BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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

I. INTRODUCTION

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.

On March 8, 2006, the OSBA submitted its Initial Comments in the Reopened Public Comment Period.

By the aforementioned Secretarial Letter dated February 8, 2006, the Commission also invited interested parties to reply to the Initial Comments of other parties. The OSBA rests on its Initial Comments as its response to the specific questions posed by the Commission.[1] However, the OSBA submits the following in response to Initial Comments by other parties which addressed issues beyond the Commission's specific questions.

[1] The OSBA notes that it previously addressed some of those questions in its comments and reply comments in the first public comment period at Docket No. L-00040169. Those previous comments and reply comments are incorporated herein by reference.

II. REPLIES TO THE COMMENTS OF OTHER PARTIES

A. Procurement Method

1. Position of the Parties

Beginning with the POLR Roundtable, parties have offered differing proposals on how default service electricity should be acquired. In that regard, the OSBA has recommended the use of a statewide procurement process after all generation rate caps have expired.[2] Under the OSBA's proposal, the statewide process would be used to acquire default service electricity for 2011 and thereafter.

In their Initial Comments, numerous parties renewed the debate about overall default service procurement as part of their discussion of the role, if any, which should be played by long-term contracts for electricity from alternative energy sources.

For example, Duquesne Light Company ("Duquesne") pointed to the high prices in the most recent competitive solicitations in New Jersey, Delaware, and Pike County Light & Power Company ("Pike") as evidence that the competitive procurement model is flawed, that the wholesale market may not be fully functional, and that some alternative to an RFP or an auction should be permitted. As possible alternatives, Duquesne suggested setting an EDC's default service rates on the basis of other electricity prices in the region, on the basis of a market price formula, or through other means (such as long-term contracts for the procurement of electricity from alternative and non-alternative energy sources).[3]

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[2] The statewide procurement process could be either an auction or a Request for Proposals ("RFP").

[3] Duquesne's Initial Comments, pp. 2-4, 7, and 10.

Similarly, the Office of Consumer Advocate ("OCA") pointed to rate shock in Pike, New Jersey, Delaware, and Maryland as support for requiring an EDC to meet its default service obligation by assembling a portfolio of resources, including long-term contracts.[4]

Furthermore, PPL Electric Utilities Corporation ("PPL") argued that an EDC should have the option to use a default service procurement process other than a standard RFP or auction and should be allowed to rely on long-term contracts as part of the mix.[5]

2. Mitigating Rate Shock

The OSBA shares the stated intent of Duquesne, the OCA, and PPL to achieve the most reasonable default service rates possible. However, the OSBA questions whether any of the procurement models suggested by those parties would have avoided the rate shock experienced in New Jersey, Delaware, and Maryland—or the rate shock Pike would have experienced even if it had not been conducting an auction immediately following Hurricanes Katrina and Rita. The simple fact is that the market price of electricity rose substantially in late 2005. Although prices have declined since the hurricanes, they are still considerably higher than they were in 2004 when the Commission approved the current default service plans for Duquesne and for UGI Utilities-Electric Division.[6] Therefore, rate shock is a distinct possibility when existing generation rate caps expire, regardless of what method is used to satisfy the statutory requirement to acquire default service electricity at prevailing market prices. Moreover, the requirements of Act 213 are likely to exacerbate that rate shock.

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[4] OCA's Initial Comments, pp. 2-4, 9-10, and A-1.

[5] PPL's Initial Comments, pp. 4-6.

[6] *See Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service*, Docket No. P-00032071 (Order entered August 23, 2004); and *Pennsylvania Public Utility Commission v. UGI Utilities Inc.-Electric Division, Petition of Office of Small Business Advocate*, Docket No. R-00017033 (Order entered May 28, 2004).

In an effort to mitigate rate shock, the Commission should promulgate final form regulations which make the wholesale market as attractive as possible to potential suppliers.

