledges this in its comments when describing the continuing role of the EDC as "to meter the service and be responsible for physically terminating a customer's service, as well as retail back-up service for short-term energy replacement." See, Direct Energy Comments at p. 7 (emphasis added). The Commission has appropriately assigned the default supply responsibility to the EDCs. It is an arrangement customers are used to. It will require no significant investment in further customer education. If done in accordance with the OCA's recommended portfolio approach, EDCs will be able to supply reliable, reasonable, and stably priced electricity to residential customers. In short, there is no compelling reason for the Commission to deviate from the path it has chosen. The EDCs should serve in the role of default suppliers.

The Commission should also reject any proposal to implement a “Texas-style” default service model in Pennsylvania. Given recent experience in Texas, this is no model to be emulated. A May 20, 2005 article in the Wall Street Journal¹ reported on a study which found that the default prices of Texas’ residential customers have jumped, on average, some 43% between January 2002 and October 2004. This is in contrast to a 17% increase (over the same time span) for customers of Texas utilities that have not undergone restructuring and are still charging traditional cost-based rates, and a 9% increase for customers of the state’s rural electric cooperatives.

According to the article, the state’s largest default supplier, TXU Energy Retail Co., has increased its regulated default service rate six times since early 2002, with the most recent increase equaling 9.9%, its second largest increase ever. Rates of the second largest default supplier, Reliant Energy Inc., have increased 41% since 2002 and are now set at 12.8 cents per kilowatt hour. Under Texas’ system, default service providers can ask for price increases twice per year based on the wholesale short term price of natural gas without any obligation to demonstrate the impact of that wholesale market index on the actual generation portfolio of the service provider. As natural gas prices have climbed steadily, so too have the default service rates, reaching today’s very high levels. Additionally, while Texas has seen extensive shopping for competitive supply among large electricity users, there has been a far lower level of switching activity for residential customers. Only one in five residential customers has switched away from their default supplier. Given such facts, there is every reason to be cautious about adopting any form of the Texas default service model in Pennsylvania. Indeed, no other PJM state has adopted the Texas model. The OCA firmly believes that the

¹ Rebecca Smith, “*Texas Electricity Deregulation Hasn’t Aided Small Power Users*”, Wall Street Journal, May 20, 2005, at A2.

process the Commission laid out in its proposed rulemaking holds much greater promise of delivering reasonable and affordable electricity supply to the Commonwealth's households. The OCA strongly encourages the Commission to adhere to its current path.

The OCA urges the Commission to adopt default service regulations that will provide residential customers with the continuation of stably priced and affordable electric generation service. Many of the elements for achieving this already exist in the Commission's proposal and the OCA has offered modifications in its Comments to assist in achieving this goal. If in formulating its final-form regulations the Commission is guided by those areas in which the providers and payors of default service are in agreement, and if it rejects those ideas that would radically alter what it has previously proposed to the detriment of consumers, the Commission will be well on the way to adopting workable default service regulations that will achieve the goals of the Competition Act.

These reply comments will now individually address a number of key issues.

II. SPECIFIC REPLIES TO ISSUES RAISED BY THE COMMENTS

A. Role of the EDC: Retail vs. Wholesale Default Service Function

As discussed in detail in the OCA's Comments, the OCA strongly supports the Commission's proposed regulations that require the EDC to serve as the default service provider. The OCA just as strongly urges the Commission to reject recommendations that the "retail default model" be adopted. The adoption of such a model introduces no efficiencies and provides no competitive benefits. If anything, it introduces additional costs and concerns. For example, when considering whether to adopt a "retail default model," one must determine the EGSs' capacity to perform the entire range of retail functions – customer care, billing, collection and metering – in a cost-effective manner. It is very likely that the EGSs' costs to perform these functions will be higher than (or duplicative of) the costs of the EDC systems that are already in place. The EDCs are currently performing the billing and collection function for all residential and small commercial customers for both distribution and generation service. While several EDCs have given the option to EGSs to provide consolidated billing and collection functions for residential customers, no EGS is doing so at this time. The same is true in other PJM states where EGSs either do not market to residential customers or, where they do, they have elected to have the EDC handle billing and collection for both generation and distribution service.

