BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Rulemaking re: Electric Distribution Company's 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
Default Service and Retail Electric Markets	:	Docket No. L-00070183

REPLY COMMENTS OF DOMINION RETAIL, INC., ON ADVANCED NOTICE OF FINAL RULEMAKING ORDER AND PROPOSED POLICY STATEMENT

Dominion Retail, Inc. ("Dominion Retail") hereby offers its Replies to the Comments of other parties at two Commission Dockets: 1) *Advanced Notice of Final Rulemaking Order* ("ANOFR") at Docket No. L-00040169 entered on February 9, 2007; and 2) the Commission's proposed Policy Statement on the *Default Service and Retail Electric Markets* at Docket No. L-00070183 ("Policy Statement") also entered on February 9, 2007. In a manner similar to the way it presented its Comments at these separate dockets, and since the critical issues that are addressed by the other parties are spread throughout the comments at both Dockets, Dominion Retail provides its replies in a single document that focuses on those critical issues rather than attempting to re-address all the issues it raised in its Comments.

I. Introduction

Dominion commends the Commission for its extensive and intensive efforts in promulgating final rules for Default Service also known as Provider of Last Resort Service ("POLR") in a timely fashion. Dominion Retail also thanks the other parties that provided Comments in these proceedings, because it is important that all views be represented prior to the Commission developing the rules that will govern the final transition to competitive markets in Pennsylvania. Dominion Retail, nonetheless, has serious concerns about some of the views expressed by some of the commenters with regard to certain aspects of the Commission's proposed default service rules and the policy statement that accompanies those proposed rules. Dominion Retail believes that some of these views are contrary to the express language of the *Electricity Generation Customer Choice and Competition Act* ("Competition Act"), 66 Pa. C.S. § 2801, *et seq.*, and are, therefore, legally unsound. Some of those same views, and others, espouse policies would be harmful to customers and the competitive *retail* market envisioned by the Competition Act and are, therefore, practically unsound as well.

Dominion Retail is very concerned with the policy implications of adopting a view of the end-state of the retail electric market in Pennsylvania that has been expressed in the Comments of the Office of Consumer Advocate ("OCA"). The OCA's view suggests that the Commission should not concern itself with the development of retail competition, and instead suggests that the only meaningful competition will occur at the wholesale level. The OCA's comments make this self-fulfilling prophecy, stating: "[i]t is clear to the OCA that for residential customers, default service will remain the primary means by which essential electric service is made available to customers on reasonable term and conditions." (OCA Comments, p. 3.) First, this statement makes clear that OCA, at least, has determined that retail competition cannot or will

not work in Pennsylvania, before we even have completed the transition to that market. The OCA urges us to give up before we start! Second, such a view implies that electric generation suppliers ("EGS") do not or cannot provide reasonable terms and conditions of service for customers—a statement with which Dominion Retail strongly disagrees. Dominion Retail has been serving nearly 100,000 residential customers at rates below Duquesne Light Company's default service rates for a number of years; a clear signal that competition can work and does work when the rules allow it to work.

If the Commission were to agree with the suggestion that it simply "give up" on retail competition, and instead focus only on ensuring that Default Service Providers ("DSP") purchase energy at the "lowest possible long-term cost" – that is, to rely solely on the wholesale market to provide any price protection to customers, it not only would run headlong into the mandate of ensuring "retail" competition found throughout the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. § 2801, *et seq.*, it also would do potentially severe harm to Pennsylvania consumers.

In the OCA's view of the world, the DSPs would be the primary purveyors of "reasonable" rates by purchasing energy in what the OCA would hope to be a competitive wholesale market at prices that would produce the lowest possible long-term rates for those customers. At first blush, this appears to be a return to cost of service rate making, but without any meaningful method of rate regulation that was the hallmark of cost of service rate regulation. The OCA's view puts complete control of default service rates in the hands of the DSP, because the OCA supports reconciliation of default service rates. In such a world, DSPs buy energy and pass all costs directly on to customers on a dollar-for-dollar basis, no matter what they spend for energy, with no meaningful review—no determination that the prices produced are reasonable.

In a world in which most customers are a default service customer, and DSPs are the only entities selling meaningful quantities of electricity in the retail market, that market will be far less robust than it is today, and cannot be trusted, at the lowest level, to produce a disciplined "market price." It is this retail competition in every other market that produces market discipline-that is, customers can decide what is best for themselves. This simple fact is the fatal flaw in the OCA's rationale, without a competitive retail market, retail rates cannot be presumed to be reasonable. The question is a simple one, does Pennsylvania want to return to the days of above market retail rates, when customers have no choice but to accept to going "default" rate. It would be a monumental policy mistake to allow DSPs to set retail rates based upon prices produced by a non-robust market, with no opportunity for choice by the consumer. If DSPs are the only entities selling in the retail market, all customers will be captive and the fundamental premise of the Competition Act, retail choice, will have been eliminated. The only way the Competition Act will produce the promised result is to allow competition to work through rules that allow for fair and balanced competition. Default service should not be a competing service, it should be as a last resort, as the Competition Act requires.

