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July 20, 2006

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

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

Dear Secretary McNulty:

Enclosed for filing, please find an original and fifteen (15) copies of the Reply
Comments of the Office of Consumer Advocate, in the above-referenced proceeding.

Sincerely,

A handwritten signature in cursive script that reads "Tanya J. McCloskey".

Tanya J. McCloskey
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50044

Enclosure

cc: Chairman Wendell F. Holland
Vice Chairman James H. Cawley
Commissioner Bill Shane
Commissioner Kim Pizzingrilli
Commissioner Terrance J. Fitzpatrick
Shane Rooney (via electronic mail)

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I. INTRODUCTION

In the Order initiating this proceeding, the Commission wisely asked what steps can be taken now to avoid the price spikes and economic disruption that have occurred in other states as they have completed the transition to greater competition in the generation portion of their formerly fully regulated electricity markets. Through written comments filed June 15, 2006 and during the Commission's en banc hearing on June 22, 2006, the OCA and a number of other parties, including the Department of Environmental Protection (DEP), industrial consumers, and several Electric Distribution Companies (EDCs), all offered viable suggestions as to how this Commission can mitigate or avoid dramatic price increases when the rate caps that now protect most Pennsylvania consumers come to an end. Those suggestions addressed the strategies that can be employed by EDCs in acquiring supply to serve their default service obligation. The OCA advocated that EDCs assemble a portfolio of resources from the wholesale markets, acquired over time, with the goal of providing reliable service at the lowest reasonable price to customers.

During the course of the June 22nd en banc hearing, however, the focus of the hearing seemed to change from the mitigation or avoidance of price increases to the promotion of retail competition as an end in itself. The OCA submits that retail electric competition is a means to an end. It is not an end in itself. The primary goal of Chapter 28 of the Public Utility Code – and indeed the entire Public Utility Code with respect to electricity – is to provide reliable, safe and adequate service at reasonable prices that are fair to both the providers and the consumers of electricity. To the extent retail competition furthers that goal, it should be embraced. But again, retail competition is not a goal in itself. The OCA urges the Commission to refocus its efforts on the protection of Pennsylvania consumers and the advancement of the

Pennsylvania economy, not the establishment of a market structure that may promote retail shopping but would be harmful to consumers and the economy as a whole.

The title of the 1996 Act that restructured the Pennsylvania electric utility industry was the “Electricity Generation Customer Choice and Competition Act.” 66 Pa.C.S. § 2801. A critical finding in the Act’s Declaration of Policy is that “Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity.” 66 Pa.C.S. § 2802(5)(emphasis added). The Act also declares that “it is now in the public interest to permit retail customers to obtain direct access to a competitive generation market.” 66 Pa.C.S. § 2802(3)(emphasis added).

The 1996 Act had many other components – regarding such issues as reliability, universal service, and market power – but to the extent that the Act focused on competition, it was competition in the generation market. The goal of the Act was to allow competition in the generation market as a means to enable consumers to receive reliable service at lower prices than would occur if generation continued to be regulated in the traditional rate base/rate of return model. The Public Utility Code was not repealed by the 1996 Act; it was amended. The overriding goal of the entire Public Utility Code remains the provision of safe, adequate and reliable service at just and reasonable prices.

It must be recalled that, prior to 1996, generation service was bundled with distribution and transmission service, and customers had no choice but to take power from the rate based plants and regulated power purchases of their local utility. If a utility wanted to charge its customers for a \$5 billion nuclear power plant that operated three months out of the year, customers had no choice but to pay for that plant (at least to the extent that the Commission found the costs to be prudent and used and useful.) Under the 1996 Act, however, once stranded

costs are paid off and the transition period is over, utilities can no longer simply rely on their own power plants and force their customers to pay for those plants. To the contrary, under Section 2807(e)(3) of the Act, the EDC must “acquire electric energy at prevailing market prices” in order to serve those customers who do not or cannot obtain energy from an alternative energy supplier. The OCA submits that, when the last transition periods for our electric distribution companies end in 2010, all Pennsylvania electric customers will in fact be receiving the benefit of competition in electric generation, whether they receive that generation from their EDC or from an alternative marketer.

