BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

<u>COMMENTS OF DIRECT ENERGY SERVICES, LLC</u>

I. Executive Summary

Direct Energy Services, LLC ("Direct" or "Direct Energy") submits these comments to the Pennsylvania Public Utility Commission ("Commission") regarding the Commission's Investigation Order requesting comments with respect to policies to mitigate potential electricity price increases.

Direct is completely aware of the pricing issues presented in the Commission's Investigation Order. Direct was involved in the Pike County mitigation effort. Direct has been involved in processes in other states in an attempt to mitigate the impact of the price increases on customers.

This Commission is in the enviable position of having a long lead time to address the potential for price shock and must use that time carefully to implement appropriate market mechanisms to ensure that competitive markets are functioning for all customers as the transition periods expire.

The two most prevalent complaints that Direct has witnessed from customers in Pike County, as well as those in Delaware and Maryland, have been that the **price for electricity has increased too rapidly and too severely** and that they have **no alternatives** to this price shock. Over the long-term, as the Commission is aware, there is no ability for the Commission to "fix" the market price for electricity. But the Commission clearly has the ability and the duty to structure the retail market so that competitive alternatives exist for customers as the transition periods expire. With this proceeding, the Commission is initiating its efforts to educate the public with information about the future of the electricity market. But beyond education, it is incumbent upon this Commission to provide customers with the tools to help alleviate any potential future crisis. That task can be accomplished – at least in part – with appropriate retail electricity market design improvements.

In the process of transitioning to a restructured electricity market in Pennsylvania, consumers were provided with long term, stable default service rates for electricity as a form of regulatory "protection." While well intentioned, one of the key unintended consequences has been that consumers are not aware of the true market price of electricity. In fact, this structure is now resulting in a wide divergence between the current market price of electricity and the current default service rates.

Protection of consumers' interests is different now than it was ten years ago. Today, the best form of protection for consumers is to develop robust and efficient retail markets which exert downward pressure on prices generally and provide consumers with real alternatives and choices. It should therefore be the goal of this Commission and this proceeding to accomplish the following objectives:

- Establish a plan to educate consumers, decisionmakers and the public in general about the market price of electricity.
- Establish a plan to educate consumers, decisionmakers and the public in general about electricity markets and the opportunities available to them.
- Implement retail market designs that will enable the development of competitive market alternatives.
- Implement a transition plan that will accomplish these goals.

- Implement a transition mechanism that, at the customers' choice, can be used to mitigate the impact of likely price increases.

II. Specific Comments

The Commission has asked for comments on six specific topics. Direct address each of those topics below.

A. Educate Customers

There are two pieces to the education puzzle. The first occurs during the transition period. The second enables customers to participate in their energy decisions during and/or after the transition period. Right now and over the next few years, customers need to be educated generally about electricity markets and how they function. They also need to be educated about the true cost of electricity. For example, through public service announcements, the Commission can speak to electricity markets and pricing. In addition, utilities could begin to put a monthly average PJM price for electricity on their customers' bills so that the customers can see first hand what a great deal they have now and where true market prices are trending.

The second piece of the education puzzle is information, the hallmark of an efficient market. When consumers are empowered with information, markets act and react responsibly. Electricity markets are new and evolving. Historically, consumers have never had access to electricity market information and, as a result, we ended up with a regulated electricity system that has given rise to distorted and improper price signals and incentives. In much of the regulated electricity world, unit prices for electricity *decrease* with increased demand. The regulated providers of electricity have every incentive to increase usage of electricity as this increases their returns. On the contrary, prices should *increase* with more demand. This is the most basic of economic principles.

The Commission should pursue alternatives that empower the customers in Pennsylvania with the information needed to manage their electricity needs. These tools include automated metering infrastructure, and policies that enable the competitive supply market to have access to the data generated with the automated metering. The Provider of Last Resort ("POLR") price must also be reflective of true market prices. It is important for a customer to see prices that accurately reflect the cost of energy so that their consumption can be altered in an efficient manner.

B. Encourage Conservation

Encouraging conservation makes sense. The key is to "enable" efficient conservation investments. This Commission has the power to enable efficient conservation. Conservation efforts and investments should be driven by information. If house A is only 70% as efficient as house B, the initial conservation investment should be made at house A.

Raw data that exists today can tell us who or what or where the most efficient conservation efforts can be made. This data is warehoused within the utilities and must be made available to the market so that there are more opportunities to provide conservation-enhancing products and services. As we move into the future, all customer usage information should be readily accessible by the competitive supply community.

Economically, it is not in the interest of the utilities to push for conservation, as conservation cuts into their earnings. In contrast, the competitive market will take this information and offer products and services which address the conservation needs of customers.

If conservation is an economically viable option for customers (and it is), the best way to realize conservation is to empower the competitive market and give customers information that they can use to see where the most efficient conservation investments should be made.