The OCA also supports the notion of the default service provider entering into long-term contracts for energy purchases. Such a view runs contrary to the notion that POLR service is intended as a temporary service and that the Competition Act envisions the "default" to be that customers take service from EGSs. The use of long term contracts for "default" service implies that customers will remain on that service in perpetuity. Moreover, this view raises the very serious question of who pays the costs of those long-term contracts when those contracts become uneconomic, as most long-terms contracts usually do. Certainly, such costs should not be borne by customers who have chosen alternative suppliers, even those who leave default service during

the term of those long-term contracts, because those customers have the right to choose and because they would be unaware that the DSP might enter into such contracts "on their behalf," and since the idea of long-term contracts is so fundamentally contrary to the express provisions of the Competition Act. In a market where everyone is concerned about future price increases, it is easy to ignore the downside of long-term contracts, even with the many lessons from the past few years. One has to look at the upside and the downside of each option, before suggesting that it can be a panacea. Contracts longer than a few years will always cause distortions in the relationship of rates to market prices and may not produce the best prices for customers.

There is no way to avoid the obvious and potentially painful fact that wholesale market prices currently are at higher levels. However, that market is a fact of life and is beyond the ability of the Commission to regulate. Nonetheless, it is retail competition that will allow customers to choose the best means of translating those wholesale prices into retail rates that customers can understand and accept. Customers must be allowed to choose what is best for them and are more than capable of making those decisions. Dominion Retail is not asking for artificially high default rates, just for rates that reflect the market so that they can offer such choices to customers.

Dominion Retail urges the Commission to fully implement the Competition Act and allow it to work, before simply assuming that retail competition will not work and thus creating a policy approach that seeks to regulate default service rates using such mechanisms as reconciliation or long-term contracts which distort market prices, for better or for worse, rather than allowing a market price to prevail. Duquesne Light Company's program is the proof that the market can work. Even though Duquesne's program involved a three-year purchase agreement and a three-year stable rate, it does not involve long-term isolation of the retail rate

from the wholesale price, or the short-term price distortion of reconciliation. It is telling that now, ten (10) years after the implementation of the Competition Act, Duquesne Light's rates have still not returned to the pre-competition levels even though wholesale market prices have risen dramatically during that same period. The Commission may recall that when it rejected Duquesne's proposal for a six year contract, it expressed the view that a contract of such long duration would ensure that the default rate had little connection to the market price. Accordingly, Dominion Retail urges the Commission to adopt the view expressed explicitly by the Competition Act that retail competition is the best way to control prices of electricity in Pennsylvania in the near-term and long-term future.

II. Replies to Specific Comments

A. Reconciliation

A number of parties, including PPL Electric Utilities, Inc., ("PPL") and First Energy ("FE"), support the Commission's proposal to allow reconciliation in certain circumstances. (FE Comments, p. 11; PPL Comments on Policy Statement, p. 10.) As discussed more fully in its Comments in this proceeding and elsewhere, Dominion Retail strongly believes that not only is reconciliation of default service rates bad public policy, it also is illegal under the Competition Act.[1] Reconciliation is bad policy not only because it divorces market price signals from the

[1] It is axiomatic that when the language of a statute is clear, there is no need to ascertain the legislative intent. Moreover, it is also clear that a statute is to be read in *pari materia*, that is, as a cohesive act. In this case, the Public Utility Code and, more specifically, the Competition Act, must be read as a cohesive whole and the legislative intent must be derived from the whole statute. The Legislature did authorize reconciliation of certain classes of costs in the Competition Act, but it did not authorize reconciliation of default service costs. Rather, the Legislature authorized reconciliation only for stranded costs. More recently, the Legislature authorized reconciliation of compliance costs in the Alternative Energy Portfolio Standards Act, 73 P.S. § 1648.3(a)(3). In both pieces of legislation, the Legislature specifically identifies Section 1307(f) as the provision that provides the reconciliation requirements. In contrast, when it came to addressing the recovery of the costs of providing default service, the Legislature did not use the word "reconciliation" nor did it refer to Section 1307(f).