Thus, the 1996 Act created two avenues for consumers to receive access to the competitive generation market. One is by purchasing generation from alternative retail electric generation suppliers; the other is through the post-transition generation service that the Act required to be provided by the EDC (or by an alternative Commission-approved provider). The Act does not favor one type of service over another. Rather, the Act recognized that, while competitive retail electric generation suppliers are free to enter or leave the market based on their own business plans and opportunities, the consumers of Pennsylvania will be assured the benefit of competitive generation markets by requiring the EDCs (or alternative Commission-approved suppliers) to acquire energy on their behalf at “prevailing market prices.”

If the only goal – or indeed the primary goal – of the 1996 Act were to force Pennsylvania consumers to purchase electric generation from alternative retail suppliers, the Act could have simply precluded EDCs from providing electric generation service. In effect, the General Assembly could have adopted the model of the original AT&T divestiture, where the “Baby Bell” companies were allowed to offer local telephone service, but were prohibited from offering long distance service in order to promote competition in long distance. But the General

Assembly obviously did not take that route for this service that is so essential to the health and safety of the Commonwealth's residents and so essential to the economy of the Commonwealth. Rather, in Section 2807, entitled "Duties of electric distribution companies", and particularly in Section 2807(e), entitled "Obligation to serve", the General Assembly carefully laid out the continuing role of the EDCs even with respect to electric generation service which, for the first time, could also be provided by alternative suppliers.

There is absolutely nothing in the 1996 Act to suggest that the service offered by EDCs pursuant to Section 2807(e) must be so "ugly" or so volatile, that consumers will have no choice but to seek competitive alternatives. It is not a "failing" of the New Jersey default service model that retail prices increased by "only" 12% to 14% this year and that residential customers have not been hit with price signals that led them to flee to competitive marketers.¹ It is not a "success" of the Texas model that residential consumers have been so negatively affected by constant rate increases from their "price to beat" provider that perhaps 30% of those customers are now purchasing their electricity from a competitor at much higher prices than their neighbors who are still served by regulated utilities or rural electric cooperatives.²

The "success" or "failure" of the 1996 Act cannot, and must not, be defined by the number of retail customers that choose an alternative provider or the number of alternative providers that choose to compete for customers. Success must be defined by whether the Act has enabled the provision of reliable service for customers at reasonable prices that benefit the economy and the citizens of Pennsylvania. The OCA submits that by using a portfolio approach

¹ See, e.g., "JCP&L Customers to See Rate Increase" ("Among all [New Jersey] utilities, the hikes ranged between 12 percent and 13.7 percent") Easton Express-Times February 10, 2006.

² See, "Bills Up 84% Since End of Deregulation", Fort Worth Star Telegram, Nov. 11, 2005; "Texas Electricity Deregulation Hasn't Aided Small Power Users", Wall Street Journal, May 20, 2005; "TXU Profit Rises 39% On Texas Electricity Prices", Wall Street Journal May 3, 2006; "Overrated", Texas Observer June 30, 2006.

that includes a variety of products, including long-term contracts, short-term contracts, alternative energy resources, demand side resources, conservation, spot market purchases, and the like, EDCs can provide customers the benefits of direct access to the competitive generation markets at prices that reflect the efficiencies brought to these generation markets over time. A portfolio approach can also help reduce or eliminate the kind of traumatic price spikes that were the original concern of this Investigation.

II. REPLY COMMENTS

A. The Comments In This Proceeding And Recent Developments In Other Restructured States Support The Use Of A Diversified Portfolio Approach For The Provision Of Default Service.

The focus of this proceeding was on strategies to mitigate potential price spikes. As the OCA has stated throughout the proceedings concerning the default service obligation, the best way to mitigate price spikes and unacceptable rate increases is to enable the EDCs to purchase a variety of products, at a variety of times, through competitive procurement processes. The worst way to do this is to precipitously raise the price of default service or make it so volatile that customers (who can) will flee the service for a slight discount and those who cannot flee, will remain to be burdened with excessive and unaffordable costs.

