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July 20, 2006

Via Federal Express

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

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

Dear Secretary McNulty:

Attached are an original and three copies of the Reply Comments of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company in the above proceeding. These comments are filed pursuant to the Commission's Order adopted May 19, 2006, in this proceeding and in accord with your letter of June 7, 2006. A copy of this cover letter and the comments have also been e-mailed to Shane Rooney (srooney@state.pa.us) today.

Please direct any further correspondence on this matter to me.

Respectfully,

Stephen L. Feld

SLF:dka

Enclosures

cc: Shane Rooney

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY COMMENTS OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY

To the Honorable Commission:

By an Investigation Order adopted on May 19, 2006 ("Order"), the Pennsylvania Public Utility Commission ("Commission" or "PUC") initiated this investigative proceeding to address issues and develop policies to mitigate electricity price increases upon the expiration of generation price caps. On June 15, 2006, Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec") and Pennsylvania Power Company ("Penn Power") (collectively, the "Companies") submitted their joint Comments pursuant to the Order ("Initial Comments") as did numerous other parties. The Commission conducted an *en banc* hearing on June 22, 2006 to hear testimony of a number of parties. The Companies now submit these Reply Comments to the June 15 initial comments and June 22 testimony of the other parties.

Introduction

The Companies welcome this opportunity to present these Reply Comments to address several of the matters raised by other parties and the Commissioners themselves in this proceeding. Although the parties in their initial comments discuss a wide variety of issues, the Companies will address only two matters in these Reply Comments. The Companies' limited response in these Reply Comments does not mean that the Companies agree with or support the suggestions of the other parties to which the Companies have not chosen to respond at this time. Rather, the Companies will address these issues in due course as the Commission continues to proceed with this investigation.

The first issue which the Companies address in these Reply Comments involves the interpretation of "prevailing market prices" (§2807(e)(3)) under the Electricity Generation Customer Choice and Competition Act (66 Pa. C.S.A. §2801, *et seq.*) ("Competition Act"). This term generated a considerable amount of discussion during the *en banc* hearing as to how such prices are to be determined. The Companies believe that there is no single prevailing market price but rather a variety of electric power products, each of which is available at a different price. The procurement of provider of last resort ("POLR") supply during the post rate cap period should be accomplished by means of a statewide process that meets the prevailing market price requirement.

The second issue that the Companies address in these Reply Comments is that the implementation of low-income assistance, consumer education, conservation, demand-side management and renewable energy programs that various parties advocate come with substantial costs. As stated in the Companies' Initial Comments, the costs of these programs should be recoverable by the electric distribution companies on a full and current basis. The issue of recovery of these costs was frequently overlooked, unintentionally or otherwise, by many of those who proposed aggressive, additional programs.

As Met-Ed and Penelec made clear in their Initial Comments, Met-Ed's and Penelec's current transition cases pending before the Commission (Docket Nos. R-00061366, R-00061367, P-00062213 and P-00062214) involve a different time period than the issues in this generic proceeding. The Met-Ed and Penelec transition cases seek to implement provisions of their restructuring agreements in the period *prior* to the expiration of their rate caps whereas this current generic investigation is primarily focused on rate impacts *after* electric utilities' generation rate caps expire, generally in 2009 and 2010. The Met-Ed and Penelec transition plans propose adjustments to, not elimination of, their respective rate caps in a manner consistent with their restructuring cases. Although the transition plans' proposed increases in generation rates may have the effect of mitigating rate shock after 2010, that mitigation is not the primary reason for these rate filings that affect rates during the rate cap period. These Reply Comments are therefore limited to the period following the expiration of rate caps. The Companies welcome the Commission's efforts in this docket to develop appropriate means to address price mitigation issues during the post-rate cap period.

I. Prevailing Market Prices and POLR Procurement

The Commission's *en banc* hearing on June 22, 2006 included much discussion as to whether "prevailing market prices" for POLR supply as used in §2807(e)(3) of the Competition Act means short-term spot market prices, e.g., PJM's LMP, or long-term forward prices. The Commission also heard that it should endorse the use of portfolio concepts in utilities' procurement of power for POLR load. The Companies believe that these concepts can be mutually compatible.