It is obvious, based upon the language of Section 2808(f) and 73 P.S. § 1648.3(a)(3), that the Legislature knows how to use the word "reconciliation" and knows how to invoke Section 1307(f) when it intends to do so, and that it did not do so in the context of the recovery of the costs default service in the rates for that service. At the threshold, the Competition Act does not

rates that customers pay, it also allows default service providers to shift costs out of period through rates that are artificially low in one period and correspondingly higher in another. With reconciliation, EGSs and customers never know what the real market price is in any given period. This causes customers to become confused and easily dissatisfied with offers from EGS that appear to be competitive one day, and non-competitive the next, for no real market reason.

While the ANOFR and Policy Statement make it clear that the Commission would like some meaningful portion of the default service provider's portfolio to include spot market energy purchases, the addition of reconciliation will ensure that no trace of those spot market prices will ever find their way onto a customer's bill in a form that will allow the customer to know what market prices were. That is because reconciliation allows DSPs to pass significant amounts of risk onto customers by not fully including the costs of all risks, including switching risk and weather related usage risk, in rates, and without any financial repercussion to the utility. The sad irony is that customers will pay those costs, only after the fact, when customers have no ability to adjust their consumption. If a customer knows that he or she is going to be paying more for electricity during a certain period of time, that customer can adjust his or her behavior to lower consumption. Reconciliation takes that option off the table for customers.

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authorize the Commission to approve reconciliation of default service rates. This concept is important because, as a creature of statute, the Pennsylvania Public Utility Commission is only empowered to do what the Legislature specifically authorizes by statute or that which may be determined by reasonable implication from the clear words of the statute. The fact that reconciliation is specifically permitted in Section 2808(f) and is not mentioned, let alone authorized in Section 2807(e)(3) makes it clear the legislative intent was that reconciliation not be permitted for recovery of default service costs. Clearly, the legislature intended that the phrase "recover fully all reasonable costs" means something other than reconciliation. To the contrary, Dominion Retail believes that this provision allows the utility to recover all reasonable costs associated with default service, in default service rates, and protects customers by allowing some review, with the operative word being "reasonable."

Similarly, the authority to authorize reconciliation cannot reasonably be inferred from the Competition Act. That is, one cannot reasonably infer that the Legislature intended that the Commission be allowed to approve reconciliation of default service costs. Not only do the words of the same Act, the Competition Act, provide for reconciliation of a certain type of costs, namely stranded costs, and not provide for reconciliation of default service costs, but the rules of statutory construction and the principles developed there-under, make it absolutely clear the mention of a thing in one place in a statute implies the exclusion of things not mentioned and that exclusion applies to the entire Act. This principle is known as *expressio unius est exclusio alterius*, and would not authorize reconciliation to be read into one part of a statute where it is not even mentioned, when the same requirement is expressly stated in another section of the very same statute.

PPL goes so far as to suggest that reconciliation is the "only way" that the statute can be implemented fully and that reconciliation is required by the Competition Act. (PPL Comments on Policy Statement, P. 10). These types of statements are clearly baseless. As demonstrated in Dominion Retail's Comments and the Comments of other parties, there are a number of ways to allow full recovery without resort to reconciliation.

One example would be for the default service provider to purchase a fairly sizable percentage of its electricity needs for default service on a month ahead basis, and use a forward index price as a basis for setting the rate that would change monthly. Not only would the resulting rates be transparent, and allow for competition, but the resulting rates would also contain strong market price signals, that would give customers a taste of the market, without full exposure to the market--assuming that approximately 50% of the portfolio consisted of longer term contracts of several months to several years. Moreover, because of the closer match between the market price of energy and the rates the customers pay, there would be virtually no need for reconciliation. DSP would have a much better idea, at the time they were setting rates, of their exposure to risk. In short, a monthly rate would provide a degree of accuracy in rates that would eliminate the need for reconciliation. However, because some risk would remain, even with this type of a plan, utilities should not be prohibited from earning profits on default service, since there is no such prohibition in the Competition Act, and risk must be rewarded.

Accordingly, Dominion Retail strongly suggests that reconciliation be removed from the default service regulations, or, alternatively and at a minimum, be coupled with a prudence review each year for the reasons discussed immediately below.

B. Prudence Review.

Several commenters, including FE (FE Comments, pp. 2-4) and PPL (PPL Comments on Policy Statement at p. 7), suggest that while they are greatly appreciative of the Commission's proposal to allow reconciliation under certain circumstances, they want the Commission to ensure that there will be no after-the-fact review of the rates for default service charged to customers. Perhaps nothing better illustrates the impractical nature of this suggestion better than PPL's plea that "the Commission should approve each DSP's default service program – including the use of long-term contracts – with no possibility of an after-the-fact review." (PPL Comments on Policy Statement, p. 10). What PPL suggests is that the Commission write a blank check on the account of all default service customers. PPL and other EDCs would have the Commission grant prior approval of purchasing plans only, and allow dollar-for-dollar recovery of all costs associated with purchases, but permit no further inquiry into the rates produced by their purchasing and rate setting habits.