In our written and oral comments, the OCA strongly advocated that EDCs should have the flexibility to secure a diversified portfolio of resources – long-term, short-term and spot; renewable and non-renewable; supply-side and demand side – designed to provide reasonable, stable and affordable rates to customers. Not only is this policy consistent with the Act, when properly interpreted, but it helps to advance other goals of the Public Utility Code, including reliability and adequacy, as well as economic development and affordability.

The OCA was not the only stakeholder that supported this approach. The Pennsylvania Department of Environmental Protection (DEP) explained the importance of this approach to the development of new resources, particularly alternative energy resources:

To encourage long-term price stability and competition that benefits ratepayers default service providers should be enabled through the Commission's default-service regulations to enter into long-term contracts....

DEP has been working with a number of developers over the last two years to bring various generating assets on line in the Commonwealth, from IGCC to waste coal to wind farms and other renewable resources. The one thing all of these projects have in common is the need for long-term contracts in order to receive private financing. To achieve resource diversification to reduce our reliance on natural gas and to meet growing electricity demand, long-term contracting options will be paramount...

DEP Comments at 9, 11. These views were confirmed by the Comments of solar developers represented by PV Now in this proceeding:

For solar projects that are developed in Pennsylvania under the AEPS, long term solar renewable energy credit ("SREC") contracts will be a key factor in enabling financing for solar photovoltaic ("PV") projects, which in turn will determine whether Pennsylvania is able to meet the solar targets under the AEPS. Long term SREC contracts will also serve to mitigate perceived market risk for SREC's and will result in lower-cost SREC's over the term of the AEPS obligation.

PV Now Comments at 1-2. It is critical to note that the development of these alternative energy resources will provide fuel diversity in the PJM generation market and reduce the number of hours where high priced natural gas fired generating units are setting the market clearing price in PJM.

In its Comments, Duquesne Light Company supported "a fixed price POLR service supplied through a portfolio of contracts" and echoed the need to include "multi-year contracts as an incentive to both stabilize volatile energy prices and to engage and support existing and new generation sources." Duquesne Comments at 3, 6. Duquesne noted the success of its own transition program for small customers who are paying lower rates today than they did twenty years ago, and concluded that the basis for that success is that "Duquesne has offered a long-term fixed price POLR service to its residential and small commercial customers that are supplied by diversified, negotiated and actively managed contracts with various suppliers." *Id.* at

8. In OCA's view, Duquesne's small customer POLR model clearly meets the requirements of the Act in that Duquesne has acquired a portfolio of resources at prevailing market prices. At the same time, Duquesne has successfully avoided the volatility and catastrophic price spikes that have been seen here in Pike County and in other states. The OCA submits that the Duquesne small customer model should be emulated for its success, not criticized because competitive suppliers may find that it is difficult to offer customers a more attractive alternative.

As the Commission is well aware, other states have faced, and are now facing, price volatility that has arisen from an over-reliance on short-term market prices during their transition to generation competition. The OCA urges the Commission to look for guidance to the responses of other states. In our Comments, the OCA cited recent legislative enactments in Delaware and Maine. In Delaware, in response to the recent 59% overall rate increase that resulted from a wholesale bidding process by its predominant electric distribution company – Delmarva – the Delaware legislature passed a requirement that, in the future, Delmarva must provide “Standard Offer Service” by acquiring “sufficient, efficient and reliable resources over time to meet its customers’ needs at a minimal cost.” See, 75 Del. Laws 242 (2005) at Section 1007(c)(1).³ The list of resources through which such service can be provided in the Delaware legislation includes: “Demand-Side Management Programs, long-term purchased power contracts, short-term purchased power contracts, self-generation, procurement through wholesale market by RFP, spot market purchases, etc.” 75 Del. Laws 242 (2005) at Section 1007(c)(1). Similarly, the Maine Legislature amended its restructuring law to “incorporate cost-effective demand response and energy efficiency into the supply of standard-offer service” and also to allow the Maine Commission to “establish various standard-offer service contract lengths and

³ www.legis.state.de.us/LIS/lis143.nsf/vwLegislation/HB+6?Opendocument

terms” for the purpose of “providing over a reasonable time period the lowest price for standard-offer service.” 2005 Me. Laws 677, amending 35-AMRSA §3212(4-B) and (4-C).⁴

