BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

**INITIAL COMMENTS OF THE**
**OFFICE OF SMALL BUSINESS ADVOCATE**
**IN THE REOPENED PUBLIC COMMENT PERIOD**

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

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

By Order entered December 16, 2004, the Commission closed the docket at M-00041792 and initiated a proposed rulemaking at Docket No. L-00040169. The proposed rulemaking was published on February 26, 2005, in the *Pennsylvania Bulletin*, at 35 Pa.B. 1421. On April 27, 2005, the OSBA filed initial comments. On June 27, 2005, the OSBA filed reply comments.

By Order entered November 18, 2005, the Commission reopened the public comment period. By Secretarial Letter dated February 8, 2006, the Commission requested interested parties to provide written comments on a specific list of questions and issues as well as on any other issues related to cost recovery under the act of November 30, 2004 (P.L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act ("Act 213"), 73 P.S. §§ 1648.1-1648.8.

The OSBA submits the following comments in response to the Commission's invitation.

## COMMENTS ON THE ISSUES LIST

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"?*

For the reasons set forth in the OSBA's comments in #7, the Commission should not further delay publication of the default service regulations in final form.

The proposed regulations already address the issue of cost recovery under Act 213.

- Proposed Section 54.185(d) requires an EDC to include its method for complying with Act 213 as part of its default service plan.

- Proposed Section 54.186(a) provides that "the electricity needed to provide default service" is to be acquired through a competitive procurement process. That requirement applies to *all* default service electricity, regardless of the energy source.

• Proposed Section 54.187(a)(3) provides for recovery through a Section 1307-type surcharge of the reasonable costs of complying with Act 213. However, as set forth in the OSBA's comments in #5, Act 213 does not prohibit an EDC from waiving recovery through a surcharge and opting to collect the costs of alternative energy as part of default service retail rates based on a "blended" wholesale price.

To the extent that additional Act 213 cost recovery matters need to be addressed but can not be incorporated into the default service regulations within a short time frame, they should be handled in a separate rulemaking. The Commission has already set a precedent for handling individual Act 213 issues in separate rulemakings.

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 Service Provider acquires alternative energy resources through a long-term fixed price contract?*

The OSBA lacks adequate information upon which to base an opinion about the need for long-term contracts to initiate development of alternative energy resources. However, nothing in Act 213, Section 2807(e)(3), or the proposed default service regulations prohibits the use of long-term contracts, provided that those contracts are the result of a competitive procurement process.

Under Section 2807(e)(3), an EDC must "acquire electric energy at prevailing market prices." Section 2807(e)(3) does not define "prevailing market prices," spell out how those

"prevailing market prices" are to be determined, *or specify the time period for which default service rates are to be set*.

Section 2807(e)(2) requires the Commission to "promulgate regulations to define the electric distribution company's obligation to . . . acquire electricity" at prevailing market prices. In promulgating those regulations, the Commission has the authority to set the length of the contracts by which the EDC may acquire energy. For example, the Commission could, by regulation, determine that default service rates based on a three-year contract are acceptable but that default service rates based on a contract for a longer period are not. However, until those regulations have been promulgated, an EDC is in compliance with Section 2807(e)(3) as long as it acquires energy at "prevailing market prices" for the time period selected by the EDC.

As set forth in the OSBA's comments in #5, Act 213 does not prohibit an EDC from conducting a competitive procurement for a quantity of default service electricity with a designated minimum percentage of that quantity to come from alternative energy sources. The EDC could design the procurement process to make the winning wholesale bidder responsible for acquiring the requisite amount of electricity from alternative energy sources. Therefore, the winning wholesale bidder (and not the EDC) would be the party to any long-term contract needed as an incentive for the development of new alternative energy projects.

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?*

Under the definition of "force majeure" in Section 2 of Act 213, an EDC or an EGS may have its obligation to provide power from alternative energy sources modified "[i]f the Commission determines that alternative energy resources are not *reasonably available* in sufficient quantities in the marketplace." (emphasis added)

Although Act 213 does not define "reasonably available," those words arguably include both the physical unavailability of a sufficient quantity of such energy and the availability of such energy only at prices which are unreasonable. Therefore, the EDC's or EGS's obligation under Act 213 should be modified if electricity from alternative energy sources is physically unavailable *or* if electricity from such sources is available only at exorbitant prices.

The proposed default service regulations already provide a vehicle for addressing force majeure. Specifically, Proposed Section 54.185(d) requires an EDC to include its method for complying with Act 213 as part of its default service plan.

One alternative for determining whether a force majeure exists would be for an EDC to seek separate bids for a quantity of default service electricity, one which includes the designated percentages from alternative energy sources and one which does not. If the low bid including alternative energy exceeds the low bid without alternative energy by a percentage approved as part of the default service plan, a force majeure would be deemed to exist. Similarly, if no responsible bidder could provide the quantity of electricity with the required amount of alternative energy included, a force majeure would be deemed to exist.

