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
Implementation of the Alternative Energy Portfolio Standards Act of 2004	Docket No. M-00051865

SUPPLEMENTAL COMMENTS OF THE OFFICE OF CONSUMER ADVOCATE IN RESPONSE TO THE COMMISSION SECRETARIAL LETTER OF FEBRUARY 8, 2006

Tanya J. McCloskey
Senior Assistant Consumer Advocate

David T. Evrard
Assistant Consumer Advocate

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street 5th Floor, Forum Place
Harrisburg, PA 17101-1923
(717) 783-5048

Dated: March 8, 2006

TABLE OF CONTENTS

I. INTRODUCTION 1

II. COMMENTS 6

A. Integration of Default Service and AEPS 6

B. Cost Recovery -- AEPS 11

C. IRRC Comments 12

1. Timing of Final Regulations 12

2. Prevailing Market Prices 16

D. EPAct 2005 17

III. CONCLUSION 19

APPENDIX A - OCA Responses to Commission Questions of February 8, 2006

I. INTRODUCTION

The Office of Consumer Advocate (OCA) files these comments in response to the Commission's November 18, 2005 Order and its companion February 8, 2006 Secretarial Letter in the above-captioned docket. In its November 18 Order, the Commission determined that it would reopen the public comment period in this rulemaking to receive additional comments in three general areas: (1) the interplay between the requirements of the Alternative Energy Portfolio Standards Act (AEPS) and the requirements of the Electric Competition Act related to the provision of default service; (2) whether, as suggested by the Independent Regulatory Review Commission (IRRC), the Commission should delay promulgation of these default service regulations; and (3) whether any revisions to the proposed default service regulations are necessary in light of certain requirements of the Energy Policy Act of 2005 (EPAct 2005). The November 18 Order included six specific questions regarding implementation of the AEPS in the context of the default service regulations. The subsequent Secretarial Letter of February 8 repeated those six questions and added a seventh and eight question addressing topics (2) and (3) above. In the Secretarial Letter, the Commission invited comment on those eight questions and "on other Act 213 cost-recovery issues not included in this list."

There are three issues either raised directly or implied in the Commission's list which, in the view of the OCA, are vital to designing a set of default service regulations that has the greatest hope of delivering stable and reasonably priced electricity to residential customers. Those issues are: (1) the use of long-term contracts for some portion of electric supply; (2) the prompt promulgation of a definitive set of default service regulations; and (3) the proper interpretation of the phrase "prevailing market prices" as used in Section 2807(e) of the Electric Competition Act.

The Commission asks whether Default Service Providers (DSPs) should be permitted to employ long-term fixed price contracts to acquire alternative energy resources. The OCA's answer is an emphatic, "yes." Not only should DSPs be permitted to enter into such contracts, such contracts should be encouraged. Moreover, long-term contracts should be encouraged not only when purchasing alternative energy resources, but they should be an important element of a DSP's overall procurement strategy for both conventional and alternative energy resources.

The OCA has consistently maintained throughout this docket that in order to provide reliable default service at reasonable and stable prices, DSPs should acquire a portfolio of generation resources that includes a variety of fuel sources and length of contract terms. Incorporating some long-term contracts into the portfolio mix will serve as a hedge against price volatility in shorter-term contracts.

In the market for alternative energy resources, while long-term contracts will help dampen the price volatility of a portfolio of resources, they also play a much more fundamental role – enabling the financing and construction of a project in the first instance. It is self-evident that projects such as Integrated Gasification Combined Cycle power plants will not get built if they have to rely on one year contracts for their output. The financial community will regard such projects as simply too risky. The same can be said for many of the other forms of generation contemplated by the AEPS.

But even with regard to acquiring conventional energy resources, the volatility-dampening effect of long-term contracts is crucial. One need only look to the recent experience of Pike County Light & Power to recognize the risk of relying exclusively on a single auction for short-term contracts for acquiring default service generation. As will be discussed later, a similar

scenario is being experienced, to one degree or another, in a number of neighboring jurisdictions where reliance has been placed on short-term contracts. Long-term contracts, therefore, have an important role in stabilizing electricity prices for consumers.

The second critical issue raised by the Commission (in response to IRRC's comments) is whether to delay promulgation of the default service regulations. To that the OCA answers an emphatic, "no." In the OCA's view, these regulations are overdue. Had a well-considered, comprehensive set of regulations already been in place, it is possible that the unfortunate result in Pike County could have been avoided. Moreover, with the filing of Penn Power's interim default service plan, there are now, or soon will be, six electric distribution companies (EDCs) operating under interim plans. In the proceedings related to these plans, the same or similar issues have been litigated repeatedly. A definitive set of regulations would set policy guidance once and for all, avoiding the current policy-setting on a piecemeal basis.

Perhaps most importantly, putting in place sooner rather than later, a set of regulations adopting the OCA's portfolio approach to generation acquisition, would allow DSPs to begin the process of procuring or negotiating some of the long-term electricity contracts that will enable a measure of price stability for customers. Those EDCs whose post-transition default service obligations will not begin until 2010 or 2011, should be in the marketplace long before 2010 to secure a portion of their portfolio for that time period. Delaying promulgation of the regulations only increases the risk of losing the opportunity to lock in power contracts at those times when price and other market conditions are favorable. In addition, it delays opportunities for getting the types of resources that will ultimately be needed to comply with AEPS financed and constructed. Many of these resources may have long development cycles, so certainty now may be of importance.