Subsequent to the filing of the initial OCA Comments, two more restructured states, Rhode Island and Maryland, have changed their laws to move away from reliance on short-term pricing and auctions. The Maryland legislation authorized the Public Service Commission to direct its electric utilities to “solicit bids to supply anticipated standard offer service load for residential and small commercial customers as part of a portfolio of blended wholesale supply contracts of short, medium, or long terms, and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner.” 2006 Md. ALS 5, 1 (Md. Senate Bill 1).⁵

In Rhode Island, legislation has just been enacted that is intended “to provide Rhode Island residents, institutions and businesses the benefit of stability through diversification of energy resources, energy conservation, efficiency, demand management and prudent procurement.” The Comprehensive Energy Conservation, Efficiency and Affordability Act of 2006, Section 1 (2006 General Assembly, S. 2903, signed June 23, 2006).⁶ The findings of the Rhode Island Legislature are instructive:

The legislature further finds and declares as of 2006:

(1) That prices of energy, including especially fossil-fuels and electricity, are rising faster than the cost of living and are subject to sharp fluctuations, which conditions create hardships for many households, institutions, organizations, and businesses in the state;

⁴ www.mainelegislature.org/legis/bills/chapters/PUBLIC677-1.asp

⁵ www.mlis.state.md.us/2006s1/billfile/sb0001.htm

⁶ www.rilin.state.ri.us/BillText/BillText06/SenateText06/S2903Baa.pdf

(2) That while utility restructuring has brought some benefits, notably in transmission and distribution costs and more efficient use of generating capacities, it has not resulted in competitive markets for residential and small commercial industrial customers, lower overall prices or greater diversification of energy resources used for electrical generation;

(3) That the state's economy and the health and general welfare of the people of Rhode Island benefit when energy supplies are reliable and least-cost; and

(4) That it is a necessary move beyond basic utility restructuring in order to secure for Rhode Island, to the maximum extent reasonably feasible, the benefits of reasonable and stable rates, least-cost procurement, and system reliability that includes energy resource diversification, distributed generation, and load management.

Section 39-1-1(7)(e). The Rhode Island law requires the state's electric distribution companies to secure a "supply procurement portfolio" in supplying its "standard offer service" that is consistent with a "least-cost procurement" standard. The portfolio is to include "energy efficiency and conservation" and permits supply contracts with "various, staggered term lengths and acquisitions." Section 39-1-27.8.

The question before this Commission now is whether it wants to wait for crises to occur as in Maryland and Delaware, or whether it is willing to take steps now to prevent those crises. In one restructured state after another, we are seeing a recognition that it is not appropriate to rely on short-term market prices and single auctions to serve the great majority of small customers who continue to receive generation from their electric distribution company. In OCA's view, the Pennsylvania restructuring law gives this Commission the discretion to permit, and indeed require, our EDCs to meet their continuing obligations to provide generation service under Section 2807(e)(3) through the use of a portfolio of resources that are acquired through competitive procurement processes at prevailing market prices. If the Commission believes it is

somehow required to impose a short-term volatile pricing regime on Pennsylvania consumers under its interpretation of the 1996 Act, then the Commission should state that clearly at this time. In that way, the General Assembly will have time to act to amend the law now, rather than wait for the catastrophic results that occurred in states like Maryland and Delaware.

The issue that this Commission must address is not whether the default service plans proposed by Pennsylvania EDCs will ensure retail shopping. The issue is whether the plans submitted under the EDCs' continuing "obligation to provide electric service" under Section 2807(e) will ensure reliable service at reasonable prices. The Public Utility Code was not repealed by the 1996 electric restructuring act; it was amended. The overriding goal of the law remains the provision of safe, adequate and reliable service at reasonable prices.

B. Two Principled Approaches To Meeting the Default Service Obligation Have Been Presented By The Pennsylvania EDCs For Consideration.

