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VIA HAND DELIVERY


James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street – 2nd Floor
Harrisburg, PA 17120

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

Dear Secretary McNulty:

Enclosed please find an original and fifteen (15) copies of the Reply Comments of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company in the above-captioned proceeding. Copies of the Reply Comments have also been sent by email to Shane Rooney, Esquire and Cyndi Page, as requested. Please contact me if you have any questions.

Very truly yours,



John F. Povilaitis

Enclosures

JFP/ck

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**REPLY COMMENTS OF
METROPOLITAN EDISON COMPANY, PENNSYLVANIA
ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY ON
PROPOSED DEFAULT SERVICE REGULATIONS**

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I. INTRODUCTION

Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company submit the following Reply Comments to the April 27, 2005 comments filed in this proceeding. The importance of this rulemaking is confirmed by the voluminous comments submitted by a wide array of interested parties on the issues addressed by the Pennsylvania Public Utility Commission's ("Commission") proposed default service regulations. The Companies continue to support the basic framework for establishing post-transition period default service laid out in the proposed regulations and urge the Commission to stay the course on the core elements of its proposals.¹ The following are the Companies' specific replies to a number of the commentators' proposals.

¹ The Companies' Reply Comments focus on proposals that operate within the framework of the proposed regulations. A number of commenting parties have filed proposals that conflict with the Commission's core concepts for default service or stray into extraneous issues such as competitive safeguards, access of competitive suppliers to customer information or development of retail POLR models. See Comments of Amerada Hess Corporation, Direct Energy Services LLC, Mid-Atlantic Power Supply Association, Reliant Energy, Inc. and Strategic Energy, LLC. To the extent these commentators submit recommendations fundamentally inconsistent with the Commission's proposed regulations, as modified by the Companies' initial comments, these recommendations are opposed.

A. Term of Service and the Portfolio of Resources Procurement Concept

The Companies will address a number of implementation plan-related proposals in subsection B. of these Reply Comments. However, two recommendations related to implementation plans advocated by the Office of Consumer Advocate (“OCA”) must be addressed at the outset due to their significance and their conflict with the fundamental premise of default service. OCA advocates a *minimum* term of service for implementation plans of five years and a portfolio of resources procurement as the model for an appropriate implementation plan. Neither of these concepts should be adopted by the Commission.

It is clear from OCA’s comments that it seeks a continuation of the electric distribution Company’s (“EDC”) pre-Electricity Generation Customer Choice and Competition Act (“Competition Act”) obligations as its model for the default service provider. Citing the “small” or “absent” level of retail competition available to residential customers in the current rate cap era, OCA states “...default service must be viewed as the primary vehicle for delivery of the promises of the 1996 Act.”² To obtain the benefits of the Competition Act for residential customers, OCA advocates an EDC purchasing strategy “designed over the long term” utilizing “[a] variety of products, resources, contracts, and financial instruments” that should “mitigate the various risks of the service and result, long term, in reasonable costs for the type of service being provided.”³

OCA’s view of the default service provider’s generation service obligation is indistinguishable from the pre-Competition Act role of the EDC. However, it is the clear

² OCA Comments, p. 2.

³ OCA Comments, p. 3.

intent of the Competition Act that the EDC's obligation to serve be modified once the transition period is over:

(e) **Obligation to serve.** An electric distribution company's obligation to provide electric service following implementation of restructuring and the choice of alternative generation by a customer is revised as follows:

(1) While an electric distribution company collects either a competitive transition charge or an intangible transition charge or until 100% of its customers have choice, whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric energy and the production or acquisition of electric energy for customers.

(2) At the end of the transition period, the commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period.

(3) If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.⁴

(Emphasis added). The Commission's regulations must make it clear that the EDC's obligation to serve is being modified at the end of transition to conform with a competitive regime wherein the EDC has a short-term duty to acquire electric energy at prevailing market prices. A specific suppliers' failure to deliver and a customers' failure to choose an alternative supplier are not events that can be assumed to continue on a long-term basis. Obligating the EDC to assemble a portfolio of resources, as described by OCA, to ensure long-term "reasonable" rates for customers is inconsistent with a default service that is available when expected service by an EGS is not delivered or a customer fails to choose an alternative electric generation supplier – the statutory

⁴ 66 Pa.C.S. § 2807(e)(1)-(3).

definition of default service.⁵ OCA's position bets against competition and the customers' freedom to shop as a restraint on prices and is in fundamental conflict with the Competition Act which states "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity."⁶