C. Reduce Peak Demand for Electricity

Reducing peak demand is a direct corollary of encouraging conservation. Increasing conservation and efficiency investments will result in a permanent decrease in peak demand. The Commission should focus more specifically on demand response and advanced metering infrastructure to enable demand response to achieve incremental, timely peak reductions.

A real-time reduction in peak demand occurs when and only when information in real time is made available to customers who can reduce that peak demand. This Commission should consider if it would like to see demand response from only the largest customers – or a large swath of customers. Currently, only the largest customers can contribute in a meaningful way to demand response. It makes sense to empower all customers with the ability to shave peak demand.

Imagine a world where a customer can turn off the air conditioning at home from a remote location and sell the electricity back to the company that is making ice for the July 4th parade. It may not happen in exactly that fashion, but this type of transaction is a definite possibility in a truly competitive electricity market. In order to get the market to that level of functionality, customers and competitive suppliers must be empowered with information that will come from advanced metering technologies and infrastructures. This Commission should act now to see that these technologies are deployed over the next several years so that when the transition period ends, the competitive market is ready to serve the customers.

D. Consider Alternatives for Avoiding Abrupt, Large Price Increases

The recent events in Pike County, Maryland and Delaware have taught us two things:

1. Customers do not like sharp price increases.
2. Customers do not like to be without options.

This Commission needs to address both of these items before the rate caps expire over the next several years.

Customer Options

Direct Energy has been involved in proceedings in all three of these jurisdictions. We have heard loud and clear that these two desires hold across consumers all three jurisdictions. The question now is how to ensure that Pennsylvania consumers do not face this same situation when the transition period ends. The answer is that this Commission should address the lack of options by promoting market rule reforms that support competitive marketer entry. With such reforms in place, the competitive marketers will be able to help consumers address the price shock problem.[1]

Evidence exists in the neighboring New York market as well as in Texas that if the retail market is set up properly, competitive suppliers will be in abundance. A recent review of the New York Public Service Commission ("NYPSC") website showed over a dozen competitive

1 Direct offers discussion on two alternatives in this document that address the rate shock mitigation issues. They are an optional pre-payment plan and elimination of stranded cost recovery. Both are viable options and both have risks and implementation complexities that can be overcome. As written, these plans will fall primarily to the utilities for implementation. Alternatively, if the Commission designs long term markets that are conducive to competitive supplier market entry, then competitive forces and ideas from alternative energy suppliers will also emerge. Those options might be long term fixed price contracts, price declining contracts, supply contracts with a financing element embedded within them, or others. The primary difference however, would be that those contracts would be held by competitive suppliers, not the utilities, diversifying the risk away from the ratepayers.

suppliers serving customers in New York. Texas shows the same dynamic. Yet Pennsylvania does not have that type of vibrant competition. Is it because competitive suppliers don't want to serve in Pennsylvania? No. It is because Pennsylvania has not properly established a workable retail electricity market. Until that happens, customers will be left without supply options.

Quite simply, suppliers will come to serve Pennsylvania consumers when the rules are fair and balanced. Fair and balanced means that the utilities must not put up artificial barriers such as earning significant returns on commodity sales (creating an incentive to retain POLR customers), providing discriminatory billing practices or restricting competitive supplier access to customer usage data. Each of these practices and others work to keep the competitive supplier community out of the Pennsylvania market.

Direct Energy and other suppliers have written extensive comments and testified in numerous cases before this Commission about retail market design changes needed for an effective competitive market. These items include short term procurement for default service and competitively neutral billing where the utility bills and collects for the competitive suppliers using rate ready billing systems. In addition, the Commission should closely examine the issues and costs associated with the implementation of advanced metering infrastructure and associated technologies. These are absolutely critical if Pennsylvania consumers are to receive any level of real options when the transition period ends in a few years.

Price Shock – Long Term Solution

This Commission specifically opened this docket to entertain ideas for mitigating price shock in Pennsylvania. Direct would submit that the key decision to address a possible price shock problem is to properly structure the procurement of POLR service. As Direct and other competitive suppliers have indicated in numerous other filings, the right form of POLR service should be short-term pricing. With this solution, customers who stay on POLR service will see less overall price shock and, to the extent price shock occurs, it will correct itself as quickly as possible.

Pike County, Maryland and Delaware are all perfect examples of why long-term POLR service procurements are ill-conceived policy. POLR customers in these areas are now saddled with POLR service rates that are above market prices for two or three years. Given that market prices have subsided from the time frame in which the long-term auctions were held, if POLR service were structured to provide short-term pricing, customers would already be seeing reductions in their POLR rates. More importantly, with the right form of POLR service and the other necessary reforms, competitive suppliers would be offering alternative products and solutions to customers in these markets.