The third major default service issue is one that is necessarily implied by the Commission's list of questions and was raised in IRRC's comments as well. It involves the meaning of the phrase "prevailing market prices" as it is used in the Electric Competition Act. The OCA has consistently maintained that the phrase includes a range of generation products of varying lengths and is not synonymous solely with spot prices or prices in the short-term energy markets. As long as a generation product is competitively procured, the price that is arrived at will constitute the "prevailing market price" for that product at the time it is procured, whether the product is short-term or long-term in nature.[1] The critical factor is whether the price reflects a competitive method of procurement, for it is the competitive sourcing process that establishes the "market price" for the product. The OCA fully supports the following statement made by PPL in its Initial Comments in this docket:

> 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. <u>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</u>. 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 Initial Comments of April 2005 (Emphasis added). Any insistence that "prevailing market prices" can mean only the prices available in the short-term energy markets, and that only short-term contracts can be utilized, is an invitation to creating a degree of volatility that is harmful to residential customers.

---

[1] It should be noted that a prevailing market price for a long-term contract typically will not be the same as the prevailing market price for a short term contract procured on the same day because of different contract terms, risk factors, or other criteria associated with the contract.

In these Comments, the OCA will generally address the topics identified by the Commission and then will provide specific responses to the questions contained in the Secretarial Letter of February 8, 2006. The OCA's specific responses to the questions set forth in the Secretarial Letter are attached as Appendix A.

II. COMMENTS

A. Integration of Default Service and AEPS

The Commission has presented a number of questions regarding the integration of the Commission's Default Service Regulations with the requirements of Act 213. The OCA addressed this topic to some degree in its Initial Comments on the proposed Default Service Regulations, filed April 27, 2005 (OCA April 2005 Comments). OCA April 2005 Comments at 19-21, 45-46. In those Comments, the OCA set forth its position that the proper role of the DSP for most utilities is that of a portfolio manager, that is, as the procurer of a variety of electric generation products -- differing in fuel type and length-of-term – necessary to meet its default service load obligations. Included in this portfolio would be the alternative energy resources needed to comply with the mandates of Act 213. As the OCA explained in its April 2005 Comments:

> Each EDC should develop a multi-year plan to acquire the needed portfolio of resources......The portfolio of products should include both short-term (one to three year) and long-term (at least five year) contracts. The approach should also include demand measures and the resources needed to comply with the Alternative Energy Portfolio Standards required under Act 213 of 2004.... The products should be combined to create a "ladder" or "tranche" approach to procurement; that is, only a portion of the load obligation should be acquired in any single year of the purchasing plan. Such a purchasing strategy, although designed over the long term, will require updating on a periodic or annual basis as the various components are implemented over time.

OCA April 2005 Comments at 2-3. In a footnote to the passage just quoted, the OCA further explained:

> The recent enactment of the Alternative Energy Portfolio Standards Act reinforces the need for portfolio planning by the POLR, or by the entity providing the full requirements of the POLR. In enacting the AEPS, the General Assembly has recognized the importance of a portfolio approach, particularly the

> diversity of resources, in supplying energy to customers in Pennsylvania. The OCA submits that the enactment of the Alternative Energy Portfolio Standards leads to an approach to default service that is portfolio based, whether provided by the EDC or a winning bidder meeting the full requirements of an EDC.

OCA April 2005 Comments at 3, fn. 1.

The OCA supports the procurement of the mandated amount and type of alternative energy resources as part and parcel of the Default Service Provider's overall default service procurement process. This integration will require the Default Service Provider to create and implement a long term procurement plan in order to evaluate the costs and benefits of various procurement options, including alternative energy resources and traditional generation supply resources. The result of that planning process should be a diverse array of generation (and potentially demand-side) products designed to meet the default service load obligations in a manner that provides reasonable and stable default service rates for customers over the term of the procurement plan.

In its April 2005 Comments, the OCA identified the need for some long-term resource contracts as part of a portfolio of resources. The OCA indicated that long-term contracts for resources could be at least five years in length. As part of the current inquiry, the Commission is seeking comment on whether contracts of ten or more years for alternative energy resources would be appropriate. Indeed, alternative energy projects, particularly those that are capital intensive, may have difficulty securing the necessary financial backing for construction without the assurance of a revenue stream from a long-term contract or contracts for the facility's output.[2]

---

[2] There has been discussion at the Federal Energy Regulatory Commission in several technical conferences that long term guaranteed revenue streams will be needed to reduce risk and finance construction.

Additionally, it may be beneficial to consumers in the long run to negotiate bilateral contracts (after an RFP is issued to solicit competitive proposals) with alternative (and traditional in some cases) energy resources to obtain access to reasonably priced capacity and energy that, in the long run, is likely to prove less expensive than, for example, additional natural gas-fired generation proposals. Such an approach is likely to allow the portfolio manager to accomplish additional benefits for consumers, such as the creation of a retail "hedge" against volatile prices in the wholesale market, as well as contribute to the market-based solution to assuring long term reliability of service with the investment in new generation resources.

The OCA would also point out that the longer term contract analysis suggested by the Commission in the context of AEPS resources should be linked to the overall longer planning period for Default Service generally so that any necessary long-term alternative portfolio components and options can be evaluated on a level playing field.

The need for such long-term contracts as part of the portfolio of resources should not be viewed as inconsistent with the provision of default service under the Electric Choice Act. There is no statutory basis for the notion that long term contracts are prohibited for Default Service under the Electric Choice Act. While the portfolio manager (*i.e.*, the DSP) should not engage in long term contracts without a sound analysis and only within the context of well-designed diverse portfolio, the statutory obligation to base Default Service or POLR on "prevailing market prices" is not a prohibition on any specific contract term or specific type of planning period for this essential service. Rather, the statutory guidance is designed to make sure that the resulting price for Default Service is based on "prices" that are derived from a competitive process and reflect the "market" for the product or service that is acquired, at the

time it is acquired. There is no requirement, for example, that the EDC procure an energy-only commodity in the form of relatively short term contracts.