If no force majeure is deemed to exist for the EDC, then no force majeure should be declared for an EGS serving customers within that EDC's service territory. Furthermore, declaring a force majeure for one EGS within that service territory but not for other EGSs in the

same service territory would give the former an unfair price advantage in competing with the latter.

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?*

No. The practical effect of the earmark for solar photovoltaic technologies is to create three (rather than two) tiers of alternative energy sources from which an EDC or an EGS must acquire designated percentages of electricity. As set forth in the OSBA's answers to #1 and #5, an EDC should acquire all of its default service electricity—regardless of the source—through a competitive procurement policy.

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 Provider's Tariff rate schedules?*

Section 3(a)(3) of Act 213 provides that costs incurred by an EDC for the purchase of electricity from alternative energy sources and costs for the purchase of alternative energy credits ("AECs") shall be recovered "pursuant to an automatic energy adjustment clause under 66 Pa.C.S. § 1307 as a cost of generation supply under 66 Pa.C.S. § 2807."

Under Section 2807(e)(3), an EDC "shall acquire electric energy at prevailing market prices . . . and shall recover fully all *reasonable* costs." (emphasis added) Under Section 1307(a), surcharges are intended to provide a public utility with a "just and reasonable return" on

its rate base and may be revoked if rates are "unjust or unreasonable." Therefore, by linking compliance with Act 213 to Sections 2807 and 1307, the General Assembly set the parameters for charging ratepayers. To fit within those parameters, EDCs should be required to utilize a competitive procurement process for acquiring electricity from alternative energy sources and for acquiring AECs.

Electric energy generated from alternative energy sources has the potential to offset volatility in the market price of electricity. Ideally, an EDC would seek bids for a specified quantity of electricity, with a bid requirement that the statutorily-designated percentage of that electricity be provided from alternative energy sources. Potential wholesale suppliers responding to such a solicitation might then be in a position to lower their bid prices to reflect the benefits of using alternative energy sources as a hedge.

Unfortunately, because Act 213 provides for the recovery of alternative energy costs through a surcharge, the Commission may not be empowered to order an EDC to conduct a competitive procurement process which results in a "blended" price for the required combination of electricity from non-alternative sources and electricity from alternative sources. However, Act 213 does not prohibit an EDC from waiving recovery of its alternative energy costs through a surcharge and opting to collect those costs through retail rates derived from a "blended" wholesale bid price in a competitive procurement process. Specifically, Act 213 does not prohibit an EDC from soliciting bids on a quantity of electricity which includes a designated minimum percentage from alternative energy sources. Moreover, an EDC can design its procurement process to place the risk of alternative energy price changes on the winning wholesale bidder, thereby obviating the need for the EDC to use a Section 1307-type reconciliation measure.

However, even if a particular EDC does not agree to a waiver, the aforementioned linkage of Act 213 to the "prevailing market prices" standard of Section 2807(e)(3) requires that EDC to acquire alternative energy and AECs through a competitive procurement process. The proposed regulations are consistent with requiring that an EDC acquire *all* of its default service electricity through a competitive procurement process.

- Proposed Section 54.185(d) requires that an EDC include its method for complying with Act 213 as part of its default service plan. That requirement immediately follows a sentence which stipulates that electricity to meet the default service plan is to be acquired at prevailing market prices through a competitive procurement process.

- Proposed Section 54.186(a) provides that "the electricity needed to provide default service" is to be acquired through a competitive procurement process.

- Proposed Section 54.186(a) draws no distinction between default service electricity acquired from alternative energy sources and default service electricity acquired from non-alternative energy sources.

If an EDC opts not to waive recovery under a surcharge, the EDC should be required to seek separate bids for a quantity of electricity, one which includes the designated percentages of electricity from alternative energy sources and one which does not. If the low bid including alternative energy exceeds the low bid without alternative energy by a percentage approved as part of the default service plan, that difference would constitute the cost of alternative energy and should be the basis for calculating recovery through the surcharge.

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?*

As set forth in the OSBA's comments in # 2, nothing in Act 213, Section 2807(e)(3), or the proposed default service regulations prohibits the setting of default service rates on the basis of long-term contracts as long as those contracts are the result of a competitive procurement process. However, the EDC should design its procurement process to place the responsibility on the winning wholesale bidder to acquire the designated percentage of default service electricity from alternative energy sources. In that way, the winning bidder (and not the EDC) would be the party to any long-term contracts needed as an incentive for the development of new sources of alternative energy.

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?*

The Independent Regulatory Review Commission ("IRRC") submitted its comments on the proposed regulations on July 27, 2005. As part of those comments, IRRC urged the Commission "to *carefully consider* the *value* of delaying the promulgation of these regulations." (emphasis added) Based on the harm which would be caused by a delay, "careful consideration" of the "value" of a delay leads to the conclusion that a delay would not be in the public interest.

