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
Default Service and Retail Electric Markets	:	Docket No. M-00072009

COMMENTS OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
ON THE ADVANCE NOTICE OF FINAL RULEMAKING
AND ON THE PROPOSED POLICY STATEMENT

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* Section 2807(e)(3) of the Public Utility Code, 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 ("AEPS Act"), 73 P.S. §§ 1648.1-1648.8. On March 8, 2006, the OSBA filed initial comments. On April 7, 2006, the OSBA filed reply comments.

By Order entered February 9, 2007, at Docket No. L-00040169, the Commission issued an Advance Notice of Final Rulemaking and invited comments by March 2, 2007. By a second Order entered February 9, 2007, at Docket No. M-00072009, the Commission issued a Proposed Policy Statement and invited comments by March 2, 2007.[1]

The Advance Notice of Final Rulemaking ("Regulations") and the Proposed Policy Statement ("Policy Statement") are inextricably linked, in that one contains the proposed final form regulations for default service and the other sets forth how the Commission proposes to apply those regulations. Therefore, the OSBA is submitting integrated comments on both documents. The OSBA is filing these integrated comments at both Docket No. L-00040169 and Docket No. M-00072009.

[1] The Policy Statement was initially issued at Docket No. L-00070183. However, a February 13, 2007, Secretarial Letter advised that the correct Docket No. is M-00072009.

COMMENTS ON SPECIFIC PROVISIONS

§54.185. Default service programs and periods of service.

Section 54.185(a) requires the default service provider to "file a default service program . . . no later than fifteen months prior to the conclusion of the currently effective default service plan or Commission approved generation rate cap for that particular EDC service territory." It is reasonable to infer from this language that the Commission does not intend the Regulations to require the reopening of post-rate cap default service plans previously approved by the Commission, *e.g.*, for UGI Electric, Penn Power, Duquesne, Pike County, Citizens, and Wellsboro. *See* also Policy Statement, §69.1802.

However, it is not clear what the Commission intends with regard to new default service plans which are currently pending before the Commission, *e.g.*, for PPL Electric, Pike County, and Duquesne. It is also unclear what the Commission intends with regard to new default service plans which may be filed later this year, *e.g.*, for Citizens, Wellsboro, and Penn Power. Without clarification, an EDC may file a default service plan, or parties may reach a settlement on a default service plan, which deviates from the Regulations in significant ways. If the Commission then rejects that plan or settlement because of the deviation, the parties will have to re-litigate the case even though there is likely to be minimal time remaining before new default service rates must be put into effect.

Accordingly, the OSBA recommends that the Commission include language which makes clear when the Regulations will take effect and how, if at all, they will apply to pending cases. The OSBA's preference is that the Regulations apply for the first time to default service programs for the period beginning January 1, 2011. Because each EDC's rate cap will have

expired by no later than December 31, 2010, the OSBA's preferred approach would make the Regulations applicable to each EDC at the same time.

In the alternative, the OSBA recommends that the Regulations expressly be made applicable to each default service program filed on or after a specified date, which date is after final review of the Regulations by the Independent Regulatory Review Commission and the General Assembly and after publication in the *Pennsylvania Bulletin*.

§54.186. Default service procurement and implementation plans.

- **Competitive Procurement**

The OSBA agrees with the requirement in Section 54.186(b)(4) that all default service electric generation supply (unless purchased on the spot market) should be acquired through a competitive procurement process. Unless the Regulations are amended to define "prevailing market prices" as the price for a specified product, in a specified market, and at a specified time (an amendment which the OSBA would oppose), *requiring* competitive procurement is the easiest way to assure compliance with Section 2807(e)(3).

Without competitive procurement, ratepayers could be charged in excess of the market price at a time when alternative service is unavailable from an EGS. That scenario could occur if the EDC were to enter an above-market no-bid contract with its affiliated interest. Conversely, without competitive procurement, the EDC might enter a below-market contract with the affiliated interest in order to undercut the ability of EGSs to compete with the default rate.

- **"Long-term costs"**

Section 54.186(b)(1) states the statutory requirement that the procurement plan must acquire default service generation "at prevailing market prices." However, Section 54.186(b)(1)

also includes a requirement that the plan be designed to provide default service "at the lowest reasonable long-term costs."

The inclusion of the reference to "long-term costs" presumably is intended to recognize that long-term contracts may be part of the default service portfolio. However, since those contracts will be acquired through a competitive procurement process, they will, by definition, meet the "prevailing market prices" standard.