Additionally, the EDC will always be required to step in as the "last resort" if the EGS fails or the term they agreed to ends. EDCs cannot simply eliminate such functions since the EDC must always be ready to serve. This results in a duplication of functions and costs. As the OCA recommended in its Comments, the "retail default model" should be rejected.

In their Comments, several retail marketers or marketer organizations supported adoption of the "retail default model." See, Direct Energy Comments at pp.4-9; NEMA

Comments at pp.3-4; Reliant Comments at pp. 17-19; Strategic Energy Comments at p. 2; Dominion Retail Comments at p. 10. NEMA suggested that the Commission set a date certain by which EDCs must exit the merchant function, changing their responsibility from that of an obligation to serve to an obligation to deliver. NEMA Comments at pp. 3-5. Reliant Energy suggests something similar, calling for the default provider role to be assumed by a competitive affiliate EGS of the EDC. Reliant Comments at pp. 17-19. Direct Energy proposes that the Commission bid out the default service function to one or more EGSs. Direct Energy Comments at pp. 4-9. All three approaches appear to require a Texas-type market structure for Pennsylvania. The Texas model, however, is unique. No other state has approached electric restructuring in the same way. Pennsylvania, for example, did not mandate the divestiture of generation or the structural separation of current EDC functions, as Texas has done. Superimposing the Texas model on Pennsylvania's structure is not a workable solution. As noted earlier, Texas' residential customers have seen substantial increases in their default service rates since the advent of restructuring in January 2002. This is directly contrary to the type of default service rate stability the OCA recommends for the Commonwealth's residential customers. In addition, the OCA notes that the "retail default model" has been considered and rejected in all of our neighboring PJM jurisdictions, notably Maryland, New Jersey, the District of Columbia, and most recently, Delaware.²

The commenters supporting the "retail default model" also urge the Commission to adopt a default service pricing approach that will lead to volatile, unpredictable prices for residential customers. For example, Direct Energy wants to provide consumers "with prevailing

² Delaware PSC, Re: Provision of Standard Offer Supply to Retail Consumer in the Service Territory of Delmarva Power and Light Co., Docket No. 04-391, Order No. 6598, March 22, 2005. The PSC rejected the "retail model" which would have chosen the standard offer supplier pursuant to a competitive solicitation, but instead approved an approach that will rely on the wholesale market for the competitive acquisition of standard offer supply by the utility.

market prices through monthly pricing.” Direct Energy Comments at p. 11. NEMA proposes a “monthly adjusted, market-based rate.” NEMA Comments at p.7. Reliant Energy’s approach is its “Market Responsive Price Model” in which prices for residential customers would change 2-3 times per year based on an external wholesale market index, similar to the Texas model. Reliant Comments at p. 10. All of these proposals have the potential for significantly degrading the provision of essential electric service to residential consumers as well as the potential to create a backlash that will threaten the public’s acceptance of industry restructuring.³ Furthermore, such an approach is likely to result in higher prices due to the significant transition costs associated with such radical change.⁴ One can also anticipate the dissatisfaction that would result among residential customers as they face volatile price changes with little ability to significantly change their consumption in response to those prices.⁵

For the reasons set forth above, and for the reasons set forth in the OCA’s Comments at pp. 30-31, the OCA urges the Commission to reject recommendations to move to a

³ The EGSs argue that the competitive marketers will provide rate stability to residential customers if there is volatile default service pricing. This argument has not been borne out by the experience in Texas where residential switching has only been about 1 in 5 customers. More importantly, this would require the Commission to find that EGSs who have no obligation to serve should be relied upon to provide an essential service to residential customers under terms that are reasonable and affordable. The Act calls for reasonable service for all customers, not just those customers who may choose to, or be able to, switch. 66 Pa.C.S. §2802(9). Default service is the means by which the Commission must ensure that this essential service is available on reasonable terms and conditions.