Unfortunately, policy makers in Maryland, Delaware and in Pennsylvania have looked at the structure put in place in New Jersey as the "right" model. But if anything, the New Jersey model has clearly provided us with the knowledge that long-term, laddered POLR service is the wrong answer for consumers. The New Jersey shopping statistics prove this out. In addition, New Jersey teaches us that its model is all about "timing." If policy makers can "time the market" and make the "right" portfolio decisions, then consumers will be rewarded. But what happens when the auction timing is done at the wrong time or with the wrong set of contracts? The result is what is happening in Maryland and Delaware right now. These customers will be saddled with above market energy prices for two or three years. Compounding these high prices is the fact that consumers will not have a range of options to help mitigate these POLR rates as competitive suppliers will not enter a market with only intermittent opportunity to "sell" to customers.

Delaware and Maryland both sought legislative solutions to their price increases. Both appear only to be putting off until another day the inevitable news that prices have risen. Pennsylvania was far more creative and adopted a competitive solution to help mitigate the increases in Pike County. The fundamental difference between the two philosophies is that the Pike County solution is a winning solution in the short run and the long run. In Pike County, there will be no interest payments, no rate deferrals and no recovery of foregone revenues. Moreover, in Pike County the groundwork has been laid to provide consumers with real competitive alternatives. In Maryland and Delaware, consumers will be saddled with yet higher costs because they are only deferring costs today. Worse, there is no guarantee that consumers in Maryland and Delaware will receive the benefits from a truly competitive retail market.

Short term POLR pricing will benefit consumers by both mitigating price shock issues and by providing a necessary element to an effective retail market.

Price Shock – Short Term Solution

Direct offers the following comments on the Commission's proposal to raise default rates in the near-term to begin moving consumers closer to market prices so that when the transition period ends, default rates will more closely approximate market prices, and any potential price shock will be lessened in severity. Our key point on this proposal is that this mechanism must not in any way impact future energy buying decisions. In practice, this means that the POLR rate must always be directly tied to the contemporary market and not "reduced" or "increased" by any prior mitigation efforts. In other words, consumers should not see a credit against his "energy" portion of the bill because he or she paid into a mitigation fund early. The credit should be applied to non-energy costs. Second, if the Commission moves forward with this proposal, the market prices must be related to the true price of electricity. Using any administrative calculation will not properly educate or inform consumers. Third, this approach must be completely optional. Optionality is important because every customer – residential, commercial, or industrial – is uniquely qualified to determine what is best for that customer given that customer's current financial position, appetite for risk, and need to save now for energy prices in the future. Fourth, any money collected through this program must be held in escrow for the specific customer that contributes to the program. In that manner, consumers who make this decision are directly benefited. Individual treatment of customers and their payment plans empowers the customers with choices and options.

Another proposal that should be considered is to permit EDCs the option of offering the early termination of stranded cost payments. Clearly, the power plants that have been recovering stranded costs have increased in value significantly since stranded costs were originally determined. The exchange for eliminating stranded cost payments would be to move customers to market based rates. Again, if a utility chose to offer this option, this choice should be at the customer's discretion. Utilities that are currently collecting stranded costs would lose that revenue stream but would begin collecting market rates for their energy sales to offset that loss.

E. Review Issues Concerning Programs to Assist Low-Income Customers

If properly implemented, the benefits of the competitive market will accrue to all customers, including those of lower income. The Commission specifically mentions and seeks comments on Universal Service and energy conservation issues. These are regulated programs funded by consumers on the regulated side of the bill. The Commission recognizes that the impact of high prices on these programs is multiplied because more people will become "needy" because of the higher costs. Again, an effective market design helps mitigate these problems.

F. Review Interplay with the Wholesale Energy Markets

The Commission is correct in drawing the pricing link between wholesale and retail markets. There are a few areas that the Commission should look to in the PJM market to alleviate some of the price increases that have arisen because of the PJM market structure. However, this is not the appropriate docket to undertake that effort. These issues include generation siting, transmission siting, ICAP/RPM, ancillary services and other items embedded in the PJM tariff. We need stakeholder input from a larger and different set of market participants than are effected by retail market design and likely to be participating in this docket. What is important for this Commission in this proceeding is to empower the customers and the competitive supply market with the tools necessary to develop and implement a fully robust and competitive retail market.

III. Summary

In the markets that have recently experienced price shock, Direct has heard two consistent complaints. The first is that price changes are too high and too severe and the second is that the customers have no options or choices to mitigate this price shock. This Commission cannot change market prices. This Commission can, however, create an environment that fosters the development of a competitive retail market, so that natural economic forces continue to exert downward pressure on prices, even in an escalating price environment, and so that customers truly have options to meet their electricity needs.

To this end, the Commission must strive for a market design that is based on the fundamental premise – embraced by the General Assembly in the Electric Choice Act – that retail markets benefit consumers. These elements include:

1. Market responsive POLR pricing
2. Utilities make no profit on commodity sales
3. Power Switch and supplier referral programs
4. Rate Ready utility consolidated billing
5. Purchase of Receivable programs
6. Customer Portability
7. Customer Information Availability

If the Commission wants to help consumers, it must establish workable retail energy markets that give customers real options to manage their energy budgets. These market design elements will enable sustainable market entry for competitive suppliers.

Respectfully submitted,

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