The potential for harm to consumers by relying solely on short term wholesale market commodity contracts has become obvious in the past year. The result is particularly devastating when a utility has had to enter the wholesale market for 100% of the default service load at one point in time in markets that have demonstrated significant volatility over the past years. Pennsylvania is painfully aware of the consequences of such a procurement strategy as a result of the auction conducted by Pike County Light & Power Company in October of 2005 to meet its POLR obligation. As a result of Pike's auction, generation rates increased for its customers by 129% and its overall rates increased by 75.2%. The following chart summarizes the impact of the Pike auction:

Result of POLR Auction Pike County Light & Power Company Residential Customers			
	Generation Rate		
	2005	2006	% Change
First 1,000 kwh	6.2982 ¢kwh	14.4148 ¢kwh	129%
Over 1,000 kwh	5.4303 ¢kwh	12.4285 ¢kwh	129%
	Total Bill		
	2005	2006	% Change
Residential Customer using 700 kwh/month	$75.50	$132.31	75.2%

The results for Pike stand in contrast to the results of its affiliate, Rockland Electric Company in New Jersey. A portion of the Rockland system is in PJM and Rockland participates in the New Jersey Basic Generation Service (BGS) auction where one-third of the POLR load is procured each year under a three year contract. As a result of the most recent BGS auction, Rockland customers will be paying about 7.6¢/kwh on average for generation as

compared to the Pike customers right across the river who will be paying about 14.4¢/kwh on average for generation. The wholesale prices obtained for Rockland in the February 2006 BGS auction were relatively high, about 11.1¢/kwh for the Rockland territory, but the impact of this wholesale price increase was mitigated since only one-third of the supply was procured at this higher rate. The rate charged to customers is a blended rate that includes the prior auction results for the other two-thirds of the supply. While the wholesale prices for a 3-year contract increased by about 55%, the total retail bill increased only about 12% to 13%.

Ratepayers of other PJM utilities that have engaged in procurements in late 2005 and early 2006 for 100% of their default service obligation will also be burdened with significant price increases. Delmarva Power & Light recently procured supply for 100% of its default service load. If fully implemented at one time, Delmarva residential customers would see an average total bill increase of 59% beginning on May 1, 2006. Residential generation rates for the first 500 kwh in the summer would increase to 10.506¢/kwh (an increase of 64%) and in the winter, residential customers would pay 11.68¢/kwh for the first 500 kwh (an increase of 93%).[3] Although final rates are not yet available, recent newspaper articles report that the bid results for Baltimore Gas & Electric, which also procured 100% of its default service obligation in early 2006, will mean overall bill increases for residential customers of 60% or more.

The OCA submits that it is now clear that procurement of default supply by DSPs must follow a strategy to mitigate the impacts of volatile markets and must include the flexibility for the DSP to enter the market at various times, particularly when market conditions are favorable. The use of long term contracts for some portion of the portfolio will be critical for providing service at reasonable rates.

---

[3] According to recent published reports, Delmarva has now proposed to "phase in" the increase in three steps at six-month intervals.

The OCA submits that the requirements of the AEPS and the requirements for default service can be fully integrated through an approach that requires the DSP to plan for and acquire a portfolio of resources to meet its ongoing default service obligation. The portfolio should include contracts and purchases of varying lengths, including long term contracts that may be needed to meet the requirements of the AEPS. The Commission has the statutory flexibility to allow the DSP to construct a diverse portfolio which will satisfy the residential customers' need for price stability, reliability and reasonable prices and allow all market participants to meet the mandates of the AEPS.

B. Cost Recovery -- AEPS

The Commission has also raised questions regarding the relationship between the cost recovery mechanism for energy costs and the cost recovery mechanism for alternative energy resources under AEPS. As noted in its April 2005 Comments, the OCA has reached the conclusion that the mandates of the AEPS have established the necessary cost recovery mechanism for all default service purchases. The OCA explained in its April 2005 Comments as follows:

> Most importantly, given the subsequent enactment of the Alternative Energy Portfolio Standards Act, which calls for fully reconcilable recovery of the alternative energy resources needed to comply with the Act, the OCA has concluded that the recovery mechanism for POLR costs will have to be reconcilable. The use of a mechanism that is reconcilable for a portion of supply and non-reconcilable for another portion of supply may result in resource purchasing that is not fully consistent with a portfolio approach. If purchasing for two types of resources must be conducted separately so that the different cost recovery mechanisms can be implemented, the benefits of portfolio management are lost. It will always be more expensive to procure two separate portfolios rather than one integrated portfolio.

OCA April 2005 Comments at 4-5.

The OCA further explained the need for coordinated acquisition and coordinated cost recovery as follows:

> Ideally, a default service provider should acquire resources from suppliers where the supplier would meet the load obligation, including the AEPS requirements. The supplier's wholesale price would reflect the cost, and benefit, of the AEPS requirement in that price. Under the proposed regulations, however, the single wholesale price would have to be split into two components – one for the reconcilable portion of the generation and one for the non-reconcilable portion. This split would be extremely difficult to implement. The effect of the proposed regulations is that an EDC will have to conduct two procurement processes, one for the AEPS requirements and another for all other supply, so that the cost elements can go into the proper recovery mechanism. The OCA submits that this approach increases costs by artificially imposing a lack of coordination in planning and purchasing.

OCA April 2005 Comments at 20.

The OCA submits that both acquisition of resources and cost recovery should be coordinated through the portfolio approach. The resulting price for the portfolio of products needed to meet the default service obligation becomes the default service rate and the basis of the "price to compare." In other words, the price of the individual products in the portfolio are blended together to arrive at this default service rate.