⁴ These transition costs include the costs of the regulatory proceedings to consider and finalize such an approach, the additional consumer education programs that would be required to implement such a dramatic change in the provision of basic electricity services to residential customers, and the likely result that an EGS would need to replicate and charge prices for customer care, billing, and collection, that are higher than those currently reflected in the EDC rates. While the EDC prices purportedly would reflect the removal of embedded costs for such services in a retail POLR model, the assumption of these services by an EGS without the current capacity to perform those functions is likely to raise prices or result in significantly degraded customer service and service quality.

⁵ The OCA does not suggest that customers cannot make consumption changes in response to prices. Rather, our point is that most residential customers use a modest amount of electricity for basic necessities that is not subject to significant usage discretion. This is particularly true for low income customers who, on average, use less electricity than higher income customers and whose household income is already severely strained to pay for electricity and other energy services.

“retail default model.” The Commission should continue EDCs as the default service providers and eliminate proposed §§ 54.183 (b) and (c) in their entirety.

B. Prevailing Market Price: Definition and Policy

The OCA supports the Commission’s overall approach to the definition of “prevailing market price” as contained in the proposed rulemaking. The definition reflects the fact that prevailing market price is realized through the procurement process included in default service implementation plans. Most commenters agreed that the statutory directive to acquire electric energy at prevailing market price can be met by pricing default service through a variety of competitive acquisition methods. 66 Pa.C.S. § 2807(e)(3). The price that results from one, or a combination, of these methods would be the “prevailing market price.” In particular, the OCA urges the Commission to consider the statement by PPL:

PPL believes if generation supply for default service is procured through a competitive process, then that supply will be acquired at “prevailing market prices.” PPL agrees with the Commission that terms of supply longer than one year will attract the needed capital investment to ensure reliable generation supplies are developed. However, PPL does not agree that longer terms may lead to a divergence from the “prevailing market price” standard. If the price for default service is tied to the term of supply, and that supply is obtained through a competitive process, then a divergence from the “prevailing market prices” will not occur. Accordingly, default service providers should be permitted to select, and obtain through a competitive procurement process, the portfolio of supply options that best meet the needs of its system.

PPL Comments p. 14.

Strategic Energy, however, argues that the Commission’s proposed definition is contrary to the Electric Competition Act. Strategic Energy Comments at p. 22. Strategic’s argument is flawed. Like the other marketers, Strategic insists there is only one way to measure “prevailing market price” – by looking toward short-term or spot wholesale market indices. This

is simply incorrect. The term “prevailing” does not refer to only one type of product or service in the market. Rather, such a term must logically refer to any or all products or services available in the market. There are long-term bilateral transactions that occur in the current wholesale market. There are contract terms for service that reflect multiple years (as clearly indicated by the results of the New Jersey and Maryland wholesale market solicitations and resulting contracts for default service in those states). Indeed, there are thousands of real-time prices established every hour in PJM, as well as day-ahead, month-ahead, year-ahead and multi-year-ahead prices. The critical point is that the default service provider should build an appropriate portfolio of resources. The cost of this portfolio is the prevailing market price for providing reliable default service. Put another way, the wholesale market will deliver the products and services that the retail market demands, and the resulting prices for those services will be the “prevailing” price of the necessary products.