Procurement of power for POLR service at "prevailing market prices" is not limited to merely the pass through to customers of LMPs nor is it obtaining a 10 year fixed price through a long-term purchase power agreement. Rather, the term, "prevailing market prices," encompasses the variety of electric power products available on the wholesale market and may include both spot purchases as well as longer term products. The term is not an "either/or" situation but must be considered in light of the circumstances and the available energy and capacity products in the market that exist from time to time.

PPL Electric Utilities Corporation's comments and testimony proposed a plan for POLR procurement for the post-rate cap period. Its plan envisions a uniform, state-wide process whereby all Electric Distribution Companies ("EDCs") would procure power to meet their POLR requirements in a uniform, statewide process applicable to all electric utilities. Although the Companies do not agree with all of the details of PPL's plan, they do agree generally that a uniform, statewide process is a sound and preferable method to obtain POLR supply. Such a process, if constructed appropriately[1], will incorporate balanced portfolio concepts that other parties in this proceeding advocate. A plan similar to PPL's proposed plan should meet the prevailing market price criteria and produce reasonable rates that are indeed reflective of the applicable power market.

The Companies' New Jersey utility affiliate, Jersey Central Power & Light Company, obviously has had first-hand experience with the Basic Generation Service

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[1] The Companies note that any statewide process must consider that Penn Power is in a different RTO than other Pennsylvania electric utilities. This means that although a statewide process as applied to Penn Power may differ in some respects from other utilities, the basic process may still be very similar to the remainder of the state.

("BGS") auction process instituted by the New Jersey Board of Public Utilities in 2002. The BGS auction process has succeeded in securing a POLR supply for that state's electric utilities and their customers at price levels less volatile than the market generally. Although persons may disagree about the effect of the BGS process on retail competition and customer behavior, the benefits and detriments of the BGS auction process present a useful model for Pennsylvania to learn from in developing its own statewide process. Because of their affiliate's experience in New Jersey, the Companies are looking forward to participating in any future proceeding commenced by the Commission to consider a statewide process for Pennsylvania.

The use of a statewide approach to POLR supply by the EDCs does not mean that at all points in time POLR prices will be the lowest source of supply. In fact, it should be assumed that most of the time POLR rates will be different than the prices at which EGSs are willing to supply simply reflecting changes in market prices, so that at times they will be higher and at other times they will be lower. In addition, the POLR price of the EDCs may be higher than EGS prices for some rate classes and lower for other rate classes. These differences, if substantial enough from a customer standpoint, will cause migration of customers to and from POLR supply. This migration presents risks for both EDCs and EGSs. However, the financial impact of customer migration can be managed by both, but at a cost. In the case of the EDCs, migration may be managed through financial hedging transactions or through recovery mechanisms such as adjustable reconciliation riders. The Companies believe that any costs that EDCs incur as a result of migration issues are required to be recovered by the terms of the Competition Act, particularly §2807(e)(3) which mandates that EDCs be able to recover all reasonable costs associated with providing POLR service.

The OCA's endorsement of a portfolio approach and the current portfolio approach implemented by Duquesne Light do not address the Companies' concern expressed in their Initial Comments that 20/20 hindsight could be used to judge the appropriateness of recovery of POLR costs. Because the Duquesne experience to date has been generally favorable, the prudence of the process has not been the focus of extensive review. The use of a portfolio approach that includes short-term and longer-term supply contracts as well as conservation and demand-side management programs makes prudence reviews very problematic because it is likely that some of these decisions will turn out to be less beneficial to customers than originally estimated when viewed from a later perspective. If the Commission desires to pursue a portfolio approach that is tailored to individual utilities and their customers, then clear, comprehensive guidelines need to be established through a formal rulemaking process so that the criteria by which prudence of POLR supply arrangements will be judged is known in advance by all stakeholders.

II. Recovery of Social Program Costs

As stated in the Companies' Initial Comments, regulated utilities historically have been viewed as the funding source for customer education, low-income assistance and conservation/demand-side and renewable programs. Numerous commenters in this proceeding confirm that regulated utilities should continue to be considered as the source of funding for these types of programs. However, only a few of those who support expansion of these programs even address the issue of utility recovery of these costs. Even those who discuss cost recovery do so in a very general manner, almost as an afterthought. The cost-benefit analyses fundamental to assessing the efficacy of these programs is hardly discussed. For these programs to provide the societal benefits that some of these same parties perceive to exist, the issues of cost recovery and cost/benefit must be fully resolved.