Five year minimum terms of service and Commission evaluation of what constitutes the correct portfolio of resources, as OCA suggests, assumes that default service is in long-term competition with service provided by EGSs and further assumes the default service provider should plan for the long-term electricity needs of customers. This is an erroneous perception of the role of the default service provider. The Commission should clarify that default service implementation plan filings are not intended to be litigations of long-term procurement policies. Instead implementation plans should be evaluated for whether they will achieve what is needed – the procurement of sufficient quantities of electricity at prevailing market prices for customers who need the safety net of default service. OCA's view of the planning horizon for a default service provider is more akin to the OCA/Duquesne six year stipulation period that was rejected by the Commission in Duquesne Light's POLR proceeding.⁷

The Commission should reject OCA's length term of service and portfolio of resources proposals as inconsistent with the Competition Act and clarify that the EDCs' obligation to serve is being modified to that of a default service provider.

⁵ Section 2807(e)(3) of the Public Utility Code defines default service in this manner. 66 Pa. C.S. § 2807(e)(3).

⁶ 66 Pa. C.S. § 2802(5).

⁷ *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).

B. Implementation Plan Issues

Various commentators submitted recommendations relating to the implementation plans and review by the Commission as outlined in Sections 54.185 – 54.188 of the proposed regulations. The Companies' Reply Comments address the following implementation plan issues: the time for Commission review of implementation plans, the length of those plans relative to the effective date of regulations, the number of customer rate classes, seasonal rates and the appropriate designation of what constitutes a large customer.

1. Time for Commission Review

The proposed regulations provide for the assignment of implementation plans to the Office of Administrative Law Judge for a six month review process. A nine month review period was urged by OCA and OSBA.⁸ Enlargement of the review period can only be achieved by shortening the EDC's time to implement the approved plan or forcing the EDC to file a proposed plan more than 17 months in advance of its effective date. Either option is unnecessary and ill-advised. The implementation plan filings will be made pursuant to the Commission's detailed regulations which should expedite the evaluation process. In addition, if the Commission adopts the Companies' recommendations regarding simplification of the default service rate (i.e., adoption of a fully reconcilable generation supply rate and elimination of the supply customer charge), a six month review period should be adequate. The Commission should retain its proposed six month review period for implementation plans.

⁸ OCA Comments, p. 22; OSBA Comments, p. 15.

2. Length of Implementation Plans Adopted Prior to Final Regulations

Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (“Constellation”) recommends that the effective length of implementation plans for EDCs emerging from transition prior to the effective date of the default service regulations should be curtailed to the shortest possible time period to ensure consistency with the regulations.⁹ This recommendation assumes there will be conflict between an approved implementation plan and the regulations. Conflict between approved implementation plans and the final regulations is unlikely since the decision makers for both matters are the same. Rather than require an implementation plan to have an unduly short time frame, the Commission should leave resolution of any actual conflict between an approved plan and the requirements of the final regulations to the time when it is clear such a conflict exists. Approved implementation plans should not have shortened life spans due to potential conflicts with the final approved regulations.

3. Number of Customer Rate Classes

Constellation recommends that the regulations provide for the Commission reserving the authority to reclassify or subdivide existing customer rate classes as part of the implementation plan.¹⁰ This proposal appears more related to enhancing the marketing efforts of EGSs than the effective provision of default service, which will likely follow traditional customer tariff classifications. Explicit reservation of Commission authority in the regulations on this point is therefore unnecessary.

⁹ Constellation Comments, p. 3.

¹⁰ Constellation Comments, p. 5.

4. Seasonal Rates

OCA recommends that default service providers be barred from proposing seasonal rates as the only rate option for residential customers, but concedes that optional seasonal rates could be proposed subject to the implementation plan review process.¹¹ EDCs should not be barred from proposing seasonal rates for residential customers as their sole default service option. This is particularly true if the Commission continues to preclude switching rules. The reasonableness of a seasonal rate proposal can be evaluated in the implementation plan review process. EDCs should not be barred from proposing seasonal rates for customers as their sole default service rate option.

5. Designation of Large Customers

There is no consensus as to what demand level should be the threshold for a large customer.¹² This diversity of opinion reinforces the appropriateness of deciding what is a “large” customer in the course of the EDC’s implementation plan proceeding. The characteristics of each company’s customer base can then be taken into account as part of the determination of what constitutes a large customer.