Including "lowest reasonable long-term costs" implies that a procurement plan will have to satisfy two standards rather than one, *i.e.*, it will not only have to meet the statutory requirement by providing for the acquisition of energy "at prevailing market prices" but it will also have to satisfy a non-statutory requirement by providing for the acquisition of energy "at the lowest reasonable long-term costs." It is questionable whether imposing this second standard is permitted under the Competition Act. Furthermore, evaluating a procurement plan on the basis of its long-term costs appears inappropriate in the case of a plan which does not propose to rely on any long-term contracts.

Therefore, the OSBA recommends either the deletion of the reference to "long-term costs" or the addition of language clarifying the circumstances under which the "long-term costs" will be relevant to approval or disapproval of a plan.

- **Length of supply contracts**

The Regulations do not specify the length of contracts a default service provider ("DSP") may enter in order to acquire electricity for default service. However, Section 69.1805 of the Policy Statement does. Specifically, Section 69.1805(2) specifies that contracts to serve non-residential customers with peak demands of 25-500 kW should not exceed one year in length. In contrast, Section 69.1805(1) provides that contracts to serve residential customers and non-

residential customers with peak demands of less than 25 kW may extend for up to three years. Furthermore, Section 69.1805(3) provides for no limitation on the length of contracts for electricity to serve non-residential customers with peak loads of greater than 500 kW.

The Commission has articulated no rationale for subjecting small business customers with peak loads of 25-500 kW to greater price volatility than the other identified customer groups. In addition, limiting contracts to one year for service to certain small business customers is inconsistent with the Commission's recognition that long-term contracts may be necessary to enable developers to obtain the funding for alternative energy projects. *See* Policy Statement, Discussion at 5 and Section 69.1806.

In view of the foregoing, the OSBA recommends that the Policy Statement be amended to allow wholesale contracts of up to three years to serve non-residential customers with peak loads between 25 and 500 kW. In the alternative, the OSBA recommends that the Policy Statement be amended to allow contracts of up to three years under each EDC's first default service program and to delay designating the length of allowable contracts for the second and subsequent programs until the Commission can evaluate the experience with the initial programs.

- **Joint Procurement**

Section 54.186(b)(2) requires DSPs with loads of 50 MW or less to evaluate the possibility of joining with one or more other DSPs in acquiring default service electricity.[2] The OSBA strongly supports this requirement for small EDCs such as Pike County, Citizens, and Wellsboro, both as a way to avoid a "small EDC" wholesale premium and as a way to create large enough tranches for procurement by rate class and procurement at multiple times during the year.

[2] *See* also Section 54.185(e), which authorizes the Commission to "direct that some or all DSPs file joint default service programs to acquire electric generation supply for all of their default service customers."

Although Section 54.186(b)(2) does not prohibit larger DSPs from engaging in joint procurement, the OSBA recommends that the 50 MW limit be increased. Based upon the most recently approved default service plans for Penn Power and UGI Electric, the OSBA believes that the ratepayers of those two mid-size EDCs might benefit by the acquisition of energy in conjunction with some other DSP. Therefore, evaluation of joint procurement should be mandatory for those two EDCs even though they have loads in excess of 50 MW.

- **Data by Rate Schedule**

Section 54.186(c)(1)(vii)(C), (D), (E), and (F) require the EDC to provide certain data to potential bidders by rate schedule. However Section 54.186(c)(1)(vii)(A) and (B) require hourly usage data and the number of customers to be provided on only an aggregated basis. To facilitate bidding by rate class, the OSBA recommends that hourly usage data and the number of customers also be provided by rate schedule.

- **Confidentiality**

Section 54.186(c)(5) provides that wholesale bids are to be treated as confidential but are to be available under a confidentiality agreement to "any third party involved in the administration, review or monitoring of the bid solicitation process." It is unclear whether the statutory advocates are among the third parties entitled to this information.

Section 54.188(f) contemplates a role for the statutory advocates in assuring that default service rates comply with Section 2807(e)(3) and the relevant default service program. However, the advocates will be handicapped in fulfilling that role without access to the bid results and to the process by which those bids will be evaluated and accepted or rejected. Therefore, the OSBA recommends that Section 54.186(c)(5) be amended to make clear that the

statutory advocates will have access to the bids and, at least, to the methodology (*e.g.*, determination of the maximum acceptable bid) by which those bids will be evaluated.

The OSBA also recommends that the Commission release the names of the winning bidders and the winning bid prices. In responding to IRRC, the Commission drew a parallel between default service procurement and procurement by the Commonwealth. Regulations, Discussion at 14. Under the Commonwealth's procurement practices, the identity of winning bidders and their bids are open to public scrutiny. *See, e.g.*, 62 Pa.C.S. § 512(d).

§54.187. Default service rate design and the recovery of reasonable costs.

