COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Policies To Mitigate Potential Electricity Price Increases
Docket Number M-00061957

Reply Comments of Hess Corporation

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INTRODUCTION

Hess Corporation ("Hess") submits these reply comments to respond to the comments submitted by various parties in this proceeding as well as the parties' testimony at the *en banc* hearings held before the Commission on June 22, 2006. Hess appreciates the opportunity to have been able to participate in the *en banc* hearings and is looking forward to continuing to work with the Commission and stakeholders in this proceeding.

As stated in Hess' initial comments and *en banc* hearing testimony, it is essential for the Commission to ensure that no price mitigation policy overrides or interferes with the development of robust and sustainable competitive retail electric markets. It is equally essential for the Commission to use the time that it has between now and the time the various Pennsylvania electric distribution company ("EDC") generation rate caps expire in 2009 and 2010 to establishing a default service consistent with the fundamental tenets of the Pennsylvania Electricity Choice and Competition Act ("Choice Act"). Failure to establish a default service that is consistent with what the Choice Act intended – a market-reflective service of last resort – will exacerbate the very problems the Commission is striving to avoid in this proceeding.

It is therefore Hess' position that should the Commission be inclined to implement a price mitigation plan to address the coming expiration of the long-term generation rate caps, then it should narrowly tailor such a plan to address that one-time problem of significant price increases in 2009 and 2010. Consistent with this approach, Hess offers the following fundamental principles for a price mitigation plan:

- The plan should not override or interfere with the goals of the Choice Act or otherwise impede the development of a robust and sustainable competitive retail electric market in Pennsylvania;

- The plan should be competitively neutral and apply to all distribution customers through a non-bypassable wires charge;

- The plan should apply only at the time of the expiration of the generation rate caps and not before so as not to expose customers to hypothetical and possibly unnecessary costs before 2009.

It will be essential for the Commission to adopt both a default service structure and, if it is inclined to do so, a price mitigation plan that provides for a seamless transition off the long-term EDC generation rate caps. Hess is confident that adoption of the principles outlined above will ensure that the Commission, using the time it has between now and 2009/2010, will spare Pennsylvania's consumers from the perilous financial and political issues that other states in the region face today.

With these observations, Hess replies to several issues raised by the parties in the initial comments and *en banc* hearing.

REPLY COMMENTS

I. LONG-TERM FIXED PRICE DEFAULT SERVICE PLANS ARE NOT PRICE MITIGATION PLANS

Several parties recommend that the Commission adopt a fixed-price default service model as a price mitigation policy.[1] The Commission should reject these proposals, however, because they will only contribute to and perpetuate the very problem the Commission is seeking to remedy in this proceeding. In addition, fixed-price default service will remove from the equation a viable solution – a robust and

[1] *See, e.g.,* Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company Initial Comments at 10-11; Duquesne Initial Comments at 6-7; PPL Electric Utilities Corporation Initial Comments at 4-5;

sustainable competitive retail market that empowers customers to choose the product that best suits their needs – in contravention of the fundamental tenets of the Choice Act.

First, the long-term fixed-price default service model suffers from the same fundamental flaw as the current generation rate caps – they are not market reflective and, in essence, freeze electricity prices in amber for substantial periods. Because a fixed-price default service model is by its very nature non-market reflective, it will always have to play "catch-up" with true market prices (whether in an increasing market or a decreasing market). Under such a model, the need for price mitigation becomes a perpetual and permanent need in search of a solution rather than a mechanism that actually is a solution.

Second, fixed-price default service will remove from the equation a viable solution to the problem of post-rate cap prices – the development of robust and sustainable retail competition that empowers customers and enables them to shop for the specific product and service they desire. Specifically, long-term fixed-price default service constitutes a barrier to entry by competitive Electric Generation Suppliers ("EGSs") because, over time, the fixed default price becomes further divorced from the market-reflective price causing, at best, limited or sporadic opportunities for EGSs to viably compete in a market where entry itself is a capital-intensive exercise.

By contrast, an hourly-price default service design that enables medium-sized and large commercial and industrial ("C&I") customers to receive and swiftly respond to timely and accurate price signals is a solution to the Commission's post-rate-cap price concerns that will not perpetuate a constant need for ongoing price mitigation. Under hourly-priced default service, customers will be able to avail themselves of competitive alternatives that they would not be able to receive under a fixed-price default service regime. Specifically, customers will be able to utilize their knowledge of the market-reflective price signal they receive to shop for the EGS product or service that best fits their specific electricity needs.

Once customers are able to receive and respond to price signals, EGSs are able to devise products and services tailored to the customer's needs.[2] If customers want to avoid exposure to market price fluctuations, then they can avail themselves of a fixed-price product from an EGS. If customers want to experience market-price fluctuations then they can avail themselves of either the EDC default service or an EGS variable-price offering and reduce their demand in response to the price signal. If customers want to avoid exposure to market price fluctuations during some hours of the day but not in others then they can avail themselves of an index or other hybrid product offering from an EGS. In every scenario, the customer under an hourly-priced default service model has a choice to avoid exposure to post-rate cap market prices without a perpetual need for an ongoing, regulator-imposed price mitigation policy. One cannot say the same for a long-term fixed-price default service model that, by its very nature, cannot remain market-reflective for any sustained period.

