Allegheny Energy

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June 15, 2006

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Policies to Mitigate Potential Electricity Price Increases
Docket No. M-00061957

Dear Mr. McNulty:

Pursuant to the Commission's May 24, 2006 Investigation Order in the above-referenced docket, please find enclosed the original and fifteen (15) copies of the Comments of West Penn Power Company, doing business as Allegheny Power.

Pursuant to the Order, Allegheny Power, for itself and its affiliate, Allegheny Energy Supply Company, LLC (AE Supply), previously advised the Commission that each company may give a presentation at the June 22, 2006 hearing. Please be advised that Cynthia A. Menhorn, Director, State Regulatory Affairs, will give a presentation on behalf of Allegheny Power, but AE Supply has elected not to give a presentation or file any written comments.

Sincerely,

Randall B. Palmer /mos

Randall B. Palmer
Senior Attorney

Enclosures

cc: Shane Rooney (via email srooney@state.pa.us)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Policies to Mitigate Potential Electricity Price Increases	: :	**Docket No. M-00061957**

COMMENTS OF WEST PENN POWER COMPANY, DOING BUSINESS AS ALLEGHENY POWER

Introduction

The Commission's May 24, 2006, Investigation Order ("Order") initiated a generic investigation entitled "Policies to Mitigate Potential Electricity Price Increases." As stated in its Order, the Commission's purpose for this proceeding is to address the issues and develop policies to mitigate the effects of the higher electricity prices that may result with the expiration of the long-term generation price caps that are currently in place for many Pennsylvania utilities.

While the Order identified six specific issues for which the ideas and perspectives of interested parties are sought, the Commission also indicated that this issues list was not intended to be exhaustive. West Penn Power Company, doing business as Allegheny Power, is, indeed, an interested party and appreciates the opportunity to participate in this proceeding. Allegheny Power applauds and supports the Commission in its decision to deal with these critical issues in a proactive manner in advance of the risk of higher electricity prices for Pennsylvania consumers as their rates begin to reflect the future transition to market-based wholesale generation costs. Accordingly, Allegheny Power offers the following comments regarding the six issues identified by the Commission, as well as additional comments regarding other issues relevant to the Commission's investigation.

Educate Consumers

The Commission's first issue for comment is consumer education. The Commission states that a significant part of the problem with the sudden price increases that resulted in neighboring states when generation price caps expired was a lack of sufficient advance notice of higher prices so that consumers could gradually adjust both their budgeting and their electricity consumption patterns.

Allegheny Power concurs that consumer education is a valuable tool in the endeavor to develop fully evolved competitive energy markets. Consumer education serves two purposes. First, as implied in the Commission's concern for customers' abilities to prepare for and accommodate price increases, consumers who better understand the effects of competitive energy markets on their bills should be better prepared for the price changes that can occur in a competitive generation market. Second, consumers who can better respond to price changes by adapting their consumption to changing market conditions is paramount to the development of a fully functioning competitive market.

It is, and has been, Allegheny Power's intent since late 1998 to keep its customers fully apprised of any and all changes to the costs of their electricity. For example, the funds for consumer education that were included in Allegheny Power's original electric restructuring settlement in Pennsylvania is specifically earmarked for this purpose and will be so utilized throughout Allegheny Power's transition period, which ends in 2010. Allegheny Power recommends that the Commission craft a message that can be provided on a consistent basis throughout the Commonwealth, preferably through the use of a pre-defined range of media outlets. This would most efficiently utilize the funds available for consumer education from an industry wide perspective.

Encourage Conservation

The Commission noted in the Order that encouraging and enabling customers to use electricity more efficiently should be a key strategy for helping them cope with increasing electricity prices. Allegheny Power agrees. Workably competitive markets that provide consumers with transparent market price signals are the best way to encourage customers to respond to increasing prices with conservation or changes in their consumption patterns. Electric consumers cannot realistically be expected to change their usage patterns until they are truly subject to market pricing signals. Allegheny Power urges the Commission to base any required conservation programs on sound economics that reflect the true cost and effectiveness of such programs. As the Commission is aware, the challenge in developing effective conservation programs is ensuring that costs are reflective of, and commensurate with, the actions taken. Care must be given in determining how to fund conservation programs properly and subsequently recover those costs.

In addition, current rate structures will need to be analyzed to evaluate the impact to utilities and how that impact may effect consumer decisions. As the result of conservation or the implementation of new programs such as time-of-use rates, utilities may incur additional costs or unexpected shifts in loads and energy consumption.

Reduce Peak Demand for Electricity

Allegheny Power agrees with the Commission's view that policies that reduce peak period electricity demands would help to reduce price spikes in the wholesale energy markets and, ultimately, reduce overall energy prices for consumers.