C. IRRC Comments

1. Timing of Final Regulations

Pursuant to the requirements of the Regulatory Review Act, IRRC submitted its Comments on the proposed regulation to the Commission on July 27, 2005. In its Comments, IRRC included several general observations about the rulemaking as a whole, as well as specific comments directed at particular provisions of the proposed regulations. Among its general comments, IRRC questioned whether it was necessary for the Commission to pursue this rulemaking at this time and cited several reasons for its view. Specifically, IRRC stated:

> [W]e question the need for the rulemaking at this time. We base this question on the following. First, the PUC has noted that the retail and wholesale energy markets will continue to evolve between now and the expiration of the last EDC rate caps in 2010. Drafting regulations today that match tomorrow's markets is an imprecise and difficult task. Second, the PUC has also stated that changes to Federal and State law could affect this rulemaking. To illustrate this point, the Alternative Energy Portfolio Standards Act, which became law in 2004, and the implementing regulations to be developed by the PUC will have a dramatic affect [sic] on how energy companies acquire electricity. Third, knowledge could be gained from the experience of other states that are making the transition from a regulated to a competitive electric market. Fourth, the experiences gained by both the PUC and the EDCs, whose rate cap periods have ended and are operating under interim guidelines could be useful when crafting regulations at a future date. Additionally, the continuing use of interim guidelines would provide the PUC an opportunity to consider various pilot programs before it finalizes these regulations. For these reasons, we urge the PUC to carefully consider the value of delaying the promulgation of these regulations until a date closer to conclusion of the rate cap periods of the major EDCs.

IRRC Comments at 1-2.

In its November 18 Order reopening this rulemaking, the Commission stated as follows:

> Several other factors contribute to our decision to reopen the default service rulemaking. One, IRRC's comments identified several issues on which parties may desire the opportunity to file comments with the Commission. These issues include comments on the need of issuing default service regulations in the immediate future, as opposed to a time closer to the end of the transition period for all EDCs.

Order at 3.[4]

---

[4] As noted in the Commission's November 18 Order, Direct Energy Services, LLC filed a Petition in this docket on October 19, 2005, seeking the reopening of the comment period and citing the above-quoted IRRC language in support thereof. On November 10, 2005, the OCA filed an Answer to that Petition, opposing the reopening of the comment period and stressing the importance of going forward with promulgation of final regulations.

While it is true that the post-transition POLR responsibilities of several of the Commonwealth's largest electric distribution companies (EDCs) will not begin until the 2010-2011 time period, there are currently five EDCs[5] operating under interim POLR plans and a sixth[6] that recently filed an interim POLR plan with the Commission. Most of these interim plans will be expiring in the next twelve to twenty-four months and the affected companies must make alternative arrangements to supply their POLR load -- arrangements that must be established and submitted to the Commission in advance of the expiration of the current plans. These companies will be making important decisions now, and in the near future, (not years from now) as to how to meet their POLR obligations. As these companies transition from their current plans to the next round of POLR, they would unquestionably benefit from the definitive guidance and certainty that would come from the Commission adopting final rules in this docket.

Indeed, as some companies have moved through successive iterations of their interim POLR plans and others have instituted their interim plans for the first time, public parties such as the OCA, OSBA, and the Commission's Office of Trial Staff, who participate in every case, are finding that certain issues are being litigated repeatedly. The OCA urges the Commission to press forward with formulating and adopting final regulations. Greater benefit will be derived from establishing firm direction and certainty for POLR participants than will be derived from waiting and continuing to establish POLR policy on a piecemeal basis.

Equally important, the OCA is concerned that a significant delay in the promulgation of POLR policies governing the post-transition period will only exacerbate the delay in planning for the implementation of any POLR procurement plan or portfolio. A POLR

---

5 Duquesne Light Co., Citizens' Electric Co., Wellsboro Electric Co., UGI Utilities, Inc. – Electric Division, and Pike County Light & Power Company.

6 Pennsylvania Power Company

plan that sufficiently diversifies procurement may not be possible if the regulations are delayed. DSPs may need to plan, and enter contracts, long before the end of the rate cap period to properly meet their obligations.

Based on recent events in Pennsylvania (Pike County) and other states (namely Delaware and Maryland), it would appear that any acquisition of 100% of the POLR load at one point in time is likely to have negative impacts on POLR customers. This is because of the risks associated with procuring 100% of the POLR load under market conditions that may reflect short term or temporary phenomena or events, such as those that occurred with Hurricanes Katrina and Rita last Fall. The OCA recommends that the Commission enunciate its preferred POLR policies and charge Pennsylvania EDCs with implementation of these policies even before the end of the particular EDC's transition period. EDCs should be planning well in advance and procuring supplies when market conditions are favorable.

EDCs will also need to initiate actions now to acquire the necessary portfolio of resources in staggered steps over a longer period of time. Indeed, it is the OCA's view that the EDCs, even those whose POLR responsibilities do not begin until 2010 or 2011, should be in the market long before 2010, beginning to secure economic resources to become a portion of their portfolio. This may be particularly necessary for alternative energy resources needed to comply with AEPS. Many of these resources have a long development cycle. Contracts may be needed now to ensure that sufficient alternative energy resources are available to meet the future compliance requirements. Significant further delay in promulgating the regulations may result in lost opportunities to lock in favorable prices and contracts that may exist now and in the near future and lost opportunities to develop alternative energy resources.

The OCA submits that the Commission should finalize its rules as soon as reasonably possible so that EDCs already beyond their transition period have appropriate guidance for meeting their default service obligation and so that those EDCs still in their transition period can begin to plan and take advantage of favorable market conditions when presented. Also, resolution of these issues sooner rather than later will allow for the development of alternative energy resources that may be needed at the end of each EDCs transition period. The OCA does not see any additional benefit – and indeed sees substantial potential harm – in waiting until closer to 2010 to complete these regulations.

2. Prevailing Market Prices

The OCA also wishes to comment on another matter raised in the IRRC Comments – the meaning of the phrase "prevailing market prices." At several points in its Comments, IRRC appears to accept what the OCA believes is an erroneous view, *i.e.,* that prevailing market prices are tantamount to one price for electricity set in the short-term wholesale energy market. The OCA squarely rejects this view and maintains that prevailing market prices are not necessarily tied to the short-term energy market. Rather, the use of the plural term "prices" clearly contemplates a variety of products and services.