Classification of customers as “large” should occur in each implementation plan proceeding.

C. Rate Issues

Numerous comments addressed elements of the Commission’s default service rate proposals. The primary subjects of rate comments were the generation-related Customer

¹¹ OCA Comments, pp. 22-24.

¹² PPL has proposed 500 kw, PECO 750 kw, Allegheny 1,000 kw and UGI proposes 1 mw except where the default service provider establishes another standard.

Charge, reconciliation of rates, the large customer hourly rate requirement and the proposed inclusion of transmission costs in the generation supply charge.

1. Customer Charge

In addition to the Companies, other parties have supported elimination of the proposed generation-related Customer Charge.¹³ As stated in the Companies' initial comments, the Commission should refrain from requiring separate costs of service studies and the breakout of a new customer charge for default service billing, collections, customer service, meter reading and uncollectible debt. These functions are not easily allocated between supply services and transmission and distribution services. Given the EDC's role in distribution service, it is implausible to assume that these functions would ever completely leave the EDC.

Besides the fact that development of a new cost-of-service-study-based customer charge will significantly add to the cost and complexity of the implementation plan proceedings, parties such as OCA aptly noted that a separately stated generation related customer charge (that may not be on a cents per kwh basis) will greatly increase the difficulty customers will have discerning their price to compare, chilling their interest in seeking a competitive supplier. A separate customer charge for generation supply should not be mandated.

2. Reconciliation of Rates

The comments relating to reconciliation of rates raise primarily two issues: whether the generation supply charge should be fixed or adjustable, and how the charge

¹³ OCA Comments, p. 18.

should relate to the Act 213 alternative energy charge which is required by the law to be an adjustable Section 1307-type rate.

OCA, for example, supports the use of a reconcilable rate for default service generation supply in view of Act 213's requirement that alternative power costs be recovered on an adjustable rate basis.¹⁴ OSBA appears to support a blended procurement process, where alternative (Act 213) and non-alternative energy is obtained in a single procurement process, as the most efficient method of obtaining power for default service customers.¹⁵ The Companies support Commission adoption of a single reconcilable generation supply retail charge developed from the results of a combined alternative and non-alternative supply procurement. This approach to the generation supply rate will not only fully comply with the Act 213 and Competition Act requirements that these costs be fully recovered, but in addition will produce a readily understandable price to compare for customers.

If the Commission adopted a fully reconcilable generation supply rate for default service, the Companies would accept the elimination of any risk adder component as part of the default service rate. The Commission should adopt a fully reconcilable generation supply charge as the product of a combined procurement that obtains alternative and non-alternative power

3. Rate Options for Large Customers

IECPA et al. proposes a fixed rate for large customer default service.¹⁶ The proposed regulations require default service providers to offer hourly service to large

¹⁴ OCA Comments, pp. 19-21.

¹⁵ OSBA Comments, p. 13-14.

¹⁶ IECPA et al. Comments, pp. 22-26.

customers but make fixed price rates optional for the EDC.¹⁷ The Companies note the arguments made by IECPA et al. and recommend that the regulations provide flexibility on the issue of default service rates for large customers. The issue of hourly rates versus fixed rates will be influenced by the type of large customers operating in each EDC's service territory as well as the point in time that this decision is being made.

Consistent with the flexibility provided by the proposed regulations on other issues, the question of whether hourly rates, fixed rates or some alternative is appropriate for large customers should be resolved in each EDC's implementation plan at the time that plan is being reviewed.

It may still be appropriate for an EDC to have a single default service rate per customer class, however that determination should be part of the implementation plan process.

4. Transmission Costs

The regulations propose including transmission costs in the generation supply rate and the hourly rates of large customers.¹⁸ This proposal has drawn the opposition of IECPA et al.¹⁹

The inclusion of FERC-approved transmission rate costs in the default service rate and the proper allocation of those costs to customers is an issue that would significantly complicate the matters that must be addressed in implementation plans. The issue of recovering these costs should be dealt with outside of the process that sets default service rates. The Companies recommend that transmission costs not be considered part

¹⁷ Small customers must be offered a fixed rate under the proposed regulations.

¹⁸ Sections 54.187(a)(1) and 54.187(e)(3).

¹⁹ IECPA et al. Comments, pp. 11-18.

of the default service supplier bids, but rather continue to be a service supplied through the EDC, with appropriate cost recovery by the EDC outside of the default service rate setting process.