As part of the infrastructure analysis that is required under the Energy Policy Act of 2005 ("2005 EPA"), consideration must be given to the current threshold level of 300 kW for advanced metering to determine whether this limitation should remain intact at least until changes in rate structures can be made to capture the additional costs that would be associated with changes to this advanced metering threshold. This analysis should take into consideration the costs to both the customer and the utility to determine the most cost-effective breakpoint for requiring advanced metering equipment. As stated above, the benefits of fully competitive markets will not be fully realized until electric customers receive, and can effectively respond to, actual market price signals. This outcome requires metering technologies and rate designs that allow customers to see real-time market price signals and alter their usage in reaction to these prices. If advanced metering is utilized in order for customers to have the ability to receive market price signals, the costs associated with the installation of the advanced metering should be paid by the customers requiring specialized metering. As with conservation programs, any mandatory metering programs should be based on a sound economic analysis that reflects the true costs and the effectiveness of such programs. The costs and benefits for both electric customers and suppliers should balance.

Consider Alternatives for Avoiding Abrupt, Large Price Increases

The Commission notes in the Order that the phasing-in of increased energy costs over a period of a few years may be one approach to mitigating the effects of sudden, abrupt retail price increases. Indeed, the Commission recognized the benefits for customers of a more graduated series of lesser price increases over a period of time when it approved the Amendment to the

Restructuring Settlement ("Settlement") for Allegheny Power in April 2005.[1] For example, the Settlement provided for increases to customers that were reasonable, while still allowing the option at any time for those customers to switch suppliers if they chose to do so. Going forward, Allegheny Power continues to support the phasing-in of increased generation charges to mitigate what could otherwise be substantial and immediate price increases as consumers transition to market generation charges.

A robust competitive retail market cannot develop until customers are exposed to true market price signals; therefore, Allegheny Power believes that the transition period for phasing in market-based rates should be as short as possible. For example, large commercial and industrial customers are typically more sophisticated than customers with lower usage and are also better able to enter into contracts with retail suppliers that will allow them to manage the risks of sudden price increases. Such large customers also typically have access to the advanced metering technologies that allow them to almost instantaneously respond to market prices. Consequently, Allegheny Power suggests that any phase-in period, if one is to exist for large commercial and industrial customers, must by its very nature be shorter in duration than for residential and small commercial customers.

Allegheny Power's Settlement mitigated large increases but in the event others do not have that opportunity or the transition period has ended, an alternative may be to index price increases that result from increased generation charges against forecasted market rates, with an annual reset to that index. A crisis situation can be avoided by reviewing the forward market 24 months in advance and then calibrating the changes to the generation charges based on the forward market while ensuring full cost recovery of purchased power costs. An annual true-up mechanism would provide that analysis while mitigating the consumer impacts. Any excess

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[1] Docket Nos. R-00039022 and R-00973981

amounts collected could be invested, with the principle being used to mitigate future increases when the transition to full market rates is completed.

If a mechanism such as this is implemented, any "early phase-in" charges must be non-bypassable to all customers, as all customers will have the opportunity to benefit from this option in the future. An excessive "early phase-in" adder that is bypassable, coupled with a decrease in wholesale prices could have the effect of artificially promoting retail switching during the rate cap period. Regardless of the structure of any phase-in, the wholesale supply of default service should be acquired through a competitive bidding structure that ensures that default supplies are procured at the most favorable prices. For example, included in the order approving the Settlement was a detailed process for a Request for Proposals ("RFP") for Full Requirements Wholesale Electric Power Supply for 2009 and 2010 for generation suppliers to serve Allegheny Power's customers in Pennsylvania. The RFP was issued on May 31, 2005, for all classes of customers. Allegheny Power had ten (10) suppliers attend the pre-bid meeting on June 10, 2005; nine suppliers subsequently filed the appropriate paperwork, including the necessary letters of credit. Five bids were received and the process was overseen by an independent consultant from Regulatory Economics Group to assure conformance with the process that was ordered by the Commission. Allegheny Energy Supply Company, LLC, an affiliate of Allegheny Power, was the winning bidder. In October 2005, the Federal Energy Regulatory Commission ("FERC") accepted the wholesale contract resulting from the RFP.[2]

Moreover, any procurement rules should be structured so that costs and risks are appropriately allocated between customers and suppliers. To do otherwise would serve either to decrease the competitiveness of the procurement process or to increase the resulting bid prices to accommodate such risks. The Commission is currently considering default service rules in its

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2 Docket No. ER05-1439-001

proposed rulemaking at Docket No. L-00040169, 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). As these rules are presently drafted, only the reconciliation of default service costs related to the implementation of the Alternative Energy Portfolio Standards Act is addressed. Allegheny Power urges the Commission to reconsider this issue. As discussed above, a true-up mechanism that ensures full cost recovery by the utility as the default service provider should be included. If a reconciliation charge is not available to the default service provider, the bid prices resulting from the procurement process will reflect this additional level of risk that will be imposed on suppliers. Such a result will translate into increased prices to customers. Additionally, any default supply contract requirements and terms should take into consideration the market structure of the PJM Interconnection, L.L.C. ("PJM"). For example, contract terms should be coincident with the PJM planning year to ensure the best prices.