First, the Commission should require that an EDC's rates for each customer class, and for each customer within each class, be as close as practicable to prevailing market prices. Such an alignment could be achieved by bidding by rate class, modernizing the EDC's generation cost allocation methodology, or making the rate design in EDC tariffs more consistent with competitive market price patterns. In addition to helping eliminate inter-class and intra-class subsidies, setting prices for each customer reasonably close to market would reduce the risk faced by potential wholesale suppliers that customers will opt out of default service and shop. Therefore, if rates were aligned with market prices, wholesale suppliers should be able to eschew part of the risk premium they otherwise would include in their bids.[7]

Second, the Commission should require EDCs to bid a variety of different portions of their load at different times and for different supply durations. As vividly demonstrated in Pike, a single-day procurement of an EDC's entire load for two full years provides virtually no diversification to either suppliers or customers. Under the Pike approach, the winning wholesale supplier faces a huge risk that the actual market prices at some time during the two-year period will be well below market prices, thereby resulting in shopping (and stranded costs for the

[7] The OSBA has consistently supported designing default service rates for small commercial and industrial customers in a way that represents a reasonable balance between precisely matching short-term prevailing market prices and offering a product with a fixed price. The OSBA observes that small business customers tend to be uncomfortable with electric rates that vary frequently with market cycles and are more comfortable with prices that are fixed for some reasonable duration. Offering "ugly" default service to small business customers would simply increase the risk that they will opt out of default supply for competitive alternatives, if those alternatives develop. Wholesale suppliers would necessarily reflect that higher risk in their bids.

supplier). Likewise, default service customers face the risk that little retail competition will develop and they will be exposed to huge rate increases with no alternatives.[8]

Although spreading out the purchase of an EDC's load could result in using some long-term supply options, the OSBA recommends against undue reliance on long-term supplies. The OSBA is skeptical about the ability of EDCs to outguess the market when they acquire the various components of their portfolio. Therefore, the OSBA believes that default service rates set solely on the basis of long-term contracts are as likely to be above market as they are to be at or below market.

Furthermore, even if each individual EDC were to use a competitive process to acquire its portfolio (including long-term contracts), the market for the individual components of that portfolio could be very thin, particularly for some of the smaller EDCs in Pennsylvania. For example, an effort to acquire default service for the District of Columbia through contracts of longer than three years' duration drew no acceptable bids. If there were only limited competition by generators to provide default service electricity under long-term contracts, it would be difficult for the Commission to evaluate the reasonableness of such contracts.

3. Statewide Procurement Process

In the OSBA's view, a statewide procurement process continues to offer the best opportunity to get reasonable prices and to mitigate volatility. Such a process could take one of two basic forms: 1) an auction or RFP in which wholesale suppliers bid on a percentage of the statewide load without regard to individual EDCs, or 2) an auction or RFP in which each EDC seeks bids on its own load but does so under the same general rules as the other EDCs.

[8] The OSBA suggests that the Pike approach, were it used by a natural gas distribution company, would likely be deemed imprudent.

Under the first approach, the prospect of selling no electricity to any of the major Pennsylvania EDCs should assure greater participation by wholesale suppliers than a process limited to a single EDC, particularly in the case of the smaller EDCs. In addition, the ability to seek bids on many more tranches than needed by a single EDC should facilitate bidding by rate class, thereby enabling the Commission to avoid the need to develop a cost allocation methodology for translating systemwide wholesale bids into class retail rates. Furthermore, because of the size of the statewide load, EDCs could purchase a significant quantity of electricity for 2011 in each quarter (or even each month) of 2010, thereby reducing the risk of a price spike caused by the weather or an international event. Such diversification would provide risk reduction benefits to both default service customers and wholesale suppliers.

Under the second approach, congestion costs could be matched to the service territory in which congestion is a significant problem rather than spread across the state on an average basis. However, even with bidding on the basis of individual EDCs, the Commission should standardize the procurement approach and, to the extent possible, the specific terms of the procurement for each EDC. Giving each EDC the leeway to specify its own peculiar terms and conditions in the supply agreement would add complexity and cost to the procurement process.

The Commission should also coordinate the timing of the procurements. Bidder interest in a single EDC should be greater if all or most of the EDCs are procuring some specific portion of their load on the same day.[9] Such coordination of timing should also make it easier to bundle the loads of several EDCs together for bidding purposes. Moreover, acquiring electricity for all EDCs at the same time would reduce the differences in default service rates throughout the Commonwealth.

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[9] The OSBA understands that the New Jersey statewide procurements follow this approach.

Finally, the Commission should encourage multiple EDCs to combine their loads for bidding purposes, thereby likely increasing participation by wholesale suppliers and making it easier to bid by rate class and to acquire portions of the load at different times and for different durations. Such a bundling could be especially valuable to small EDCs which might not attract a significant number of bidders on their own.

B. Recovery under Section 1307

In addressing the Commission's questions about blending the costs of electricity from alternative energy sources with the costs of electricity from non-alternative energy sources, several parties renewed the debate over the extent, if any, to which default service rates should be reconcilable.