As stated in our oral comments at the June 22nd en banc hearing, the OCA submits that Pennsylvania EDCs, in their initial comments, presented two principled approaches to meeting their default service requirements in a way that may mitigate the danger of price spikes as rate caps expire. The first approach – which is very close to the proposal made by OCA – was the Duquesne approach under which the EDC secures a portfolio of resources and manages that portfolio over a period of time. That approach has been highly successful during the years since Duquesne's rate cap expired and could serve as a model for other Pennsylvania utilities. The second approach upon which the OCA commented at the June 22nd en banc hearing was the PECO/PPL approach under which the EDCs would begin to secure their resources well in advance of the end of their rate cap period, but would do so through a tightly structured series of auctions. Under this methodology, which is closely modeled on the New Jersey approach, the EDC would auction off one third of its customer load each year for three years on a staggered

basis on a full-requirements, load following basis. This approach spreads the risk of potentially harmful auction results over a three year period. As PPL states in its Comments in comparing its proposal to the procedure that has been utilized in New Jersey:

The overall rate for default service in New Jersey has been significantly less volatile than rates in other jurisdictions because New Jersey's recent procurements reflect only one-third of New Jersey's total POLR needs. The higher price for this year's procurement has been blended with the prices of procurements made in 2005 and 2004. This is simply proof of the old adage, "don't put all your eggs in one basket" which translates in these circumstances to "don't buy all of our supply on a single day."

PPL Comments at 18.

While the OCA agrees with much of the reasoning presented by PPL and PECO in support of the three year staggered procurement process, the OCA still submits that this type of process, standing alone, will not adequately protect consumers and is less beneficial than the broader portfolio approach proposed by Duquesne and by the OCA. As the OCA pointed out in its Comments of June 15, 2006, the New Jersey approach has evolved to this three year staggered procurement process and New Jersey is now in the process of re-evaluating this approach. In the Matter of the Provisions of Basic Generation Service for the Period Beginning June 1, 2007, N.J. Docket No. EO06020119 (Order of March 24, 2006).

The OCA has several concerns with the three-year staggered procurement put forward by PECO and PPL. First, the three year staggered auction proposal does not accommodate the type of longer term contracts that many developers have told the PUC and DEP are necessary in order to get new resources built in Pennsylvania. See, OCA Comments of June 15, 2006 at 27-29; DEP Comments at 9-11. Those resources can benefit the environment and, by moving natural gas off the margin in more hours of the year, reduce overall generation costs for all Pennsylvania consumers. In addition, a mechanistic auction approach – even when

spread over three years – removes the flexibility that an EDC can utilize to acquire the combination of resources that best serves its customers’ needs. Finally, the three year auction proposal for “load following” supply also may result in higher than necessary bids from generation suppliers. Bids that include load following and sales risks as part of their full requirements contracts appear to include substantial risk premiums. As the OCA pointed out in its initial comments, while the average of spot market clearing prices in Eastern PJM were about \$65 per MWh in 2005, the wholesale bids received in the recent auctions in New Jersey, Maryland, and Delaware for load following service were nearly all above \$100 per MWh. Clearly, there is a substantial risk premium being built into those wholesale bids, and a portion of that premium may relate to the risk of sales changes and load following during a period of volatile fuel prices.

By contrast, a more diverse portfolio approach would allow the utility to acquire blocks of power to serve baseload needs at a fixed price on a longer term basis, while acquiring shorter term or spot supply and demand resources to meet peak demands and load following needs. By allowing the EDC the flexibility to determine its needs, introduce and utilize demand response, conservation, and other resources, the risks and accompanying substantial risk premiums can be mitigated, thus lowering prices to all consumers.

The OCA submits that it may also be possible to combine some elements of the Duquesne and PPL/PECO approaches. For example, the option to utilize structured auctions could be a part of an EDCs portfolio procurement. That is, an EDC could acquire a portion of its resources through annual auctions for blocks of power (in megawatts or megawatt hours, not percentages of customers), but could preserve the ability to incorporate long-term contracts with new or existing generators to serve a portion of their baseload needs. The utilities could also

utilize spot or short-term markets to purchase energy (or sell unneeded energy) to reflect changes in sales. Again, as long as all of these resources are procured through some type of arms' length competitive process and represent prevailing market prices for the products acquired at the time of their acquisition, then this methodology would comport with the requirements of Section 2807(e).