Under such a "no-review" scheme, customers will not be able to rely on the market to discipline the wholesale prices that DSPs pay for energy (because there will be little or no competition); customers will not have the ability to adjust consumption in the face of price increases (because reconciliation will divorce real market price information from rates; customers will have no real ability to know if it may be in their best interest to shop, and so they will not); and, DSPs will recover energy costs on a dollar for dollar basis, with interest. Such a world is not what the Competition Act requires.

While Dominion Retail strongly disagrees with the proposal to allow for reconciliation of default service rates, and Dominion Retail does not believe that regulation should be allowed to supplant the market in the rate setting function, in the event that the Commission chooses to go

down that road, Dominion Retail believes that it is imperative that the Commission also require prudence review of the costs and associated rates. One need only look as far as Section 1307(f) to realize that the *quid pro quo* for dollar-to-dollar recovery is the prudence review of Sections 1317 and 1318. Obviously, the General Assembly was concerned that if gas utilities were permitted to recover gas costs on a dollar-for-dollar basis, without review of their purchasing practices or the alleged cost basis of their rates, that there would be no incentive for the utilities to behave prudently. Commission review and approval of purchase plans alone, simply is not sufficient for this purpose. The only way to accomplish that goal is through after the fact prudence review.

Dominion Retail recognizes that there is risk associated with prudence review and it has suggested an alternative by which DSPs can virtually eliminate risk and still recover fully reasonable costs. Recall, the statute does not guarantee dollar-for-dollar recovery. Those alternatives are far more promising than imposing the burden of annual reconciliation and review filings. That return to the days of regulated rates is not what the Competition Act promised to Pennsylvanians.

C. Definitions – "Prevailing Market Price"

At least one commenter has suggested that the Commission must modify the definition of prevailing market price to include the notion that the prevailing market price is the price for energy products over the "agreed upon term" at the "prevailing market price at the time the generation supply is purchased." (PPL Comments on ANOFR, p. 4.) Based upon PPL's suggested definition, a DSP could purchase energy today to meet its needs in 2020, and the price paid today would be considered to be a "prevailing market price." Clearly such a definition is not what was intended by the plain language of Section 2807(e)(3) of the Competition Act.

Rather, that Act requires the utility to purchase the energy in real time, that is, as it needs the energy for actual default service needs. While Dominion Retail believes that the ANOFR's proposed definition is somewhat ambiguous, as it pointed out in its Comments, PPL's suggestion would make the definition, and the statutory requirement that energy be purchased at prevailing market prices as the energy is needed, virtually meaningless. Accordingly, PPL's proposed definition should be disregarded.

IV. Conclusion

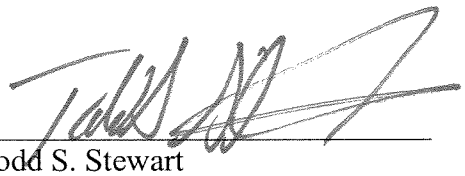
As discussed in this Reply Comment, as well as in its Comments on the ANOFR and the Policy Statement, Dominion Retail believes that the Commission is at a critical juncture. The Commission must decide whether it will fully implement the provisions of the Competition Act and allow market prices to be passed on more directly to customers taking default service, or whether the Commission will continue the legacy regulatory mechanisms such as reconciliation and long-term contracts, that are not envisioned by the Competition Act. Without a robust retail market, the default service rates paid by customers cannot be presumed to be reasonable.

Going halfway down the road to real competition will be far worse for customers than never having gone down the road at all. Without giving competition a real chance--by not reverting to reconciliation or other regulation of prices--the entire premise of the Competition Act—the eventual existence of competition—is foregone, and the market based world it requires cannot ensure that customers pay reasonable prices. Without competition, customers will be captive of default service providers as customers of unregulated monopolies.

Dominion Retail commends the Commission for its willingness to take bold steps in order to implement the Competition Act. Dominion Retail urges the Commission to continue on

that path and to take all necessary steps, including the elimination of all vestigial regulatory mechanisms such as reconciliation and attempts at price control for default service rates.

Respectfully submitted,



Todd S. Stewart
Attorney ID # 75556
Hawke McKeon Sniscak & Kennard LLP
100 North Tenth Street
Harrisburg, PA 17101
717-236-1300
717-236-4841 (fax)
tsstewart@hmsk-law.com

Counsel for Dominion Retail, Inc.

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