- **Flat rates**

In its summary of the changes made to its original proposed regulations, the Commission states that "[r]ate design should be simplified to provide normal incentives for energy conservation and to facilitate customer choice . . . through the elimination of declining blocks, demand charges, etc." Regulations, Discussion at 5. Similarly, the Commission indicates in the Policy Statement that the new Price To Compare ("PTC") "should not incorporate declining blocks, demand charges, or similar elements." Policy Statement, §69.1810.

The OSBA agrees with the Commission that demand charges and declining blocks are inconsistent with the way DSPs acquire energy in the wholesale market and that they complicate comparison shopping, particularly for small business customers. In addition, the use of demand charges and declining blocks could have the effect of pricing default service to low load factor customers above market and pricing default service to high load factor customers below market (as is already the case in Duquesne). Under that scenario, the low load factor customers will be

overpaying for default service but will not be attractive to EGSs, while the high load factor customers will be attractive to EGSs but will have little, if any, incentive to shop.

Section 54.187(c) prohibits declining block rates. Unfortunately, however, there does not appear to be a comparable provision in the Regulations which expressly prohibits demand charges. Therefore, the OSBA recommends the insertion of language which specifically prohibits demand charges, thereby effectuating the Commission's stated intent.

- **Shifting costs from Distribution to Generation**

Section 54.187(d) contemplates the shifting of certain costs, *e.g.*, uncollectibles and other customer care costs, from current Distribution rates to default service rates. The language expressly prohibits double recovery of those costs through both the Distribution rate and the default service rate. However, the language does not specify how the shifted costs are to be measured.

In the OSBA's view, the only costs to be shifted to the default service rates are those which the EDC would be able to avoid if it were not the DSP. To shift more than those avoided costs would result in an inflated default service rate, which shopping customers would bypass. Consequently, customers who do not receive competitive offers from EGSs, *e.g.*, small business customers with low load factors, could become the "residual payors" of costs which are actually Distribution costs caused by shopping customers.

Therefore, the OSBA recommends the addition of language making clear that the costs shifted from Distribution to default service are to be only the costs the EDC would be able to avoid if it were not the DSP.

Although the OSBA agrees that there may be generation-related costs which should be shifted from Distribution rates to default service rates, the OSBA questions the usefulness of a

cost allocation proceeding for each EDC in 2007 or 2008. *See* Policy Statement, Discussion at 6 and §69.1808(b). Even if the generation-related costs in the Distribution rates are identified in 2007 or 2008, those EDCs with capped generation rates will not be able to transfer those costs to their default service rates until 2010 or 2011. By that time, the dollars identified in 2007 or 2008 are likely to be outdated. Therefore, rather than inviting or requiring each EDC to initiate a cost allocation proceeding (or even a full-fledged Distribution rate case) in 2007 or 2008, the OSBA recommends that the Commission initiate a generic proceeding. In such a generic proceeding, the Commission could make policy decisions regarding issues such as the specific kinds of costs to be shifted, whether the amount to be shifted should equal only the amount the EDC would avoid if it were not the DSP, whether those costs should be subject to reconciliation or some other updating mechanism, and by what cost of service methodology the reduction in Distribution rates and the increase in default service rates should be allocated among the rate classes.

- **Reconciliation**

Section 54.187(e) requires the DSP to use an automatic adjustment clause under Section 1307 of the Public Utility Code, 66 Pa. C.S. §1307, for the recovery of costs related to complying with the AEPS Act. However, Section 54.187(f) makes the use of such a clause optional for the recovery of costs related to non-alternative energy. That means that the portion of the default service rate related to AEPS Act costs will be reconciled while the larger portion of the default service rate (related to non-alternative energy costs) will be reconcilable only if the DSP so chooses. This approach is flawed for at least two reasons.

First, if the AEPS-related portion of the rate is reconciled while the non-AEPS-related portion is not, it will be difficult for the DSP to acquire electricity on a blended basis, *i.e.*, at a

bid price which includes both alternative and non-alternative energy. As a result, the DSP will lose the possibility of getting a better price on a blended basis than will be available if it acquires alternative and non-alternative energy separately. Furthermore, the quantity of alternative energy to be acquired may be too small to be acquired by rate class.

Second, as the Commission recognizes, the failure to reconcile non-alternative energy costs is likely to result in either an overcollection or an undercollection by the DSP. *See* Policy Statement, Discussion at 7-8 and §69.1809. If there is an overcollection, the DSP will be enriched at the expense of its default service customers. On the other hand, if there is an undercollection, the default service rate will be below market and the ability of EGSs to compete will be undercut.