The OCA agrees that the "prices" that are relied upon by the DSP must reflect one or more competitive procurement processes pursued by the DSP pursuant to its Commission-approved implementation plan. In the context of that implementation plan a DSP can seek to procure a combination of short-term, long-term and intermediate-term contracts for electricity. The DSP could also seek competitive bids for energy management or DSM services or the renewable or alternative energy resources mandated by the AEPS. The price that emerges from the competitive procurement process for the product that is purchased is a "market" based price.

In this regard, the OCA is in full agreement with the Initial Comments of PPL in this proceeding. PPL stated:

> 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 at 14 (Emphasis added).

Thus, for any DSP, the price it charges for default service will be a composite of the prevailing market prices for purchases of varying lengths and varying types of services that it has made in compliance with its approved POLR implementation plan. As noted in the PPL Comments, these purchases will constitute "the portfolio of supply options that best meet the needs of its system."

D. EPAct 2005

The November 18 Order invites comment on how the mandates of EPAct 2005 impact this rulemaking proceeding. In particular, the Commission references Section 1252 of EPAct 2005, which requires electric utilities to offer time-based rate schedules to each of their customer classes no later than eighteen months after enactment of the act, which occurred August 8, 2005. In addition, Section 1252 provides that electric utilities must provide each customer requesting a time-based rate with a time-based meter capable of enabling the customer to receive the rate. As a precursor to utilities offering either time-based rate schedules or time-

based meters, Section 1252 requires each state regulatory authority to "not later than eighteen months after the date of enactment of this paragraph" conduct an investigation and issue a decision whether or not it is appropriate for electric utilities "to provide and install time-based meters and communications devices for each of their customers which enable such customers to participate in time-based pricing rate schedules and other demand response programs."

Section 1252 includes several exceptions to the requirement that state commissions conduct such an investigation. One exception is where a state has already implemented the standard concerned, or a comparable standard.

With respect to the installation of time-based meters, the OCA submits that the Commission may have already implemented this standard with the promulgation of its Advanced Meter Deployment Regulations at 52 Pa.Code § 57.251 *et seq.* No further inquiry on metering may be necessary under EPAct 2005.

As to EDCs offering time-based rates, the OCA submits that the Commission may wish to conduct a separate inquiry. The OCA is aware that for residential customers, some EDC's already have time of use rate schedules available that may already comply with this Section of EPAct 2005. Not all utilities have such an offering for residential customers at this time. The Commission may wish to gather information regarding the costs and benefits associated with such offerings for those utilities that do not have such a rate schedule before making a final determination. The size of the utility, the usage profile of residential customers, the cost of the meters and their associated communication and billing system changes, will need to be evaluated. It is the OCA's view that time of use rates and other "advanced" metering options should remain voluntary for residential customers, a view that is supported by EPAct 2005.

III. CONCLUSION

The OCA appreciates this opportunity to further comment on the proposed Default Service Regulations. The structures of default service, and the processes used to procure supply to meet the obligation, are of critical importance to all Pennsylvania consumers. The OCA will continue to work with the Commission and interested stakeholders on these important issues.

Respectfully Submitted,

Tanya J. McCloskey
Senior Assistant Consumer Advocate
David T. Evrard
Assistant Consumer Advocate

Counsel for:
Irwin A. Popowsky
Consumer Advocate

Office of Consumer Advocate
555 Walnut Street 5th Floor, Forum Place
Harrisburg, PA 17101-1923
(717) 783-5048

Dated: March 8, 2006
87711

APPENDIX A

OCA Responses to Commission Questions of February 8, 2006

1. Should Act 213 cost recovery be addressed in the Default Service regulations as opposed to a separate rulemaking? Is it necessary to consider Act 213 cost recovery regulations on a different time frame in order to encourage development of alternative energy resources during the "cost recovery period"?

OCA Response: Act 213 cost recovery should be considered as part of the Default Service regulations since the Act 213 cost recovery mechanism is an integral part of the planning and procurement of resources necessary to meet the default service obligation. It is the OCA's position that the default service provider should plan to meet its default service obligation through the use of a portfolio of resources procured through competitive processes. The portfolio should contain resources of varied types, varied fuel sources, and varied contract lengths. The alternative energy resources needed to meet the Act 213 requirements should be part of the portfolio of resources that the EDC utilizes to meet its default service obligation. Through this portfolio approach, the default service provider can mitigate the risks inherent in the market, reduce volatility in default service rates, and provide more reasonably priced service.

Critically, the use of a portfolio of purchases, including long term contracts, will facilitate the development of resources needed to meet the default service obligation. Alternative energy resources, particularly resources such as coal gasification projects, are capital intensive projects that may require a more certain and longer term revenue stream to obtain necessary financing. Long term contracts may be particularly appropriate for obtaining these types of alternative energy resources.[7]

The OCA would also note that alternative energy resources may take significant time to develop and construct. Given the requirements of Act 213, the OCA submits that default service providers should already be planning for the procurement of these resources, including analyzing whether contracts should be entered now so that facilities can be developed to meet the upcoming need for the resources.

With alternative energy resources being an important component of the portfolio of resources needed to meet the default service obligation and the need to plan for or procure these resources already present for default service providers, the Commission should address cost recovery as part of the default service regulations as soon as possible. Additionally, since EGSs must also meet the Act 213 standards, it will be necessary for the price of default service to properly reflect the cost of acquiring these resources so that proper price comparisons can be made.

The OCA urges the Commission to address these matters expeditiously through its regulations. Establishing the cost recovery mechanism will be an important part of providing the certainty necessary for default service providers to begin to plan for and acquire necessary resources.