II. HOURLY-PRICED DEFAULT SERVICE FOR C&I CUSTOMERS IS A SOLUTION TO THE EFFECTS OF REMOVAL OF LONG-TERM GENERATION RATE CAPS, AND NOT THE PROBLEM

[2] *See* Hess Initial Comments at 4; *Policies To Mitigate Potential Electricity Price Increases*, Docket No. M-00061957, Transcript of *En Banc* Hearing (June 22, 2006) ("Tr.") at 136.

Several parties have used this proceeding, in addition to the Commission's Provider of Last Resort ("POLR") proceeding, to question the appropriateness of the hourly-price default service once the generation rate caps expire. These parties, all outspoken opponents of the hourly-priced default service model, advocate their preferred wholesale market model (long-term fixed price default service) in the guise of price mitigation and, in doing so, mischaracterize hourly-price default service. Contrary to the arguments raised by these parties, hourly-priced default service for large and medium-sized C&I customers is a viable solution to the problem posed by the likely effects of the expiration of the long-term rate caps, the elimination of which will only exacerbate the problem sought to be addressed in this proceeding.

A. Hourly-Priced Default Service Will Not Deprive Customers of the Ability To Choose A Fixed-Price Supply Product

The Duquesne Power and Light Company ("Duquesne") labels hourly-price default service for large C&I customers as "a failure by any measure," a model that has "failed to cerate any meaningful competition," and a model not desired by large C&I customers because they "do not want hourly pricing."[3] These arguments mischaracterize hourly-priced default service as somehow condemning C&I customers to hourly pricing solely by virtue of the fact that the default service is an hourly-priced service.

First, as discussed above, in an hourly-price default service model customers can avail themselves of a fixed-price product from an EGS if they wish to avoid market price fluctuations – they will have that *choice* under this model. The fact that

[3] Duquesne Initial Comments at 2-4.

the EDC (i.e., the default service provider) cannot provide the fixed-price service does not condemn customers to hourly-priced service if they do not want it; nor does it reduce the amount of competitive products that EGSs are trying to tailor to suit the customer's specific price (and non-price) needs.

Second, with respect to Duquesne's claims that the hourly-priced default service model has failed "to create any meaningful competition" and has resulted in "prohibiting Duquesne from offering long-term fixed-price contracts to its customers,"[4] Duquesne's "response" to questioning from Vice Chairman Cawley at the *en banc* hearing belies these claims. At the hearing, Vice Chairman Cawley asked what was so attractive about a Duquesne fixed-price supply service that customers would want that product to the exclusion of what the EGSs could offer in terms of a fixed-price supply product.[5] Duquesne was unable to articulate a responsive answer to Vice Chairman Cawley's question.[6]

Third, statistics measuring customer migration throughout the PJM region undermine Duquesne's claims that hourly-price default service is "a failure by any measure" that somehow makes Pennsylvania less attractive to businesses than neighboring states. For example, in the Duquesne service territory, where hourly-priced service is the default service for customer above 300 kilowatts ("kW"), EGSs were serving 92.8% of the eligible customer load.[7] In Maryland, where hourly-priced

[4] *See* Duquesne Initial Comments at 4.

[5] Tr. at 105-06.

[6] *Id.*

[7] *See Petition of Duquesne Light Company for Approval of its Plan for Post-Transition Period POLR Service*, Docket No. P-00032071 (Jan. 9, 2006), at 11.

default service has been implemented for customers with peak demands of 600 kW – and these customers have not been exposed to the same sudden price increases that have been experienced by the Baltimore Gas and Electric Company residential customers – 91.2% of the eligible customer load is served by a competitive supplier.[8] In New Jersey, competitive suppliers serve 84.99% of CIEP customers (i.e., customers subject to hourly-priced default service).[9] The statistics all suggest that, contrary to Duquesne's claims, customers throughout the PJM region who are exposed to hourly-price default service are, in droves, responding to that signal to avail themselves of the supplier and product of their *choice*.

B. Hourly-Priced Default Service Will Increase Competitive Pressures on Competitive Electric Generation Suppliers, Not Decrease Them

The Industrial Energy Consumers of Pennsylvania ("IECPA") and U.S. Steel Corporation ("U.S. Steel") claim that the implementation of hourly-priced default service will "force" consumers into the competitive market in order to obtain a fixed price option.[10] Because, according to IECPA and U.S. Steel, EGSs will be cognizant of this fact, they will therefore have the opportunity to raise their competitive offerings artificially above the market price because the customer will be without options.[11]

Hess respectfully disagrees with these assertions because, as has been demonstrated in the Duquesne service territory, the expansion of hourly-priced default service will result in robust competitive retail electric markets that will provide

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[8] *See* Maryland Public Service Commission Electric Choice Enrollment Monthly Report, Month ending May 2006, <http://www.psc.state.md.us/psc/electric/enrollmentrpt.htm>.