The OCA would reiterate its earlier concern about the suggestion that “prevailing market price” must be interpreted to mean reliance on short-term or spot wholesale market prices. Such an interpretation would doubtlessly lead to unstable and volatile rates for residential customers. As an example, Reliant Energy proposes using a Texas-style “market responsive pricing model” which, for residential customers, will permit default service prices to adjust several times a year in step with an index of wholesale market prices. Reliant Comments at p. 10. As noted earlier, this structure has resulted in Texas’ households seeing price increases on average of 43% since the advent of restructuring in January 2002, a direct result of pegging the default service price to increases in the price of natural gas, regardless of the impact of that increase on the cost to the provider. Prices for customers of Reliant Energy Inc. in Texas have jumped 41% since 2002. This contrasts to a 17% increase for customers of Texas utilities that

still charge traditional cost-based rates and 9% for customers of rural electric cooperatives.⁶ The general approach taken by the Commission in its proposed rulemaking holds out the potential to prevent such a harmful result for residential customers in Pennsylvania. Utilizing the OCA's recommended portfolio approach for procuring default service supply, extreme price volatility can be eliminated or substantially moderated, and residential customers can realize price stability and predictability.

As set forth in the OCA Comments, prevailing market price should be the blended price of the various components of the portfolio of resources acquired by the default service provider to meet its load. See, OCA Comments pp.4-6, 29-30, 34. The price will be adjusted annually as new components are phased in, but the changes should be modest, and overall, prices should be somewhat stable. This result would clearly be preferable to models that utilize short-term pricing and result in volatile default service rates for residential customers.⁷ The Commission should reject any proposals that try to tie prevailing market price to short-term or spot market pricing.⁸

C. Default Service Implementation Plans

Most EDC comments, and those of the EAPA, support the Commission's position that EDCs should be permitted to develop company-specific default service implementation plans. The OCA also supported such plans given that the Commonwealth's EDCs are of distinctly different sizes, belong to different RTOs, have different service territory characteristics

⁶ See *supra* note 1.

⁷ Direct Energy argues that short term pricing may not necessarily result in price volatility. Direct Energy references an "internal analysis" of the New Jersey auction results in 2004. Direct Energy Comments at 12. Direct Energy claims that there would have been a range of default service prices from 4.33¢/kwh to 6.45¢/kwh, a differential of almost 50% during the year.

⁸ As noted by the OCA in its Comments, other states such as Maine and New Jersey that have had to address this issue sooner than Pennsylvania have moved toward multi-year "laddered" approaches to default service procurements for residential customers.

and have staggered termination dates for their transition periods. In short, what is appropriate for PECO may not be appropriate for Citizens' Electric. That said however, the OCA submits that each default service implementation plan should have the same goal with regard to residential customers – to provide reliable service at stable and reasonable rates over the long-term.

Three commenters -- PPL, OSBA and Morgan Stanley -- suggested the Commission adopt a statewide procurement process modeled after New Jersey's descending clock auction. Direct Energy also recommended that the Commission implement a "one size fits all" approach or a statewide procurement method. Direct Energy Comments at p.12. The OCA is concerned that a one size fits all approach would not be conducive to the type of portfolio management for default supply strategy that the OCA has advocated in its Comments. The OCA continues to recommend that an EDC serve the role of a portfolio manager that acquires a portfolio of resources in the competitive wholesale market to meet its load obligations. The portfolio or procurement process should be designed to provide reliable service at stable rates. It should also emphasize diversity of resources, a variety of contract terms and it should incorporate any state-mandated public policy requirements. This would include, of course, compliance with the Alternative Energy Portfolio Standards Act. Through this portfolio approach, the EDC should be able to procure reliable supply at the lowest reasonable cost.

The OCA submits that for residential customers, reliable service at stable, reasonable prices, on reasonable terms and conditions, should be the goal of default service. In Pennsylvania, where there are a number of diverse electric service territories, a procurement strategy that meets the unique needs of each particular service territory may be the best way to serve Pennsylvania consumers.

For the reasons set forth here, and in the OCA's Comments, the OCA supports the proposed regulations at § 54.185, calling for EDC-specific default service implementation plans.