D. Competitive Procurement

The Companies have supported the concept of a single procurement process to acquire alternative and non-alternative power, as part of the recommendation for a single reconcilable generation supply charge addressed in section C.2. above. In addition to this issue, the comments have raised other issues relating to the actual competitive procurement including: the mandate of a state-wide bidding process, scope of procurement issues, third party review, scope of the Commission's role in evaluating a procurement, the length of the Commission's review period and procurement in the context of a supplier default.

1. State-Wide Bidding Process

OSBA supports a state-wide bidding process commencing in 2011 when all the EDCs are expected to have emerged from their transition periods.²⁰ The Companies agree with this recommendation for companies in the same power pool and urge the Commission to identify state-wide procurement as a goal for Pennsylvania.

Coordination of the state-wide competitive procurement will require careful direction from the Commission which should be provided as the EDCs and other interested parties approach 2011 when a state-wide procurement is possible. Implementation of a state-wide procurement will require the Commission to address the

²⁰ OSBA Comments, pp. 6-7.

technical issues associated with companies transitioning from their separate implementation plans established prior to 2011. The Commission should establish the goal of a state-wide competitive procurement in 2011 and focus carefully on the details of transitioning to this approach which could vary for different EDCs.

2. Scope of Issues Resolved in the Procurement

The Companies agree with Constellation's recommendation that the non-price issues relating to the competitive procurement should be resolved in advance of the actual procurement so that the focus of the procurement is strictly price.²¹ Narrowing of the issues to price assures bidders they are operating on a level playing field. If issues other than price are outstanding during the procurement compliance review period, the rapid evaluation process envisioned by the Commission and numerous commenting parties will not be practical. Procurement should focus on price.

3. Third Party Review

Several comments have raised the issue of selecting a third party to review the results of the competitive procurement process and the authority of the third party. Constellation recommends that use of a third party evaluator should be made mandatory and the third party should be selected by the Commission.²² IECPA et al. seeks additional details in the regulations on the procedure for selecting a third party and specification of the scope of authority for the third party.²³

The Companies oppose mandatory selection of the third party evaluator of the procurement by the Commission and a precise specification of their authority in the

²¹ Constellation Comments, pp. 7-8.

²² Constellation Comments, p. 7.

²³ IECPA et al. Comments, pp. 10-11.

regulations. This is the type of issue that benefits from the flexibility the Commission has built into the proposed regulations. Proposed Section 54.186(d) provides that the procurement may be subject to oversight by a third party that reports to the Commission and maintains adherence to confidentiality agreements. This is an appropriate amount of direction on the subject of third party evaluations.

There is no need to compel the use of a third party evaluator or detail their precise authority in the regulations. These issues are easily addressed in the implementation plan proceeding, including the threshold issue of whether the EDC's form of procurement would benefit from the involvement of a third party. The nature of the procurement should dictate the details of third party participation and that will become clear only at the time the implementation plan is filed. The Commission's regulations should not compel the use of a third party evaluator and specify their precise role at this time.

4. Scope of the Commission's Role in Evaluating Procurement

The proposed regulations properly describe the Commission's role relative to the results of the procurement process as one of verifying that the procurement occurred consistent with the implementation plan previously approved by the Commission. OCA recommends a broader role for the Commission, starting with its evaluation of the implementation plan and continuing through the Commission's evaluation of the results of the procurement.²⁴ Specifically, OCA believes the Commission should review an implementation plan "to determine if it is properly designed to produce the lowest priced, reliable electric supply and only includes reasonable costs for recovery."²⁵ OCA also suggests that the regulations impose on the Commission the obligation to determine, as

²⁴ OCA Comments, pp. 52-54.

²⁵ OCA Comments, p. 52.

part of the procurement evaluation process, whether the process produced “non-competitive” results.²⁶

The Commission should reject these recommendations that arise from OCA’s incorrect view of the role of the default service provider. Essentially OCA seeks to convert the implementation plan process into a prudency review of procurement plans, followed up by a Commission obligation to reject the results of that process, even if it is followed to the letter, on the vague ground that the results were “non-competitive”. OCA’s proposed standards fit with a model where the default service provider is competing with EGSs for customers, rather than the true role of default service as a safety net. The enhanced regulatory burden OCA proposes being placed on the Commission is inconsistent with the principles of the Competition Act to rely on market forces rather than regulation.