The OCA has also discussed cost recovery issues related to Act 213 in its April 2005 Comments at pages 19 to 21 and 45 to 46, and in these Supplemental Comments at pages 11 to 12.

---

[7] As discussed in response to Question 6, it will be important that long term contracts are properly structured so that customers obtain the appropriate benefits of the long term arrangement.

2. Do the prevailing market conditions require long-term contracts to initiate development of alternative energy resources? May Default Service Providers employ long-term fixed price contracts to acquire alternative energy resources? What competitive procurement process may be employed if the Default Services Provider acquires alternative energy resources through a long-term fixed price contract?

OCA Response: There has been much discussion at PJM and FERC that current market structures may not be supportive of the construction of new generating resources, whether traditional resources or alternative resources. Many have suggested that long-term contracts are necessary in order to provide the revenue certainty necessary for investors in generation projects. The OCA anticipates that this is particularly the case with alternative energy resources.

The adoption of the OCA's proposals with respect to the long term planning for Default Service would be an important step taken at the retail level to establish a mechanism for the development of new capacity and long term reliability of electric service. In the end, establishing a framework that requires the provision of reliable service to customers is of critical importance to the Commonwealth. The OCA submits that the default service regulations should be developed in a manner that allows for the development of resources needed to provide reliable service.

It is the OCA's position that default service providers should be acquiring a portfolio of resources as a means of meeting their default service obligation. This portfolio should include long term contracts when the default service provider as the portfolio manager has determined that such an approach will contribute to reliability, price stability and affordability of this service. Alternative energy resources required by Act 213 should be one type of resource that default service providers consider and utilize for the long term contract portion of their portfolio.

Long term bilateral contracts can be obtained through a number of competitive processes, including Request for Proposal processes and arms-length negotiations with non-affiliated generation resources. For example, an RFP could be issued seeking a certain percentage of the EDC's load, with criteria that reflect the AEPS requirement. Alternatively, an RFP could be issued just for alternative resources needed to meet the various requirements. Once a range of acceptable bids are received, the default service provider should be allowed to enter into bilateral contracts. This process should be subject to oversight by the Commission through the default service implementation plan review process. All of the resulting contracts entered into by the default service provider for the purpose of providing Default Service will then be blended into a tariffed default service rate that is approved by the Commission.

These longer term contracts can be negotiated with a variety of pricing options and the default service provider should have the flexibility to establish the pricing parameters for the particular contract in its RFP documents. It is again important to note that the price of the long-term contract procured through these processes will reflect the prevailing market prices for the various products that are being acquired, at the time the resources are acquired, because the process by which the contracts will be entered into will be open and transparent. As such, there will be various "prices" for various contracts, all of which will reflect the competitive nature of the particular type of contract or product being solicited.

3. Should the force majeure provisions of Act 213 be integrated into the Default Service procurement process? Should Default Service Providers be required to make force majeure claims in their Default Service implementation filing? What criteria should the Commission consider in evaluating a force majeure claim? How may the Commission resolve a claim of force majeure by an electric generation supplier?

OCA Response: The force majeure provisions should not be part of the Default Service procurement process or the default service regulations. The OCA would note, however, that default service regulations that recognize the need for long term contracts as part of a portfolio of resources may forestall or eliminate the need for a force majeure in the future.

Circumstances that might warrant the force majeure provision being invoked are likely to affect all Default Service providers and all EGSs operating in the Commonwealth since both EDCs and EGSs must comply. As such, the OCA recommends that the force majeure provisions be addressed separately in a forum where all interested stakeholders can participate.

A default service provider should not be required to make a force majeure claim as part of the implementation filing, particularly since the implementation filing may cover several compliance periods where circumstances could change. The inability to procure alternative energy resources or certificates during a default service procurement process may identify the need for a force majeure to be declared, but the procurement process proceeds after the review of the implementation plan.

There are at least two criteria that the OCA has identified that should be applied in evaluating a force majeure claim. The AEPS Act sets forth the definition of "force majeure" as follows:

> Upon its own initiative or upon request of an electric distribution company or an electric generation supplier, the Pennsylvania Public Utility Commission, within 60 days, shall determine if alternative energy resources are reasonably available in the marketplace in sufficient quantities for the electric distribution companies and electric generation suppliers to meet their obligations for that reporting period under this act. If the commission determines that alternative energy resources are not reasonably available in sufficient quantities in the marketplace for the electric distribution companies and electric generation suppliers to meet their obligations under this act, then the commission shall modify the underlying obligation of the electric distribution company or electric generation supplier or recommend to the General Assembly that the underlying obligation be eliminated.

73 P.S. § 1648.2.

The criteria for evaluating whether "alternative energy resources are reasonably available in the marketplace in sufficient quantities" must include both physical availability and economic availability of resources. The physical availability criteria is a question of whether there are enough alternative energy resources available in the region (as defined by the Commission) to

supply the needed alternative energy certificates (*i.e.*, one Mwh of energy for each certificate) to meet the obligations of the EDCs and EGSs in Pennsylvania.

In addition to the question of physical availability, there is a question of whether the resources are economically available, *i.e.*, whether the resources can be acquired at prices that are reasonable and will result in just and reasonable rates for customers. The OCA does not believe that it was the intent of the General Assembly that the resources be procured no matter the cost to ratepayers. The Commission must also consider whether the resources can be procured in an economic manner.

The OCA would also suggest that when considering a force majeure claim, the Commission consider whether only a partial exemption is necessary rather than a complete exemption. Under Act 213, the Commission can either "modify the underlying obligation . . . or recommend to the General Assembly that the underlying obligation be eliminated." It is possible that some alternative energy credits may be available, although not in sufficient quantities to meet all of the requirements of Pennsylvania EDCs and EGSs. In that circumstance, the Commission should exercise its discretion under Act 213 to "modify the underlying obligation" rather than eliminating the obligation altogether for a compliance period. The Commission should also consider establishing specific time limits on an exemption, such as granting the exemption for only one year at a time, if the Commission finds that development is progressing and sufficient resources can be available in a reasonable time. Limiting the exemption period will avoid dampening investment in the resources.