D. Cost Recovery, Rate Design and Rate Unbundling

1. Introduction

As a general matter, the OCA submits that the cost recovery and pricing associated with default service must reflect the fact that electricity is an essential service, must only include the reasonable costs of default service, and must be understandable in order to facilitate price comparisons with products offered by competitive suppliers. The OCA is concerned that the Commission's proposed regulations would not achieve this objective. The Commission proposed three separate rates for default service – a customer charge, a non-reconcilable Generation Supply Charge, and a reconcilable charge for recovering the cost of purchases made to comply with the Alternative Energy Portfolio Standards Act. Through the customer charge the Commission proposes to collect such things as the costs for customer billing, collections, customer service, meter reading, as well as uncollectible expense, administrative or regulatory expenses, taxes and a return component. In its Comments the OCA opposed creation of the customer charge on the grounds that it was unnecessarily complicated and included costs that were not properly part of a default service rate. The OCA also opposed two separate supply charges, one reconcilable and one non-reconcilable. The OCA noted that the Alternative Energy Portfolio Standards Act, which calls for reconcilable cost recovery of complying with the Act, leads the OCA to the conclusion that a reconcilable charge must be used for default service.

Most of the EDCs were also critical of all or part of the proposed customer charge. See, PPL Comments at pp. 9-10; Allegheny Comments at pp.8-9; Duquesne Comments

at pp. 26-31; UGI Comments at pp. 9-12; Met-Ed/Penelec/Penn Power Comments at pp. 6-7; Citizens'/Wellsboro Comments at pp. 17-19. Additionally, many EDCs recommended a move to a reconcilable charge for default service. PPL Comments at pp. 6-7, 9-10; PECO Comments at pp. 5, 16; Met-Ed/Penelec/Penn Power Comments at pp. 2-5; UGI Comments at pp. 12-13; Allegheny Comments at p. 7; Citizens'/Wellsboro Comments at pp. 16-17. This approach supports the OCA's overall recommendation that EDCs be required to manage their default service portfolio, including the obligation to comply with the Alternative Energy Portfolio Standards Act, in an integrated fashion.

The Comments of the various parties raised two other issues to which the OCA wishes to respond. First, NEMA sought to require embedded cost studies and revenue requirement cases to unbundle many distribution costs that they allege should be transferred to and reflected in the default service price. See, NEMA Comments at pp. 5-6. See also, Strategic Energy Comments at p.23 and MAPSA Comments at p. 4. The EGSs seek to include in the default service rates the cost of such things as the customer call center, customer information and recordkeeping, customer agreement initiation and maintenance, customer enrollment and switching support, billing, credit and collection, revenue accounting and disbursement, uncollectibles, and EDI capability, among others. See, e.g., Strategic Energy Comments at p. 24. The EGSs seek policies that would result in higher default service prices, thus allowing them "head room" to market their services to residential customers. The OCA does not support the inclusion of costs in the default service rates that unreasonably and unnecessarily increase the price of default service.

The second issue arises from the joint Comments of Met-Ed, Penelec and Penn Power and concerns certain aspects of the reconcilable Generation Supply Charge they recommend. Of specific concern is the proposal for quarterly (as opposed to annual) adjustments to the charge and their suggested inclusion of a “risk adder” as part of the charge. Met-Ed/Penelec/Penn Power Comments at pp. 2-6. The OCA submits that adjustments to default service rates should occur no more than once per year. Additionally, there is no basis for a risk adder to a fully reconcilable, dollar for dollar, recovery mechanism.

2. Costs Included In The Default Service Rate Should Be The Reasonable Costs Of Providing Default Service.

As the OCA set forth in its Comments, the costs that the regulations, and the EGSs, propose to allocate to default service rates are not costs that are necessarily avoided by an EDC when a customer switches to an alternate supplier. For example, even if a particular customer chooses to receive a bill from the alternate supplier, that does not mean that the EDC can reduce its overall billing costs by an appreciable amount. The EDC still has to bill customers and maintain its overall billing system. It must also maintain the capacity to resume all billing functions if the customer returns or the supplier determines it will no longer offer billing services.