The use of a longer term laddered or portfolio approach for small customers was also endorsed in this proceeding by the Comments of Constellation Energy Group Companies, which includes Constellation Energy Commodities Group, Constellation Generation Group, and Constellation New Energy. Constellation specifically urged the Commission “to refrain at this time from implementing a monthly or time-of-day pricing structure for default service for residential and small commercial customers” and noted that residential and small commercial customers are not in a position “to manage the risks associated with a default service product based on short term procurements.” Constellation Comments at 3. Instead, Constellation advocated a methodology that will “achieve an effective balance between obtaining the most competitive price and providing the most stable product for default service customers.” *Id.* at 7. As stated by Constellation: “The risks to residential customers of price fluctuations, including drastic price increases, can be mitigated through a portfolio approach of contracts with varied terms, which ties the cost of default service more closely to changing market prices, while continuing to offer reliable supply.” *Id.* at 7-8.

The goal of the 1996 Act was to provide tools to customers to lower rates by allowing direct access to a competitive generation market. This purpose was recognized by President Judge Colins of the Commonwealth Court in the first Court decision reviewing the Act. In his Opinion regarding the challenge of Indianapolis Power & Light Company to PECO

Energy Company's stranded cost recovery, President Judge Colins made the following observation about the purpose of the Act:

The purpose of the Competition Act is clear: to relinquish the local utilities' monopoly control over the generation of electricity and to invite competition in an effort to lower electric generation rates for the citizens of this Commonwealth. *See generally* 66 Pa.C.S. § 2802 (detailing impetus for, and objective of, Competition Act).

Indianapolis Power & Light Company v. Pa. PUC, 711 A.2d 1071, 1078 (Pa. Commw. 1998).

As was explained at the June 22nd en banc hearing by the William R. Lloyd, Jr., Small Business Advocate, who was a member of the House of Representatives at the time the 1996 Act was passed, the debate in the General Assembly was about how to lower rates, not about how to raise rates or make them more volatile. Retail customer choice was a means to an end of delivering lower rates to customers. As the Act makes clear, customers may choose an alternative supplier, or they may choose to remain with their EDC. See, 66 Pa.C.S. § 2807(e)(3). It is up to the customers to choose, and they should not be penalized for making this choice or forced to choose an alternative to the EDC because of "ugly" default service.

C. The Focus On Retail Shopping Statistics Is Misplaced.

At the June 22nd en banc hearing, the Commissioners requested comment on how an approach, such as the three-year New Jersey approach, or a portfolio approach, would result in robust retail shopping by small customers. While the OCA recognizes the Commission's interest in robust retail shopping, the OCA respectfully submits that the focus on retail shopping statistics is misplaced. If the cost to Pennsylvania of high retail shopping statistics is higher and more volatile electricity rates, then the cure is worse than the disease. As noted earlier, while the 1996 Act had many goals, the primary competitive goal was to give Pennsylvania consumers access to competitive generation. That goal can be accomplished by requiring our EDCs to

acquire resources in the competitive generation market at prevailing market prices and then offer that generation to customers. If competitive retail marketers can provide cheaper, greener, or otherwise more attractive generation products to retail consumers, that is all the better.

As the OCA noted in its initial Comments of June 15, 2006, the portfolio approach has been endorsed in a Resolution by the National Association of Regulatory Utility Commissioners (NARUC) in 2003. Significantly, the NARUC Resolution not only found that portfolio management is a good way to manage risks and enhance reliability, but also that it “is wholly consistent with efforts to create competitive wholesale electric markets” and that it “improves the performance of wholesale and retail markets.” See, OCA Comments of June 15, 2006, Appendix C.

The OCA submits that a portfolio approach is consistent with the Commission’s efforts to educate and encourage customers to evaluate alternative supplies. The Commission has spent much time and effort educating customers as to the “price to compare” and how to use that price to compare to consider and evaluate offers. A longer term, more stable price to compare provides the information consumers need to evaluate the impact of offers and the impact of alternative pricing structures. It is very difficult for customers to evaluate any competitive offer when there is an ever-changing price to compare. Providing the customer with a longer-term price that will allow them to make a more informed and reasoned decision should better enable productive retail customer choice.

