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July 20, 2006

James McNulty, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
2nd Fl., 400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary McNulty:

Enclosed are the original and fifteen copies of the Retail Energy Supply Association's Reply Comments for filing in the above-referenced matter. An electronic version has been emailed to Shane Rooney as required by the Commission's May 24, 2006 Order.

Sincerely,

Kevin J Moody

Kevin J. Moody
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

KJM/jls
Enclosures

HAR:67160.1/MID051-237505

BEFORE THE PENNSYLVANIA
PUBLIC UTILITY COMMISSION

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

REPLY COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

I. INTRODUCTION

The Retail Energy Supply Association ("RESA")[1] submits these reply comments to respond to the comments submitted by various parties in this proceeding as well as in response to the discussions at the *en banc* hearing held on June 22, 2006. In its initial comments RESA noted that, should the Commission adopt a price mitigation plan at this time, any such plan should not disrupt the development of a viable competitive market. RESA commends the Commission for recognizing the possibility exists that a significant pricing disparity could exist between capped rates and market prices at the time rate caps expire. It is RESA's position that the Commission has time to monitor electric prices as well as further developments in other states' markets over the next few years before implementing any price mitigation plan or default service model.

RESA aptly differentiates the purposes of a price mitigation plan from those of a default service design; however, several parties'[2] so-called price mitigation proposals are in fact nothing more than long-term default service designs that fail to adequately address price mitigation design. In the first section of these reply comments RESA will address

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1 RESA member companies include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, MidAmerican Energy Company URS, Reliant Energy Solutions, Sempra Energy Solutions, Strategic Energy, LLC, SUEZ Energy Resources NA, Inc. and U.S. Energy Savings Corp. The opinions expressed in this filing may not represent the views of all members of RESA.

2 Including, but not limited to, PPL, PECO, IECPA, OCA and OSBA.

the failure of several parties to provide a price mitigation plan or the principles by which a plan should be evaluated. RESA provides guiding principles for a price mitigation plan, should one be determined to be necessary. The second section of these reply comments responds to the long-term default service proposals proffered by several parties and explains how those long-term proposals not only fail to provide price mitigation, but are also contrary to the goals and directives of the Electricity Generation Customer Choice and Competition Act ("Electric Choice Act" or "Choice Act") because they will deny consumers of the Commonwealth the benefits of competition.

II. PRICE MITIGATION PLANS

A. Long-term Auction Models (NJ-BGS, MD-SOS) or other Long-term Fixed Price Default Service Plans are not Price Mitigation Plans.

Several parties advocate long-term fixed price models as a price mitigation tool. Long-term fixed price contracting (*e.g.*, New Jersey's current 3-yr BGS-FP wholesale market model) fails to address the question of what to do should the default price be significantly higher than current market prices at the expiration of rate caps. Just as rate caps set prices that are not market responsive for several years, so too are the prices set by long-term default service product models. Specifically, long-term procurement models fail to adequately respond to changing market prices and will, at times, create significant price differentials. Long-term auctions are nothing more than rolling rate-caps that inhibit the development of a robust, sustainable competitive retail market. The Commission would be wise not to go down a regulated pricing path that creates an on-going need to address price mitigation. While long-term contracting advocates attempt to persuade the Commission that such a design will mitigate price increases, the reality is that long-term contracts will *not* prevent default customers from eventually experiencing significant price changes due to price adjustments in the wholesale market. This has been seen with the recent New Jersey auctions where residential customers experienced price increases of 12-14%. To further compound the problem, consumers will be left with little to no choice but to pay the auction prices because retail competition is not sustainable under this market design. Once again, New Jersey provides a clear example of the lack of competition under this design as only 26 of 3.2 *million* residential customers are served by competitive suppliers.[3]

As evidenced in the past three years of rising commodity prices, most Pennsylvania electricity customers have default prices that are lower than prevailing market prices. However, we only know this now because we are in the position of looking in hindsight. The use of long-term auctions as a price mitigation tool during the rate cap period is actually counterproductive to the goal of creating a solution for what may happen when rate caps expire. Indeed, long term contracting may actually *create* the need for ongoing price mitigation, whereas sufficiently adjusted market pricing eliminates this need. Default service designs that utilize long-term contracting will continue the need to address the issue of price mitigation for Pennsylvania's consumers because the default prices will always have to play "catch-up"(both increasing and decreasing, depending on then current market conditions) with true market prices, a problem that is eliminated with a more market responsive model.