Metering is an even clearer example. When a meter is read, the same kilowatt-hour usage is used to bill the customer for distribution service and generation service. It is clear that there will not be two meters or two meter readings to read the same usage off the same meter. Meter reading is not a cost that is avoided by the EDC when a customer shops for generation.

NEMA suggests, however, that the Commission should engage in an unbundling proceeding to allocate costs such as billing and metering, to the generation function. NEMA Comments at p.6. While the OCA agrees that default service rates should include reasonable costs of providing default service, the costs must be those associated with providing the service and should only be costs that are avoidable when a customer shops for generation. If the costs are not avoidable, remaining customers will end up paying twice for these costs.

Any costs included in the default service rate should also be the necessary costs for providing default service, and not merely an attempt to create “headroom” for EGSs. For example, including the costs of metering and billing in default service rates seems unnecessary at this time. All EGSs in Pennsylvania currently choose to bill through the EDC for their residential customers. At this time, there is little or no evidence to show that EGSs can provide customer care, billing and collection services to mass market residential customers more efficiently than the EDCs. There is no record of EGS billing and collection of a consolidated bill from residential customers in large numbers outside of Texas, a market that is unique in its structure and implementation.

The OCA submits that the Commission should ensure that default rates are not increased to include costs that properly belong in distribution rates. The Commission must also ensure that default service customers are not charged twice for the same service.

3. Generation Supply Charge – Quarterly Adjustment and Risk Adder

The FirstEnergy Companies proposed that the Generation Supply Charge be reconcilable, subject to quarterly adjustment, and include an adder to compensate for risk. With respect to quarterly adjustment, the OCA would note that the purchased gas cost (“PGC”) rates of natural gas distribution companies are currently adjusted quarterly and the frequent changes to

the PGC rate make it difficult for customers to compare prices and shop for alternative suppliers. So, too, would quarterly changes to electric default service rates make offer comparisons difficult. Among other things, the FirstEnergy Companies argue that quarterly, as opposed to annual, adjustments would minimize the level of rate changes from one twelve month procurement period to the next. However, if the OCA's multi-year portfolio management approach to default supply procurement were utilized, price adjustments from year to year would, by the very nature of the process, be moderated. The FirstEnergy Companies also argue that quarterly adjustments to the Generation Supply Charge would keep it "in sync" with the prevailing market price. Here the Companies fall into the fallacy that prevailing market price is defined exclusively by the short-term energy market. As the OCA discussed above, reliance on short-term energy markets for setting default service rates will inevitably lead to unstable and volatile pricing. The prevailing market price should reflect the price of the variety of products sold in the wholesale market, including contracts of varying length.

Regarding the FirstEnergy Companies' suggestion that a risk adder be included in the Generation Supply Charge, the OCA would note that there is no reason whatsoever to include such an adder if the charge is reconcilable. As the OCA stated in its Comments: "the risk of resources needed to support default service should be reflected in the cost of the portfolio of resources that the default service provider procures to meet its obligation and should be based on the recovery mechanism adopted. For example, if the default service provider is using a dollar for dollar fully reconcilable recovery mechanism, there is no risk and no need for any risk adjustment." OCA Comments at p. 45. The OCA continues to hold that inclusion of a risk adder for an EDC with dollar for dollar, reconcilable recovery would be entirely inappropriate and unnecessary.

For the reasons stated, the OCA urges the Commission to reject any suggestion that the Generation Supply Charge be adjusted more frequently than annually or that the charge include any form of “risk adder” if the charge is to be reconcilable.