Review Issues Concerning Programs to Assist Low-Income Customers

Through its Low Income Payment & Usage Reduction Program ("LIPURP") and the Low Income Usage Reduction Program ("LIURP"), Allegheny Power ensures, in a cost effective manner, that low-income customers who have difficulties with their electric costs continue to have access to affordable electricity. Through these programs, Allegheny Power works with eligible customers to:

- Establish affordable payment arrangements that maintain electric service and guide customers towards self-sufficiency in paying their electric bill; and,
- Provide assistance in reducing their energy consumption to a more affordable level.

For example, the LIPURP utilizes alternate payment agreement plans, which consider assistance grants and debt reduction as additional factors in reducing the customer's arrearage. A participating low-income customer is placed on a plan that requires monthly payments that are based on a percentage of income or an established minimum payment determined by usage and household occupancy. This payment amount, however, cannot exceed the customer's projected budget. An additional $5.00 monthly payment is required toward the unamortized balance. Funds to pay the current charges are obtained from the customer's LIPURP payment, LIHEAP cash assistance, and $1 Energy Fund grants. Funds to cover the monthly shortfall are covered by LIHEAP assistance and LIPURP Monthly Supplemental Grants. Arrearage Retirement Funds cover a percentage of the unpaid arrearage. Participants are provided energy education; home energy audits, weatherization and budget counseling in an effort to reduce their electric bills and assist them in better managing their personal finances. All of the above criteria are subject to adjustment, as needed, to ensure that the programs are as effective as possible.

Review Interplay with the Wholesale Energy Markets

The Commission stated in its Order that the nexus between the retail and wholesale electricity markets requires a review of the current wholesale market structure and the Commonwealth's retail market. Allegheny Power urges the Commission to consider the benefits that flow to customers from a fair, robust, and competitive wholesale market when the Commission participates in the stakeholder and governance processes at PJM.

A competitive bid process used statewide by the investor-owned utilities to procure the default electric supply is another way of ensuring an appropriate nexus. The competitive bidding process in Pennsylvania has achieved the fundamental criteria for success as reflected by the

Settlement, namely prices that are comparable to other bid processes and reflect a significant number of bidders. Although other states such as New Jersey have used an auction process to procure wholesale electric supply for POLR load, Allegheny Power continues to advocate the use of the competitive bid processes used successfully in Pennsylvania and Maryland. Those processes were premised upon the establishment of clear and specific criteria before actual bidding commenced to ensure that comparable bids were received from qualified bidders. As a result, a number of bids were received. The competitive bid process is cost effective with the utility conducting the bid while being fully open to review and monitoring by the Commission.

The results of the 2005-2006 Maryland statewide bid for providing 8,259 MW of default service load for one, two, and three-year contracts provide another example. This bid process demonstrated both a significant number of bidders as well as a diversity of supply. Of the sixteen eligible bidders, thirteen submitted bids with eleven winning suppliers for the period. Starting in June 2006, there are twelve different suppliers serving default service load.[3]

Regardless of whether an auction process or RFP process is used to procure supply, if structured properly the supply will be priced at the prevailing market prices. Although Allegheny Power suggests that a statewide process be consistently applied across the Commonwealth, it has been clearly demonstrated in comparing the market prices from New Jersey, which were the results of an auction, and from Maryland, which were the results of a competitive bid, that either process given the proper pre-approved structure yields market results.

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[3] See *The Commission Staff's Report/Observations on Standard Offer Service Bid Process and Results* (Maryland Public Service Commission, March 7, 2006).

Additional Issues

Incentive Ratemaking

The statement of Commissioner Shane attached to the Order poses the following questions:

> "Should the Commission undertake incentive ratemaking to share the benefits of lowering LMP prices? Could interruptible or demand-side management rate designs be implemented which offer financial rewards to both the customers and the default service provider? Could financial incentives be offered which relieve transmission congestion and result in lower LMP prices?"

Allegheny Power supports the implementation of incentive ratemaking as a means to increase transmission investment and, thus, relieve transmission congestion. When transmission congestion is relieved, lower locational marginal energy prices ("LMPs") will result. Allegheny Power urges the Commission to work in concert with the FERC in this effort. In terms of a retail rate structure for passing through these benefits, Allegheny Power supports the implementation of a fully reconcilable recovery mechanism to pass through all transmission charges and benefits to customers.

Estimation of Summer Air Conditioning Costs

Commissioner Shane also requested utilities to estimate the marginal cost of air conditioning in July, August and September. Unfortunately at this time, Allegheny Power is unable to complete a study such as this. In the alternative, Allegheny Power suggests that the Commission inquire as to whether or not PJM may have the ability to perform a study such as this across the Commonwealth.

Conclusion

Allegheny Power appreciates this opportunity to comment on the issues raised in the Commission's Order and to be included in the further development of the record in this proceeding. What has occurred is not a failure of competition, but a slower than anticipated development of the market. A market in order to develop needs certainty in order to move out of transition. This Commission needs to stay the course while continuing to provide the utilities with the proper processes and regulatory framework in order to move competition forward.

Respectfully submitted,

West Penn Power Company,
doing business as Allegheny Power

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Dated at Greensburg, Pennsylvania this 15th day of June 2006