B. Appropriate Outcomes of a Price Mitigation Plan.

RESA believes that, should a price mitigation plan be implemented, it should be aimed at directly addressing the one-time problem of significant price increases at the end

[3] http://www.state.nj.us/bpu/energy/elecSwitchData.shtml

of the rate cap period. Customers should be given assurance that any pricing disparity they may face when rate caps expire is a one time issue and that going forward there will be market reflective default pricing that will allow for the development of a robust, sustainable competitive retail market where a number of products and services are available from a variety of retail providers. RESA offers the following fundamental principles for a price mitigation plan. These principles address price mitigation and ensure that the opportunity for competition in Pennsylvania will not be hindered after the expiration of rate caps:

- Provides desired customer benefits
- Applies to all applicable distribution customers via a non-bypassable credit
- Is competitively neutral
- Does not harm the utilities
- Will not impede the development of a viable retail competitive market
- Does not override the goals of the Choice Act

RESA submits that if a mitigation plan is implemented, it should apply only at the time rate caps expire and not be applied in advance where money would be collected prior to rate cap expiration. As we all know, prices change with changing market conditions. We don't know where prices will be at the time rate caps expire, so implementation of a price mitigation plan now for an event that might not even occur is unnecessary. Premature adoption of a price mitigation plan would not serve anyone's interest, but most importantly would not benefit the consumers that would be funding the hypothetical, yet unknown and undetermined mitigation need. A sound default service design and mitigation plan will provide for a smooth transition off rate caps and ensure that the Commonwealth avoids the various financial and political issues others states are facing today.[4]

III. DEFAULT SERVICE DESIGNS

A. Any Default Service Design Must Conform to the Goals of the Electric Choice Act.

RESA submits that it is imperative to ensure that the policy directives declared in the Electric Choice Act, Section 2802, are followed when considering the appropriate structure of a price mitigation plan or default service design. On this issue, key directives in the Choice Act include:

- Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity.
- There must be a fair and orderly transition from current regulated structure to a structure under which retail customers will have direct access to a competitive market for the generation and sale or purchase of electricity.

These policy directives clearly require creating a market design that allows for robust, sustainable retail competition and codify the importance of allowing retail choice to work for all customer classes. When considering an appropriate price mitigation plan, should one be found to be necessary, the Commission must ensure that any plan is not contradictory to the goals of the Electric Choice Act. Instituting a price mitigation plan that mandates long-term requests for proposals ("RFPs") or auctions, as proposed by some parties, is just another form of economic regulation, and not the competitive market-oriented construct required by the Electric Choice Act. Because such a market design is not responsive to changing market conditions, the resulting market structure

4 Motion of Commissioner Terence Fitzpatrick dated May 19, 2006.

will be one of economic regulation, not competition. This is contrary to the goals and policy directives of the Electric Choice Act. This is also not price mitigation.

Customers – under any default service design – will ultimately pay market prices, so the issue comes down to which structure meets the goals and directives of the Choice Act and promotes a robust, sustainable competitive retail market. In places where long-term contracting is used for default service, such as New Jersey, competition will not exist for those consumers, leaving them with little to no competitive choices. In contrast, in states where default prices sufficiently reflect changes in wholesale prices, competitors are assured that the default prices will not become below market for extended periods of time and, as a result, are in a position to enter and remain in the market to the benefit of consumers: for example, New Jersey hourly priced default service ("CIEP"), Maryland hourly priced default service ("HPS"), and Texas no price-regulated default service for large commercial and industrial ("C&I") customers and market responsive default service for residential and small non-residential customers. More specifically:

- In Maryland, 90.5% of HPS load is served by competitive suppliers.[5]
- In New Jersey, 84.99% of CIEP customers are served by competitive suppliers.[6]
- In Texas, at the start of retail competition on January 1, 2002, all large C&I customers received electric service without the option of a price-regulated default service offer.
- In the Duquesne Light Company service territory where hourly priced service is the default service for customers above 300 kW, as of December 31, 2005 competitive suppliers were serving 92.8% of that load.[7]

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5 Month ending March 2006 Electric Choice Enrollment Monthly Report http://www.psc.state.md.us/psc/electric/enrollmentrpt.htm

6 New Jersey Electric Statistics CIEP Switching as of March 31, 2006 http://www.bpu.state.nj.us/wwwroot/energy/CIEP.pdf

The Choice Act specifically set the standard for default service in the post-transition period as electricity procured at "prevailing market prices."[8] Thus, the General Assembly clearly understood that a viable competitive retail market will develop only if default service reflects market prices in a timely manner.