E. Deployment of Interval Metering

Several marketers emphasized the importance of moving to interval metering for all customers, not just the largest commercial and industrial customers who elect hourly pricing for default service. See, Direct Energy Comments at p. 14; Strategic Energy Comments at pp. 8-9. While the OCA supports the continuing evaluation of new technologies and is supportive of the voluntary selection of alternative pricing methods and meters to support those methods, the suggestion that default service should be accompanied by a move to “real time” pricing or the mass installation of interval meters to provide hourly pricing for all customers is without merit. The cost of installation of such meters, the billing changes that would be required to implement such alternative pricing proposals, and the costs associated with customer education to move toward such price options would be substantial for most residential customers. As the OCA set forth in its Comments, the basic default service rate for residential customers should be a fixed rate. Residential customers could be offered other options such as time-of-day rates, but these should be voluntarily chosen by the customer.

F. Customer Switching

Dominion Retail offers a proposal to link the level of customer switching to the right of the EDC to continue to serve as the default service provider. Dominion proposes that the Commission “incentivize EDCs to be promoters of customer choice” and “specifically link the EDC’s privileged and incumbent position as the default service provider to the degree of customer switching.” Dominion Retail Comments at p. 9. This proposal is accompanied by an

auction or allocation of a percentage of default service customers to an EGS who seeks to provide this service if the EDC fails to stimulate customer switching of a set amount. Dominion Retail pp.9-10. The OCA submits that this proposal should be rejected.

The underlying premise of the Electric Competition Act was that when competitive market forces were brought to bear on the generation of electricity, those forces would reduce the cost of generating that electricity and in turn, reduce the price of the generation service to retail customers. Significantly, under the Act, a customer does not have to leave his or her retail electric distribution company to gain access to competitive market generation. Rather, once the transition period is over, the customer can choose between purchasing generation from an EGS or purchasing unbundled generation from an EDC at a price that is designed to reflect the costs to the EDC of acquiring generation in the competitive wholesale market at prevailing market prices.

The Commission's policies should not be geared toward incentives for customer switching. The goal of the Electric Competition Act was to lower costs to customers, not to achieve any particular level of retail customer switching. The OCA urges the Commission to resist any suggestion to the contrary. The OCA would also note that previous attempts to pursue this method in the PECO Energy service territory were not very successful and should not be repeated.⁹ For these reasons, Dominion Retail's proposal should be rejected.

⁹ As the Commission is aware, NewPower was selected to be the competitive default service provider for approximately 20% of PECO's residential customers. Before the end of the first year of the CDS term, NewPower left the market and returned all customers to PECO. In the PECO Market Share Threshold program, Dominion Retail was selected to provide service at a discount to a percentage of PECO Rate R customers for a one year term, but Dominion did not elect to continue to serve the customers at that price at the conclusion of the term and returned the customers to PECO. In the MST program, no bids were received to serve PECO Rate RH customers.

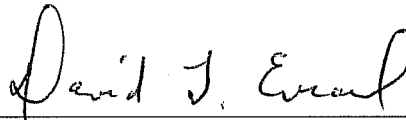
G. Access to Customer Information

A number of marketers proposed that the Commission impose more uniformity on the rules and procedures in place among the EDCs with respect to access to customer information and the use of EDI protocols to exchange metering and billing data. See, Strategic Energy Comments at pp.27-28; MAPSA Comments at pp. 7-8. The OCA agrees that such an approach should be explored and has participated in the Commission's Electronic Data Exchange Working Group, as well as in the development of voluntary business practices by the Retail Electric Quadrant at the North American Energy Standards Board. It is appropriate to adopt uniformity in such transactions and methods of exchanging electronic data between EGSs and EDCs.

III. CONCLUSION

The OCA appreciates the opportunity to file Reply Comments on some of the critical issues regarding the provision of default service in the post-transition period. The OCA will continue to work with the Commission and the stakeholders to develop default service regulations that provide residential ratepayers with reliable electric service at reasonable and stable rates.

Respectfully Submitted,



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DATED: June 27, 2005
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