The OSBA supports recovery of education costs as part of a surcharge or distribution cost while the OCA believes that the costs of customer education should be included in base rates since utilities are getting back into filing base rate cases. (Tr. 59-60) As stated in their Initial Comments, the Companies advocate recovery of the costs in §1307 adjustable mechanisms. This method allows full and current recovery of actual costs without the probability of over or under recovery. At the same time, the §1307 process accommodates changing funding needs and the establishment of new programs or the elimination of marginal programs. This flexibility will be especially important as the state moves into the post-rate cap period and the concomitant uncertainties associated with these programs during that period.

Most of those who advocate advanced metering installation do not address who will pay for this expensive infrastructure investment. When questioned about who bears the cost of advanced metering, the DEP states that it has not performed any cost analysis (Tr. 191) but yet is content to recommend extensive installation of this equipment. This perception of the inherent "good" of such metering regardless of cost or actual benefit should be a red flag to the Commission not to mandate advanced metering unless and until objective, quantitative evidence demonstrates that such metering will produce benefits greater than the costs. In addition, the allocation of these large capital costs among customer classes must be fully vetted and resolved before such a mandate is proscribed.

If after appropriate analysis the Commission finds that advanced metering should be implemented on a statewide basis, then it should seriously consider promoting the enactment of a distribution system improvement charge ("DISC") amendment to the §1307 of the Public Utility Code as discussed with Chairman Holland during the *en banc* hearing. (Tr. 189) Such an amendment would clearly remove the cost disincentive associated with the installation of advanced metering on a broad scale. Without such an incentive, utilities' capital expenditure plans are forced to choose among infrastructure investments because the capital required to fund all potential infrastructure uses is not unlimited. Capital for advanced metering or other demand side programs must compete, in terms of potential company and customer benefits, with other infrastructure needs. The availability of a DISC-type mechanism allows advanced metering costs to be recovered in a full and timely manner and would thereby avoid creating competition between advanced metering installations and other infrastructure investments.

Several commenters advocate that demand-side management programs be implemented only on a voluntary basis. The Companies believes that this is appropriate because, as they stated in their Initial Comments, the success of these programs is entirely dependent on customer acceptance and participation. Voluntary participation encourages customers to achieve individual benefits that outweigh the costs and inconvenience that they may bear in implementing these programs.

Demand response programs have existed for several decades and the cost-effectiveness of these efforts has been spotty at best. Although proponents of some of these programs claim that benefits in excess of costs have accrued to customers, in many cases these are merely assertions without rigorous analyses that truly demonstrate long-term cost-effectiveness. As we move forward, the Commission must determine that demand response programs clearly produce tangible benefits that exceed the associated costs. In the absence of clearly demonstrated benefits in excess of costs, we will be wasting customers' money and depriving society of tangible benefits associated with the use of such money for more productive uses. The Commission should fully support demand response programs that make economic sense but should strongly challenge those who promote such programs to definitively prove their claims. The Companies will support the Commission in this endeavor to ensure that their customers achieve real benefits from demand response programs.

Notable by its general absence in the discussion and comments on the need for low-income customer assistance programs in the post-rate cap period is the cost recovery issue. In order to ensure adequate funding of universal service programs in their service territories, utilities need a flexible means of recovering the costs of these programs, no more, no less. The OCA is correct in advocating a larger amount of funding of these programs from governmental revenues. In the absence of adequate, continuing funding through governmental revenues, however, a §1307 approach provides an effective means to fund universal service programs.

III. Conclusion

The Companies commend the Commission for embarking on this important investigation to better prepare Pennsylvania for competitive energy markets. The initial comments and the testimony presented at the *en banc* hearing clearly demonstrate the complexity of the issues as well as their importance to the state's future. The Companies look forward to continuing to work with the Commission and other parties to fashion reasonable solutions to these issues.

Respectfully submitted,

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Dated: July 20, 2006