[9] *See* New Jersey Board of Public Utilities, New Jersey Electric Statistics CIEP switching as of March 31, 2006, <http://www.bpu.state.nj.us/wwwroot/energy/CIEP.pdf>.

[10] *See* IECPA Comments at 27; U.S. Steel Comments at 4.

[11] *Id.*

customers with an ample choice of competitively priced product offerings. In this environment, it is Hess' experience that if, as IECPA and U.S. Steel argue, an EGS were to raise the price of its competitive offerings to take advantage of the lack of a fixed-price default service, there would be another EGS waiting in the wings to offer a more competitively priced service to that customer. The EGS best positioned to offer a product that, in terms of both price and non-price attributes, is best tailored to the customer's needs will prevail. The marketer who prices competitive service simply to game the lack of a fixed-price default service will fail. This is what robust competitive retail electric markets are all about and these are precisely the type of markets that the expansion of hourly-price default service will produce.

On the other hand, the establishment of a fixed-price default service that enables EDCs to compete directly with the EGSs' competitive offerings will erect substantial barriers to market entry, making the development of robust competitive retail electric markets impossible. It is under this scenario – where little to no competition will exist in the Pennsylvania EDC service territories – that IECPA's and U.S. Steel's doomsday prophecy of being "forced" into an above-market fixed-price default service will become reality.

Given these circumstances, it is perplexing to Hess as to why a utility fixed-price offering that is, in essence, a product of first and only resort in a non-competitive environment would be more attractive to customers over those of EGSs who have to compete with and innovate against one another in a robust competitive environment. The large energy user panel's failure to articulate a responsive answer to this same question directly posed by Vice Chairman Cawley at the *en banc* hearing only deepens that mystery for Hess.[12]

C. Hourly-Priced Default Service Is Not Designed To Be An "Ugly" or Unattractive Price Model, But A Market-Reflective Model Designed To Empower And Benefit Customers

Commissioner Shane openly questions the appropriateness of an hourly-priced default service model, characterizing it as making default service "ugly" simply to encourage fixed-price product offerings from competitive EGSs, a remark seized upon by many long-term fixed-price default service advocates in this proceeding.[13] In addition, Commissioner Shane, addressing the EGS panel at the *en banc* hearings, suggests that "what's good for the merchant generator goose [i.e., the offering of a fixed-price supply product] is good for the utility gander."[14]

Hess respectfully disagrees with the substance of Commissioner Shane's statements. First, in order to create a properly functioning competitive retail market – one in which customers will have many suppliers and many products from which to choose – default service must be *market reflective*. The goal is not to make default service perpetually "ugly or "unattractive" by comparison to an EGS product, but rather to enable customers to receive and respond to market reflective price signals that provides them with the vital information they need to make an informed choice of the electric supply product that best fits their particular needs. The ability of the customer to make this informed choice, in turn, spurs innovation among EGSs to

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[12] Tr. at 66-67.

[13] *See Policies To Mitigate Potential Electricity Price Increases*, Docket No. M-00061957, Statement of Commissioner Bill Shane (May 19, 2006), at 3.

[14] Tr. at 164.

design products tailored to fit customer needs, thereby creating a more efficient and sustainable electricity market. Such a structure will result in the development of products and services that are more customer-responsive than what the regulated, EDC-centric structure can provide.

The key, however, to unlocking these benefits of the retail competition envisioned and mandated by the Legislature in the Choice Act is the conveyance of the market-reflective price signal to the customer. Only when a customer is able to receive and respond to this signal can EGSs devise a product and service that optimally fits the customer's needs.[15] By contrast, enabling EDCs to offer fixed-price supply products as the default service product – which inhibits customers from receiving and responding to a market-reflective price signal – simply because "what's good for the goose is good for the gander" will not result in the robust competitive retail electric market mandated by the Choice Act. What's more, the fixed-price default model will only serve to perpetuate the problem the Commission seeks to address in this proceeding where the hourly-price default model, by ensuring the development of a robust and sustainable competitive retail electric market, can serve as a solution.

CONCLUSION

With the initiation of this docket, the Commission begins the process of addressing what will happen to customers at the time of the expiration of the long-term generation rate caps in 2009 and 2010. The Commission has every right to be concerned about the potential level of increase in electricity prices in 2009 and 2010

[15] Tr. at 135-36.

but must also take great care and proceed cautiously with a price mitigation design is narrowly tailored to address the problem and does not interfere with the fundamental tenets of the Choice Act.

Hess respectfully submits that adhering to the principles outlined in its initial and reply comments and *en banc* hearing testimony will ensure that a price mitigation plan, if adopted, not only conforms to the purposes outlined in Commissioner Fitzpatrick's Motion[16] and the Commission's Order[17] but also does not impede the development of a robust and sustainable competitive retail electric market. Hess appreciates the opportunity to comment on these important issues and looks forward to its future participation in this proceeding.

Respectfully submitted,

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[16] *See Policies To Mitigate Potential Electricity Price Increases*, Docket No. M-00061957, Motion of Commissioner Terrance J. Fitzpatrick (May 19, 2006).

[17] *See Policies To Mitigate Potential Electricity Price Increases*, Docket No. M-00061957, Investigation Order (May 24, 2006).