Rather than relying on New Jersey-style auctions, the Commission has opted to follow Pennsylvania's own natural gas model. A critical part of natural gas regulation in Pennsylvania is the annual Section 1307(f) proceeding. Whatever the perceived shortcomings of the New Jersey model, the New Jersey auction at least assures default service customers that they are paying a price actually set through competition. The best way to provide that same assurance to ratepayers under the natural gas model is to *require* reconciliation. With reconciliation, default service ratepayers will be assured that they are paying no more than the cost of competitively bid contracts (and no more than the DSP actually paid on the spot market).

- **Customer Classes**

Section 54.187(h) tentatively creates a new small business class for customers with a maximum registered peak load of less than 25 kW. Furthermore, Section 54.187(h) at least implies that this new customer class will be grouped with the residential classes for purposes of competitive procurement of default service generation. In addition, Sections 69.1805 and

69.1807(3) of the Policy Statement indicate that procurement should be done by customer classes and that small business customers with a peak demand of less than 25 kW should be grouped with residential customers.

The OSBA strongly endorses procurement by rate classes, in that it is an efficient, market-based method to avoid interclass subsidies. The OSBA also recognizes that the cost to serve a new class of small business customers with a peak demand of less than 25 kW is generally similar to the cost to serve the residential classes. Therefore, the OSBA agrees with the Commission's grouping of this new small business class with the residential classes, provided that the resulting wholesale price for the entire group is not translated into separate retail rates, such that the new small business class subsidizes one or more of the residential classes.

- **Fixed-rate option**

The Commission indicates that comments are to focus on the changes made to the prior draft of default service regulations and are not to revisit issues parties have advocated in prior filings and, in effect, have lost. Regulations, Conclusion at 24. Because of that admonition, the OSBA will not repeat its oft-stated arguments in favor of fixed rates of at least one-year for small business customers.

However, the OSBA notes that the Commission indicates in the Policy Statement, §69.1805(3), that "[t]he DSP may propose a fixed-price option [for non-residential customers with a peak demand greater than 500 kW] for the Commission's consideration."[3] Therefore, the OSBA recommends that if DSPs are permitted to propose a fixed-rate option for non-residential

[3] As drafted, Section 54.187(j) of the Regulations requires rates for these customers to be adjusted no less frequently than monthly but does not provide for the possibility of a fixed-rate option. It will be necessary to amend Section 54.187(j) to authorize the fixed-price option contemplated by Section 69.1805(3) of the Policy Statement.

customers with a peak demand greater than 500 kW, then DSPs should also be permitted to propose a fixed-rate option for non-residential customers with a peak demand of 500 kW or less.

§54.188. Commission review of default programs and rates.

Section 54.188(f) allows parties to file exceptions to DSP tariffs which implement quarterly adjustments. Although this provision is appropriate, it is not sufficient. Just as with the Commission's regulation of natural gas, there should be an annual reconciliation proceeding. The OSBA, and presumably at least some other parties, lack the resources to conduct meaningful discovery and to litigate default service rates on a quarterly basis. However, those parties have been able to participate fully in the annual Section 1307(f) proceedings.

The Regulations contemplate greater involvement by the Commission and interested parties in the approval of generation procurement than in the approval of natural gas procurement. Therefore, it may be sufficient simply to designate one of the quarterly adjustment filings as requiring a more extensive submission by the DSP, with an evidentiary proceeding only if a party files an exception. Furthermore, after the first few years, the annual reconciliation proceeding for default service electricity may only rarely require the filing of testimony, public hearings, and briefing.

§54.189. Default service customers.

Section 54.189(a) provides that, at the end of the rate cap period, non-shopping customers will automatically be assigned to default service. By implication, shopping customers are not to be so assigned unless they take some affirmative action to select default service.

A significant number of small business customers in the PECO service territory are receiving service from an EGS following their assignment pursuant to the Market Share Threshold ("MST") program. *See Petition for Approval of PECO Energy Company's Market Share Threshold Bidding Assignment Process,* Docket No. P-00021984 (Order entered February 6, 2003). It has been alleged to the OSBA that many of these customers would actually save money if they were to return to default service. Although the OSBA has no basis on which to determine the accuracy of that allegation, Section 54.189(a) assumes (perhaps incorrectly) that PECO's small business customers continue to shop because they actively compare EGS service to default service and not because of inertia or the lack of necessary information.

Therefore, the OSBA recommends that Section 54.189(a) be amended to preserve the opportunity (during consideration of PECO's default service program) to return MST customers to default service unless they act affirmatively to remain as EGS customers.

CONCLUSION

The OSBA respectfully requests that the Commission revise the Final Regulations and the Proposed Policy Statement in accordance with the recommendations set forth above.

Respectfully submitted,

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