The Companies are confident that EDCs, as part of their implementation plans, will reserve the right to reject procurement results that are aberrant due to world events or events of another nature that drastically skew competitive procurement results. OCA’s proposed standards for approval of implementations plans and evaluating the procurement result of those plans should be rejected. The Commission’s proper role in evaluating procurement results is to determine consistency with the implementation plan.

5. Compliance Verification Period

Constellation seeks to shorten the time for Commission evaluation of procurements to two days.²⁷ The Companies support a three day maximum evaluation period which is a reasonable compromise period that should be adopted. The

²⁶ OCA Comments, p. 53.

²⁷ Constellation Comments, p. 8.

Commission's procurement evaluation period should be no more than three business days.

6. Reliance on the RTO/ISO to Obtain Supplies

The Companies support the regulations' references to obtaining power quickly through the RTO/ISO in the event of a supplier default or problems in completing a procurement. OCA recommends that these references be stricken from the regulations.²⁸ The proposed regulations prudently recognize that reliance on the RTO/ISO to cope with these types of supply inadequacies is appropriate. OCA's opposition to the Commission's endorsement of this remedy stems from their core view that default service should be a competitive offering and the EDC should plan for long term service to a significant number of customers. The Commission's references to reliance on the RTO/ISO in supply failure circumstances is true to the proper role of default service as a safety net and should be retained.

The regulations should reference the RTO/ISO as the means to resolve procurement difficulties and default situations.

E. Miscellaneous Recommendations

Two other comments that do not fit within the foregoing general categories of topics warrant a reply by the Companies.

1. Flow Through of DSM "Savings"

PJM posits a scenario where a default service provider resells default service power made available from customer demand side management efforts at higher market

²⁸ OCA Comments, pp. 39, 48-49.

prices. As the Companies understand PJM's proposal, the profits from such resales would then be flowed back to the customers who made the sale of excess power possible.²⁹

The Companies challenge the basic premise of PJM's recommendation, which is that default service providers will purchase more power than is needed by default customers. Moreover, PJM's proposal does not take into account the equity of routing the benefit of all such hypothetical transactions to customers, when EDC expenditures supported demand side management programs. PJM's DSM "savings" proposal should be rejected.

2. Compulsory Retail POLR Model

Dominion Retail, Inc. recommends a retail POLR pilot program that would force customers to take third party supply. Such forced shopping programs are inadvisable as a state-wide mandate. The Companies recommend that the Commission not devote resources to development of such programs. The Commission should not direct initiation of state-wide retail POLR programs that force customers to take third party supply.

II. CONCLUSION AND SUMMARY

The Companies reply comments are summarized as follows:

- The Commission should reject OCA's length term of service and portfolio of resources proposals as inconsistent with the Competition Act and clarify that the EDCs obligation to serve is being modified to that of a default service provider that provides service at prevailing market prices.
- The Commission should maintain its proposed six month review period for implementation plans.

²⁹ PJM Comments, pp. 6-7.

- Previously approved default service plans should not terminate when the default service regulations are made final.
- It is unnecessary for the Commission to reserve authority to create additional customer rate classes as part of its implementation plan review
- EDCs should not be barred from proposing seasonal rates for customers as their sole default service rate option.
- Classification of customers as “large” customers should occur in implementation plan proceedings.
- A separate customer charge related to generation supply should not be mandated.
- The Commission should adopt a fully reconcilable generation supply charge as the product of a combined procurement that obtains alternative (Act 213) and non-alternative power.
- The issue of appropriate rate design for large customer default service should be determined in each EDC’s implementation plan and take into account the characteristics of each EDC’s service territory.
- FERC–approved transmission charges should be recovered by EDCs outside of the default service cost recovery process; it is not necessary to make transmission costs part of the default service procurement program.
- The Commission should establish the goal of a state-wide competitive procurement in 2011 with careful attention to the issues relevant to each EDC.
- Procurement should focus primarily on price.
- The regulations should not compel the use of a third party evaluator and specify its precise role at this time.
- The Commission’s proper role in evaluating the result of a procurement is to determine consistency of the procurement with the implementation plan.
- The Commission’s procurement evaluation period should be no more than three business days.

- The regulations should reference the RTO/ISO as the means to resolve procurement difficulties and default situations.
- PJM's DSM "savings" proposal should be rejected.
- The Commission should not direct initiation of state-wide retail POLR programs.

The Companies look forward to the Commission's issuance of default service regulations and their progress through the regulatory review process.

Date: June 27, 2005

Respectfully submitted,



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