B. *Long-Term Auction Models (NJ-BGS, MD-SOS) or other Long-Term Fixed Price Default Service Plans Stifle Competition.*

Under the guise of providing price mitigation plans, several parties have used this opportunity instead to advocate their preferred wholesale market model where the utility remains, in essence, the only provider for retail electricity. Long-term default service proponents falsely argue that customers will be shielded from rising commodity prices. However, BGS-style or other long-term auctions *do not shield* customers from paying true market prices. This is evidenced by the 83-99% increase in auction prices for the 2004-06 3-year product auction in New Jersey, the furor occurring in Maryland, and the situation with Pike County. While the proponents of economic regulation market structures in this instance argue that pricing one-third (1/3) of the volume at the lower 2004 auction prices results in a lower BGS price, it is also true that when wholesale prices fall, the higher prices from previous auctions will continue to be borne by consumers.

The consequences of a default service design that more slowly incorporates increases in market prices are that: (1) consumers also must pay higher prices for a longer period of time when market prices fall, because it takes longer to roll off the long-term

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

8 66 Pa. C.S. § 2807(e)(3).

contracts; and (2) retail choice is denied to consumers and they are left with no choice but default service. Default service under these circumstances is not a backstop service as required by the Choice Act, but the service of first and only resort.

Contrast this scenario with one where the default product is sufficiently responsive to changing market prices. In these markets customers have many options, including a multitude of long-term products and short-term products, offered by a variety of competitive retailers. In fact, in both the New York and Texas competitive markets, residential customers can choose among a variety of products and services and providers. Offers that exist include a 5-year product, 3-year product, one-year products, month-to-month products, and various other terms and products, including renewable energy based products.[9] The sudden, significant price increases currently being experienced by virtually all customers on fixed price default service in Maryland and other states are prime examples of what happens when wholesale prices become artificially disconnected from retail prices (via economic regulation decision-making rather than consumer-oriented, competitive decision-making).

Suppliers may not be willing to make investments in a market wherein default prices falls below market prices for any substantial period of time. Since longer-term fixed default prices exacerbate the risk of the default prices becoming out of market, the unattractiveness of this market structure to competing retail providers is compounded. Additionally, a long- term default service structure does not support supplier entry

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9 www.powertochooseny.com reports a 5-yr Price Protection Program offer in Consolidated Edison's service territory;
www.powertochoose.com reports a 3-yr fixed rate plan throughout the competitive areas of Texas. In addition, there are a variety of other products and services available, including a 5 year product in TXU's area.

because, over time, the fixed retail price becomes decoupled from prevailing wholesale market prices, leading – at best – to limited or sporadic opportunities for competition.

As mentioned earlier and contrary to what parties promoting longer-term default service models suggest, a default service model that relies on long-term contracting will – eventually – reflect both wholesale price increases and decreases and thus will not shield customers from the gamut of wholesale price changes. While a long-term auction structure may be market responsive at a single point in time, the going-forward market prices are going to change and these changes will either create or, more significantly and just as likely, destroy a viable competitive retail market. The conditions established by this market structure are not conducive to a robust, sustainable competitive market and lead to little or no customer choice, contrary to the General Assembly's directives. Therefore, the Commission should avoid market models that will not fulfill the competitive retail market goal of the Choice Act.

C. Market Reflective Default Models Promote Competition

As RESA and other panelists noted at the *en banc* hearing, a successful default service model must reflect market conditions on a timely basis to allow for sustainable robust retail competition to flourish. A market responsive model sends customers true market price signals both when prices are on the rise as well as when they are in decline. The Choice Act envisioned a competitive market – not default service, as suggested by several parties – bringing the benefits of retail choice to customers. Although RESA believes that a market responsive default service model is appropriate, there is no need for the Commission to make definitive findings regarding default service structure in this proceeding – that is for the POLR NOPR.[10] As RESA stated above, any price mitigation plan should be limited to the one-time potential problem of significant price increases at the end of the rate cap period.

IV. CONCLUSION

RESA submits that adhering to the mitigation principles outlined in these comments will ensure that a price mitigation plan, if determined to be necessary, not only conforms to the purposes detailed in Commissioner Fitzpatrick's Motion[11] and the Commission's Order[12] but also will not impede development of a robust and sustainable competitive retail marketplace as envisioned by the Choice Act. RESA commends the Commission for recognizing that there may be a need for a price mitigation plan at the expiration of rate caps, but RESA urges the Commission to monitor market prices to determine with more certainty price levels at the time of rate cap expiration rather than making assumptions now of prices levels over the next several years.

While RESA clearly believes that, as a matter of sound public policy, a default service design reflective of current market prices is appropriate, the Commission need not determine a default service model in this proceeding. Furthermore, RESA appreciates the opportunity to comment on these important issues and looks forward to working with the

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[10] *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.

[11] Motion of Commissioner Terence Fitzpatrick dated May 19, 2006.

[12] Docket No. M-00061957 (May 24, 2006).

Commission and all stakeholders to develop a successful and competitive retail electric market for the benefit of electricity consumers in Pennsylvania.

Respectfully submitted,

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