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 shall be recovered "pursuant to an automatic energy adjustment clause under 66 Pa.C.S. § 1307 as a cost of generation supply under 66 Pa.C.S. § 2807."

In its Initial Comments (as well as in its previous comments at Docket No.L-00040169), the OSBA proposed that the Commission allow an EDC to waive recovery of its alternative energy costs through a Section 1307 surcharge if that EDC is acquiring electricity from alternative and non-alternative energy sources on a combined basis through a single RFP or auction and if that EDC is recovering the costs of that electricity through "blended" rates.

In contrast, numerous other parties argued in their Initial Comments that because an EDC is entitled to use a Section 1307 surcharge to recover alternative energy costs, EDCs should use a

Section 1307 surcharge to recover the costs of *all* electricity acquired for default service customers.[10]

The OSBA recognizes that Section 1307 has been used in the past for the recovery of fuel costs and purchased power costs, but the General Assembly neither stated nor implied in the Competition Act that *any* default service costs may be recovered through such a surcharge. Furthermore, the legislature explicitly provided in Act 213 for recovery of *alternative energy costs* under a Section 1307 surcharge. If the legislature had thought that either Section 1307 or the Competition Act already permitted recovery of default service costs through a surcharge, it would have been unnecessary to include explicit language in Act 213 authorizing a Section 1307 surcharge to recover the alternative energy portion.

The Commonwealth Court has rejected the Commission's attempt to authorize wastewater utilities to collect certain investments in collection systems through a Section 1307 surcharge. Critical to the Court's holding was the fact that the General Assembly explicitly authorized the use of a surcharge for the collection of water distribution system improvements but did not do so with regard to wastewater collection system improvements. *See Pennsylvania Public Utility Commission v. Popowsky*, 869 A.2d 1144 (Pa. Cmwlth. 2005), appeal denied ___ A.2d ___ (Pa. 2006). In view of that holding, the OSBA does not believe that the Commission has the legal authority to permit recovery of non-alternative energy costs through a Section 1307 surcharge.

The OCA also argued in its Initial Comments that a single Section 1307 surcharge should be used for alternative and non-alternative energy costs because having two separate generation

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[10] OCA's Initial Comments, pp. 11-12 and A-6; PPL's Initial Comments, p. 11; Initial Comments of the Exelon Companies ("Exelon"), pp. 5 and 10; and Initial Comments of Citizens' Electric Company and Wellsboro Electric Company ("Citizens'/Wellsboro"), p. 3.

cost lines on a customer's bill would complicate shopping.[11] However, it should be possible to show only one generation cost line on a customer's bill, which line equals the sum of the non-alternative energy rate and the alternative energy rate. Furthermore, if the goal is to facilitate shopping, then reconciliation should be minimized, in that the EGSs contend that reconciliation is a barrier to shopping.[12]

C. Hourly Pricing

In their Initial Comments, the Industrial Energy Consumers of Pennsylvania, *et al.*, ("IECPA"), suggested that electricity acquired for industrial customers on the basis of hourly pricing will not include electricity generated from alternative energy sources.[13]

Assuming that IECPA is correct, an EDC will have to meet its Act 213 obligation entirely from the electricity it acquires for default service customers who are not on hourly pricing. An EDC's Act 213 obligation is calculated on the basis of the quantity of electricity it sells to *all* default service customers, regardless of whether those customers are on hourly pricing or are not on hourly pricing. Therefore, both hourly-priced and non-hourly-priced customers should share in paying for the cost of complying with Act 213. In the case of hourly-priced service customers, the EDC could forecast the cost of complying with Act 213 for a subsequent calendar year. This cost estimate could then be added to hourly prices on a per kWh basis for that future year. Finally, at the conclusion of the future year, the EDC could "true-up" its compliance cost forecast with its actual compliance costs and adjust hourly prices, as appropriate, for the next future year.

[11] OCA's Initial Comments, A-6.

[12] Initial Comments of Strategic Energy, LLC ("Strategic"), p. 3; Initial Comments of Dominion Retail Inc. ("Dominion"), pp. 2-3.

[13] IECPA's Initial Comments, pp. 18-19.

III. CONCLUSION

The OSBA respectfully requests that, in promulgating default service regulations and any additional regulations needed to implement Act 213, the Commission consider the aforementioned reply comments.

Respectfully submitted,

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