The Commission should reject the proposals of those Commenters who would make the EDCs’ default service as volatile and expensive as possible as a means to promote retail shopping. The National Energy Marketers Association (NEMA), for example, suggests in its Comments that:

[A]s long as a utility is providing commodity-related services to small commercial and residential customers, the commodity component of the “price to beat” should start with a monthly-adjusted, market-based rate to which should be added a utility’s fully allocated embedded and projected stranded costs associated with providing all of the otherwise competitive commodity related products, services, information and technologies currently bundled in full service rates. By reflecting a utility’s embedded and stranded costs of providing competitive services, consumers will quickly find that it is no longer in their interest to purchase competitive products and services from a utility that is designed to connect, maintain and reliably deliver.

NEMA Comments at 3. The OCA agrees that if EDC default service can be loaded up with enough costs, and if it is subject to radical change every month based on volatile market conditions, some consumers may learn that “it is no longer in their interest” to purchase generation from the EDC – assuming that there are in fact any reasonable alternatives. But this is an expensive lesson to learn, both for consumers and for the Pennsylvania economy as a whole. For business customers, of course, the lesson learned from this experience might be to move to another state in which they are able to receive just and reasonable electricity rates. For residential customers, the lesson may be that Pennsylvania is no longer a place in which they can receive affordable electricity service, thus placing at risk the health and safety of the public.

The OCA would also note that NEMA’s comments do not reflect the full obligation of the EDC in Pennsylvania to serve. NEMA suggests that the EDC should only connect and deliver electricity. NEMA Comments at 3. In Section 2807(e), however, the Pennsylvania law makes it the obligation of the EDC to not only connect and deliver but also to “acquire” electricity for customers. NEMA’s model is based on a structure that was not the design of the legislation in Pennsylvania.

A well-designed default service will bring the benefits of generation competition to Pennsylvania consumers and can provide a stable price to customers upon which they can base critical decisions about their electricity supply and their electricity supplier. To the extent that alternative suppliers can offer something that consumers want, or can more efficiently procure supply to meet customer needs, retail competition may develop. But retail shopping was not the goal of the Act and the Commission should not force customers to choose an alternative supplier under the pretext of implementing the Act.

D. Small Companies Should Not Be Required To Rely Upon Spot Purchases To Meet Their Default Service Obligation.

At the June 22nd en banc hearing, Commissioner Shane called on parties to respond to the suggestion of David Boonin that Pennsylvania EDCs meet their default service requirements by purchasing all of their energy in the day-ahead spot market. Dr. Boonin correctly noted in his Comments that the recent auctions in our neighboring states all appeared to include a substantial risk premium over and above the PJM spot market prices when averaged over the course of the year. Boonin Comments at 2. The OCA agrees with the concern about the risk premium being included in these auction prices and made the same point above and in our initial comments. See, OCA Comments of June 15, 2006 at 9, 25-26. The OCA is concerned, however, with Dr. Boonin's solution of relying wholly on spot market prices, even when coupled with his suggestion for a "Volatility Protection Fund" to guard against volatility in the actual bills paid by customers. The collapse of the California market in 2001 has been attributed in part to the requirement that utilities had to purchase all of their power in the highly volatile spot market. See, Ed Kee, "Vesting Contract Hedging", *The Electricity Daily*, Vol. 16, No. 77. While the PJM markets have proven far superior to the California market in almost every respect, we simply do not know whether PJM wholesale day-ahead spot prices will be a

reasonable basis for setting retail rates indefinitely into the future, particularly if significant supply is mandated to be purchased in these markets. Certainly, if such an approach is used, the actual price charged to customers should be based on a rolling average of spot prices over the course of a year, and should not be changed to reflect only the cost of energy in a given hour or even in a given month. In other words, even if energy is purchased on an hourly basis, the price charged to customers should reflect average prices over the course of the year in order to prevent excess volatility.

The OCA would note that two small utilities, Citizens Electric Company and Wellsboro Electric Company, have been able to do well in procuring supply for their customers through Request for Proposal and contracting processes. These two companies have been able to manage their purchases to provide reasonable rates for customers. So, too, has UGI-Electric been able to manage of portfolio of purchases that allows for relatively stable prices to customers at reasonable rates.