The IRRC comments are based on the mistaken assumption that proposed "interim" default service plans are being reviewed, and can continue to be reviewed, under "interim guidelines." However, there are no "interim guidelines" which establish the procedure for

reviewing default service plans, the appropriate length of default service plans, the acceptable methods for acquiring default service electric energy, and the acceptable method for collecting the costs of that electric energy from customers. Instead, each interim default service plan has been *sui generis*. Consequently, in order to review (and, in many cases, litigate) interim default service plans, the Commission and the parties have expended significant resources. That expenditure of resources could have been avoided, or substantially reduced, if the regulations had been in place. Furthermore, the absence of regulations has been a major barrier to assuring that default service rates reflect "prevailing market prices" rather than the interclass and intraclass subsidies embedded in capped generation rates.

If the final form regulations are delayed for several additional years, the Commission could be required to review and approve, or disapprove, at least one additional "interim" default service plan for Duquesne Light Company ("Duquesne"), Penn Power Company ("Penn Power"), Pike County Light & Power Company ("Pike County"), UGI Utilities, Inc.-Electric Division ("UGI"), Citizens Electric Company ("Citizens"), and Wellsboro Electric Company ("Wellsboro"). As evidenced by the most recent Duquesne, Pike County, and UGI "interim" default service cases and the pending Penn Power case, another round of "interim" plans is likely to trigger litigation over issues which would be substantially resolved under the proposed regulations.

The Competition Act was approved by the General Assembly and signed into law by the Governor in 1996 and took effect on January 1, 1997. It is unlikely that the General Assembly and the Governor contemplated that the default service regulations required by Section 2807(e)(2) would still be in the "proposed" stage more than nine years later.

*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?*

Although the Energy Policy Act of 2005 ("EPA05") imposes certain requirements regarding time-based pricing, compliance does not require a further delay in publishing the default service regulations in final form.

Section 2621(d)(14)(A) of 16 U.S.C. requires an EDC to offer a time-based rate schedule to each customer class and, upon request, to each individual customer. At least arguably, Pennsylvania is already in compliance with this federal requirement. Specifically, Section 2806(a) of the Public Utility Code, 66 Pa.C.S. § 2806(a), provides that "all customers of electric distribution companies in this Commonwealth shall have the opportunity to purchase electricity from their choice of electric generation suppliers." Therefore, each Pennsylvania customer already has the opportunity to acquire electricity at a time-based rate from an EGS.

Admittedly, EGSs are not functioning aggressively in each EDC's service territory. The lack of EGS activity is likely due to the fact that the shopping credits established in the restructuring proceedings are below current market prices. As the rate caps are replaced with market-based rates, EGS activity should increase. However, if compliance with Section 2621(d)(14) requires earlier action, the remedy is to require each EDC to file tariffs offering time-of-use rates. Many EDCs already have such tariffs, at least for some customers.

The Commission could also insert language into the default service regulations requiring an EDC to offer a time-of-use option to those customers whose default service is not required to be hourly pricing.[1] However, such an insertion may be unnecessary. The proposed regulations

[1] The proposed regulations require hourly pricing for customers with loads greater than 500 kW unless, at the default service provider's request, the Commission approves a fixed-rate option for those customers. *See* Proposed Section 54.187(d).

already require a fixed-rate option of at least one year for all residential customers and for all other customers with loads of 500 kW or less. *See* Proposed Sections 54.182, 54.185(c), 54.187(b), and 54.187(c). Under 16 U.S.C. § 2621(d)(14)(B)(i), a rate based on advance or forward wholesale acquisition qualifies as "time-of-use pricing" as long as the rate is set for a specific time period and does not change more often than twice a year. Therefore, a fixed rate which is set through a competitive procurement process (as contemplated by the proposed regulations) and which does not change during a one-year period should qualify as "time-of-use pricing."

Section 2621(d)(14)(F) of 16 U.S.C. requires the Commission to determine whether it is appropriate to implement the requirement that each EDC offer a time-based rate schedule. In making that determination, the Commission is required by 16 U.S.C. § 2625(i) to investigate, and issue a decision on, whether or not it is appropriate for EDCs to provide and install meters and communications devices to enable customers to take advantage of time-based rates and other demand response programs. At least arguably, Pennsylvania is already in compliance with this federal requirement in the case of EDCs which are no longer recovering stranded costs.

Specifically, through the POLR Roundtable, the Commission received input on whether, and where, to draw a line between customers entitled to a fixed price default service option and customers required to have hourly pricing as their default service option. Based on that input, the Commission determined in the proposed regulations that the line should be drawn at 500 kW. *See* Proposed Section 54.187(d). Subsequently, the Commission received comments and reply comments on that determination. Consequently, the Commission appears to have conducted the "investigation" required by EPA05. The Commission's publication of final form default service regulations will constitute the "decision" mandated by EPA05, at least with regard to EDCs no

longer collecting stranded costs. If further action is required with regard to EDCs which are still recovering stranded costs, there is no apparent need to delay the default service regulations pending that action.

WHEREFORE, for the reasons set forth above, the OSBA respectfully requests that the Commission promptly publish default service regulations in final form and proceed separately to promulgate any additional regulations needed to implement Act 213.

Respectfully submitted,

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