4. Given that Act 213 includes a minimum solar photovoltaic requirement as part of Tier I, should these resources be treated differently from other alternative energy resources in terms of procurement and cost recovery?

OCA Response: The solar photovoltaic requirement in Act 213 does not require different treatment for procurement or cost recovery under the OCA's portfolio approach to the procurement of resources. Under the OCA's approach, a variety of competitive processes, including RFPs for specific resources and negotiations of bilateral contracts at arms length, can and should be used to procure default service supply. These methods should allow for any unique circumstances that may arise, or have to be addressed, related to meeting the photovoltaic requirement. In particular, long term contracting may be a necessary component for effectively meeting the solar requirements under Act 213.

The solar photovoltaic requirement should also be treated the same as other alternative energy resources for cost recovery purposes. The POLR rate, which recovers the reasonable costs of acquiring the POLR supply, should include all resources used to meet the obligation. The rate is a blend of all elements and products in the portfolio.

5. Should the Commission integrate the costs determined through a §1307 process for alternative energy resources with the energy costs identified through the Default Service Provider regulations? How could these costs be blended into the Default Service Providers Tariff rate schedules?

OCA Response: As discussed in the OCA's Comments of April 2005, it is the OCA's view that since the passage of Act 213, which requires recovery of the costs of alternative energy resources through a Section 1307 mechanism, such a mechanism would be necessary for the recovery of all POLR supply costs. To isolate certain resources for special ratemaking treatment could result in a procurement plan that improperly favors one resource type over another resource type. Such a plan could be sub-optimal.

If the Commission determines to allow two separate cost recovery mechanisms for POLR supply costs, it may still be appropriate to blend the two rates for billing purposes. The customer will still need to compare total generation costs to competitive supplier offers since the customer who shops will shop for all generation needs. For residential customers, having two different rates which the customer must then "blend" to arrive at a comparison will only complicate the offer comparison process.

Additionally, the OCA would note that there is no reason to isolate the impact of alternative energy resources on the customer's bill. In fact, identifying alternative energy resources as a line item on the bill that appears to be an additional charge to the customer conveys the wrong impression, and may lead to negative customer response regarding the requirements for alternative energy resources. Alternative energy resources, if procured as a part of an appropriate portfolio of resources, could well have benefits that reduce overall costs. Such benefits are difficult to capture in a separate line item charge.

6. May a Default Service Provider enter into a long-term fixed price contract for the energy supplies produced by coal gasification based generation if the resulting energy costs reflected in the tariff rate schedules are limited to the prevailing market prices determined through a competitive procurement process approved by the Commission?

OCA Response: Default service providers should be permitted to enter into long-term fixed price contracts for energy supplies produced by coal gasification-based generation and other resources as part of their procurement plan. The energy costs that result from that contract are the prevailing market prices for that product, which necessarily become part of the tariffed default service rate when it is blended with the prices for other components of the portfolio.

The statutory guidance with respect to "prevailing market prices" is written in the plural, thus contemplating more than one product or contract. The definition of "prevailing" should not be interpreted to necessarily refer to short term wholesale market prices. The test is whether the price for an individual product or contract represents a price that reflects a competitive method of acquiring the product or contract. A prevailing market price for a long term contract will not be the same as the prevailing market price for a short term contract procured on the same day because of the different contract terms, risk factors, or other criteria associated with the contract.

If the Commission question is intended to suggest that a long term contract would be entered into but that recovery of costs from ratepayers would not be tied to the contract price, such an approach would be contrary to the cost recovery provisions of the AEPS. The AEPS provides that "any direct and indirect costs" for compliance as defined by the Act "shall be recovered on a full and current basis pursuant to an automatic energy adjustment clause..." 73 P.S. § 1648.3(a). To base recovery on something other than the contract price would result in the default service provider either failing to recover its costs, or recovering more than the cost of the contract. Since the contract price reflects the prevailing market price for the resource being acquired and the term of the contract, there is no reason to base cost recovery on anything other than the contract price.

If the Commission question is intended to suggest that the long term contract price would not include the energy component, and the default service rate would be based on a short term energy price, this approach could represent the worst of both worlds for ratepayers. Ratepayers could end up losing the benefit of the low cost energy that the contract payments are supporting under such an approach, and end up paying for higher priced energy in the short term market.

Long-term contracts are a necessary part of a reasonable resource portfolio, but these contracts should be structured so that ratepayers receive the full benefit of the long-term contract.

7. Should the Commission delay the promulgation of default service regulations until a time nearer the end of the transition period, as suggested by the Independent Regulatory Review Commission in its comments on the proposed regulations?

OCA Response: No. The OCA strongly urges the Commission to provide necessary guidance as to the direction and future of default service in Pennsylvania as soon as possible for several reasons. First, many EDCs are already beyond their rate cap periods and are providing default service to customers. These EDCs, as well as all parties to the proceedings, need guidance to avoid lengthy and unnecessary litigation, as well as to properly serve customers at reasonable rates.

Second, even for those utilities that will not begin to provide default service under the regulations until closer to 2010 and 2011, guidance from the Commission now will allow them to properly plan for the obligation and respond to any opportunities that might arise. EDCs should be planning for their obligations and should be looking for opportunities to enter contracts when market conditions are favorable even before the end of their rate cap period. If market conditions are favorable, EDCs should enter contracts for portions of their default service obligation in the future. For alternative energy resources that may take some time to develop, EDCs should be pursuing contracts that may be necessary to assure that the resource is developed and available at the time it is needed. To properly plan, and even to properly enter into any needed contracts, EDCs and resources will need to know the rules of the road. The rulemaking should be completed as expeditiously as possible.