The OCA continues to submit that the better approach is to provide the flexibility to the EDCs to utilize a portfolio of long-term, short-term, and spot purchases to provide default service in the most reliable and economical manner for their customers. This is the model used by the natural gas distribution companies in Pennsylvania and in the procurement of almost every other commodity by businesses. By locking in blocks of power on a long-term basis, and dealing with peak demand and load-following requirements on the spot market, or through other measures that focus on demand response or peak load shaving, the EDC is in the best position to provide service to its customers on a least cost basis.

E. Consumer Education Remains Important But Should Be Directed Toward Informing Customers Of Steps They Can Take To Mitigate The Impact On their Bills Of Potentially Higher Prices.

At the June 22nd en banc hearing, the Commissioners also asked for comments on consumer education initiatives. As the OCA noted in its Comments of June 15, 2006, consumer education is vital in order to prepare customers for potentially higher electric bills, but more importantly, to educate customers as to what they can do to mitigate the impact of these higher prices on their bills. OCA Comments of June 15, 2006 at 11-12. The OCA agrees with several of the EDC Commenters who urge the Commission to refrain from spending too much on public education now about potential effects several years from now, since prices and impacts may vary dramatically over the next several years depending on a variety of circumstances. *See, e.g.*, PECO Comments at 3. Efforts are better spent at this time in keeping customers generally informed as to developments in the wholesale markets and providing them with information on how to conserve so that they may take necessary steps to protect against substantial bill increases. A more specific, directed consumer education campaign should be developed as the rate cap expiration period approaches.

For those EDCs whose rate caps have expired, or are about to expire, however, it is critical that adequate information on price changes is communicated to customers in a timely fashion so that they may adjust their budgets or take any necessary steps. As soon as the projected price or range of prices is known, that information should be broadly communicated to customers, along with information on steps that consumers can take to lower their monthly bills.

The OCA stands ready to work with the Commission and interested stakeholders in developing any necessary consumer education. The OCA looks forward to working with all stakeholders in creating a consumer education message for Pennsylvania consumers.

F. Wholesale Markets And Market Structures Require Continuing Attention From This Commission.

While many Commenters pointed out that the Commission does not have jurisdiction over the wholesale markets or market structures to any great degree, the OCA submits that the Commission, nonetheless, can have a significant impact on these markets. As the OCA noted in its Comments of June 15, 2006, the Commission, as a member of the Organization of PJM States, Inc. (OPSI), is able to participate in and affect PJM market development. OCA Comments of June 15, 2006 at 30-31. Chairman Holland properly stressed this critical role at the June 22nd en banc hearing and the OCA looks forward to continuing to work with OPSI and the Commission on issues of major importance at PJM.

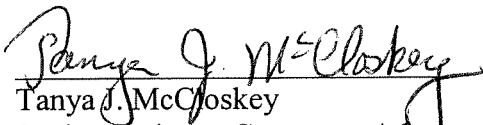
Second, the OCA submits that the structure of retail default service can facilitate the development of supply resources needed for the wholesale markets to operate efficiently. As the OCA has noted throughout this process, allowing a default service provider to include long-term contracts with resources in its supply plan will encourage the development of new resources, including renewable resources that are essential for reliability and the economic success of the PJM markets.

The Commission should consider the positive impact that a well-designed default service portfolio procurement standard can have on the wholesale markets. The OCA submits that a design that allows the default service supplier to acquire a portfolio of long-term and short-term resources, including renewable and demand response resources, will best facilitate the development of a robust competitive generation market and best serve Pennsylvania consumers.

III. CONCLUSION

The Commission should keep its inquiry focused on how to mitigate or avoid potential increases in electricity prices. The goal of the 1996 Act was not to reach any particular level of retail shopping, or to force customers to abandon default service. The goal of the 1996 Act was to utilize generation competition as one means of providing the lowest reasonable price for reliable electric service. The best way to achieve this goal is through the acquisition of a diverse portfolio of resources over time through competitive procurement processes.

Respectfully Submitted,


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Dated: July 20, 2006
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