8. Does the Commission need to make any revisions to its proposed default service regulations to reflect the mandates of the Energy Policy Act of 2005?

OCA Response: The OCA does not anticipate that the Commission will need to make any revisions to the default service regulations as a result of the Energy Policy Act of 2005. Any requirements of the Energy Policy Act of 2005, such as the requirement for an electric utility to offer a rate to all customers that reflects the cost of providing service at different times (such as a time of day rate) can be incorporated into the default service implementation plan. If, for example, an EDC does not have a voluntary time of day rate for residential customers, it should include such a voluntary rate schedule in its implementation plan filing. The Commission will need to review each implementation plan to ensure that the requirements of the Energy Policy Act of 2005 are met.

CERTIFICATE OF SERVICE

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
	Implementation of the Alternative Energy Portfolio Standards Act of 2004	:	M-00051865

I hereby certify that I have this day served a true copy of document, Supplemental Comments of the Office of Consumer Advocate in Response to the Commission Secretarial Letter of February 8, 2006, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 8th day of March 2006.

SERVICE BY INTEROFFICE MAIL

Robert F. Young
Deputy Chief Counsel
Law Bureau
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street P.O. Box 3265
Harrisburg, PA 17120

Shane Rooney
Law Bureau
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street P.O. Box 3265
Harrisburg, PA 17120

SERVICE BY FIRST CLASS MAIL

William R. Lloyd
Small Business Advocate
Office of Small Business Advocate
Commerce Building - Suite 1102
300 North Second Street
Harrisburg, PA 17101

Paul E. Russell, Esquire
PPL Electric Utilities Corporation
Two North Ninth Street
Allentown, PA 18101-1179

Kent D. Murphy, Esquire
Exelon Business Services Co.
2301 Market Street, S23-1
P.O. Box 8699
Philadelphia, PA 19101-8699

Richard S. Herskovitz, Esquire
Assistant Counsel
Duquesne Light Company
411 Seventy Avenue 8-2
Pittsburgh, PA 15219

Tracey McCormick
Executive Director
RESA
P.O. Box 6089
Harrisburg, PA 17112

Mark Baird
Reliant Energy, Inc.
7642 W. 450N
Sharpsville, IN 46068

Mark C. Morrow, Esquire
UGI Utilities, Inc.
460 North Gulph road
King of Prussia, PA 19407

Linda Evers, Esquire
First Energy Solutions, Inc.
2800 Pottsville Pike
P.O. box 16001
Reading ,PA 19612-6001

Gary Jeffries, Esquire
Senior Counsel
Dominion retail Inc.
1201 Pitt Street
Pittsburgh, PA 15221

Janine Durand, Esquire
Senior Counsel
PJM Interconnection ,LLC
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Pamela Polacek, Esquire
McNees Wallace & Nurick, LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166

J. Michael Love, President
Energy Association of Pennsylvania
301 APC Building
800 North Third Street
Harrisburg, PA 17102

Jay L. Kooper
Amerada Hess Corporation
One Hess Plaza
Woodbridge, NJ 07095

Lisa M. Decker, Esquire
Constellation Energy Group, Inc.
111 Market Place Suite 500
Baltimore, MD 21202

John L. Munsch, Esquire
Allegheny Power
800 Cabin Hill Drive
Greensburg, PA 15601

John F. Povilaitis, Esquire
Ryan, Russell, Ogden & Seltzer, LLP
800 North Third Street
Suite 101
Harrisburg, PA 17102-7714

Gregory K. Lawrence, Esquire
McDermott, Will & Emery LLP
28 State Street
Boston, MA 02109-1775

Harry Geller
Executive Director
PA Public Utility Law Project
118 Locust Street
Harrisburg, PA 17101

F. Michael Langely
Chief Executive Office
Allegheny Conference on Community Development
425 Sixth Avenue, Suite 1100
Pittsburgh, PA 15219-1811

Daniel J. Desmond
PA Department of Environmental Protection
400 Market Street
P. O. Box 8772
Harrisburg, PA 17105

Julie A. Coletti, Esquire
Strategic Energy, LLC
Two Gateway Center
Pittsburgh, PA 15222

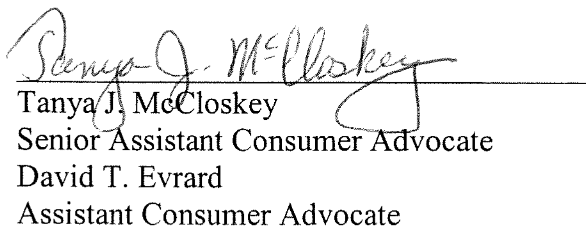
John L. Carley, Esquire
Assistant General Counsel
Pike County Light & Power Co.
c/o Consolidated Edison Inc.
Room 1815-S
4 Irving Place
New York, NY 10003

David Magnus Boonin
President
TBG Consulting
1210 Pine Street
Philadelphia, PA 19107

Frank Richards
Richards Energy Group Inc.
3901 Nolt Road
Building #1
Landisville, PA 17538

Keith G. Dorman
Coordinator
Economic Growth Through Competitive Energy Markets Coalition (CEM)
1628 King James Drive
Pittsburgh, PA 15237

Craig Goodman, Esquire
National Energy Marketers Association
3333 K. Street, NW Suite 110
Washington, DC 20007



Tanya J. McCloskey
Senior Assistant Consumer Advocate
David T. Evrard
Assistant Consumer Advocate

Counsel For
Office of Consumer Advocate
555 Walnut Street 5th Floor, Forum Place
Harrisburg, PA 17101-1923
(717) 783-5048
84117.doc