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June 3, 2011

VIA PERSONAL DELIVERY

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

Re: Investigation of Pennsylvania's Retail Electricity Market
Docket No. I-2011-2237952

Dear Secretary Chiavetta:

Pursuant to the Commission's Order entered April 29, 2011 in the above-captioned proceeding, enclosed herewith for filing are an original and six (6) copies of the Comments of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company.

Please date stamp the additional copy and return it to me in the enclosed, postage-prepaid envelope. Please contact me if you have any questions regarding this matter.

Very truly yours,

Bradley A. Bingaman (mag)

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dlm
Enclosures

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electricity Market	: :	**Docket No. I-2011-2237952**

COMMENTS OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN POWER COMPANY

I. INTRODUCTION AND BACKGROUND

On April 29, 2011, the Pennsylvania Public Utility Commission ("Commission") entered an Order initiating an investigation into Pennsylvania's retail electricity market in the above-referenced matter. The investigation is proceeding in two phases. The first phase will assess the status of the current retail market and explore if any changes should be considered to allow customers to further benefit from competition. The second phase, in turn, will examine the issues raised during the initial phase and determine how to best implement any necessary changes.

In its Order, the Commission directed interested parties to submit written comments and answer the following eleven questions by June 3, 2011:

1. What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?

2. Does the existing retail market design in Pennsylvania present barriers that prevent customers from obtaining and suppliers from offering the benefits of a fully workable and competitive retail market? To the extent barriers exist, do they vary by customer class?

3. What are the economic and managerial costs associated with electric distribution companies ("EDCs") fulfilling the default service role? Are the EDCs accurately passing those costs along to default service customers? Do default service rates include any elements that are not cost-based? Is an examination of distribution rates needed to ensure proper cost allocation? Are there barriers to competition as a result of having EDCs provide default service?

4. Are there unintended consequences associated with EDCs providing default service, and related products, such as time-of-use rates?

5. Should default service continue in its current form? Does default service impede competition or otherwise prevent customers from choosing electricity products and services tailored to their individual needs? Does default service provide an advantage to the incumbent EDC and/or its generation affiliate(s)?

6. Can/should the default service role be fulfilled by an entity, or group of entities, other than the EDC? If the default service role should be filled by an entity other than an EDC, what mechanisms could be employed to transition the default service role away from the EDC and onto competitive electric generation suppliers ("EGSs")? Are different approaches appropriate for different customer classes? What criteria should be used to ensure that EGSs are qualified to assume the default service role and maintain reliable service?

7. How can Pennsylvania's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electricity market? Are there additional market design changes that should be implemented to eliminate the status quo bias benefit for default service?

8. What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?

9. What changes, to Regulations or otherwise, can the Commission implement on its own under the existing default service paradigm to improve the current status of competition in Pennsylvania?

10. What legislative changes, including changes to the current default service model, should be made that would better support a fully workable and competitive retail market?

11. Are there, or could there be, potential barriers being created by the implementation of the EDC Smart Meter plans?

Following the receipt of written comments, the Commission will hold an *en banc* hearing on June 8, 2011 to allow interested parties to discuss the topics raised in this proceeding. A second *en banc* hearing will be scheduled and conducted after the second phase of the investigation is launched.

Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), Pennsylvania Power Company ("Penn Power") and West Penn Power Company ("West Penn") (collectively, "the Companies") share the Commission's objective to foster retail competition throughout their service territories and the Commonwealth and appreciate the opportunity to participate in this important proceeding. The Companies respectfully submit the following comments and responses to the directed questions set forth in the Commission's April 29, 2011 Order, and look forward to working with the Commission and other interested parties.

II. COMMENTS AND RESPONSES TO DIRECTED QUESTIONS

With the expiration of generation rate caps on December 31, 2010, the Companies have successfully transitioned customers to market-based pricing for electricity. While the procedures are now in place for competition to flourish in their service territories, the Companies fully support the Commission's efforts to determine if there are better or additional ways to bring the benefits of competitive electric generation markets to Pennsylvania. The Companies caution, however, that any such actions must not place any undue risk on or cause financial harm to the electric distribution companies ("EDCs") currently serving as default service providers. That said, the Companies provide the following responses to the questions set forth in the Commission's Order.

1. ***What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?***

Market-based default service rates were implemented upon the expiration of generation rate caps, which for Met-Ed, Penelec, and West Penn customers, as well as the majority of Pennsylvania EDC customers, occurred on December 31, 2010[1]. According to the information posted on the Commission's electric competition website, www.papowerswitch.com, there are currently up to 25 available suppliers and up to 51 available brokers/marketers/consultants currently making offers for business customers in the Companies' service territories. For residential customers served on Rate RS or residential time-of-use rates, there are up to four available suppliers and up to two available suppliers for renewable energy add-on options currently making offers in the Companies' service territories. The Companies expect the number of suppliers available to residential customers to increase over time.

Set forth below is a summary of the Companies' retail electricity choice activity for April 2011 which illustrates (based on SIC Code), among other things, the number of EGSs serving load, the amount of load currently served by alternative suppliers, and the percentage of load shopping in each of the Companies' service territories:

[1] Penn Power's generation rate caps expired on December 31, 2006. Therefore, market-based default service rates went into effect in Penn Power's service territory in 2007.

Residential

Company	Number of EGS Serving Load	MWH for Shopping Customers	MWH for Non-Shopping Customers	Total MWH	Percentage of Load Shopping
Met-Ed	13	6,348	434,041	440,389	1.4%
Penelec	11	7,615	395,683	403,298	1.9%
Penn Power	6	18,558	112,365	130,923	14.2%
West Penn	12	7,053	559,228	566,281	1.2%

Commercial

Company	Number of EGS Serving Load	MWH for Shopping Customers	MWH for Non-Shopping Customers	Total MWH	Percentage of Load Shopping
Met-Ed	24	125,272	148,772	274,044	45.7%
Penelec	21	164,506	172,516	337,022	48.8%
Penn Power	9	76,417	44,876	121,293	63.0%
West Penn	19	288,181	66,544	354,725	81.2%

Industrial

Company	Number of EGS Serving Load	MWH for Shopping Customers	MWH for Non-Shopping Customers	Total MWH	Percentage of Load Shopping
Met-Ed	20	396,514	44,039	440,553	90.0%
Penelec	19	459,025	35,165	494,190	92.9%
Penn Power	3	126,497	4,142	130,639	96.8%
West Penn	13	339,307	224,366	563,673	60.2%

*** Percentages based on April 2011 usage.

Market-based default service generation rates are in their nascent stage and competition is just now beginning to take hold. Nonetheless, the Companies are supportive of actions and initiatives that would continue to foster competition and increase customer choice. However, based on the statistics set forth above, it appears that default service as currently structured is not impeding the development of a competitive retail market for the industrial and commercial customer classes where shopping is robust. Therefore, the Companies believe that the Commission should focus its attention and efforts on issues that will make it easier for EGSs to interest residential class customers in their products and ways to enhance competition for residential customers.

2. ***Does the existing retail market design in Pennsylvania present barriers that prevent customers from obtaining and suppliers from offering the benefits of a fully workable and competitive retail market? To the extent barriers exist, do they vary by customer class?***

As a general matter, the Companies believe that the barriers to market entry are minimal, as evidenced by the number of EGSs that have been licensed and are active. The Companies acknowledge, however, that Pennsylvania's existing retail market design may have certain features that have made it difficult for EGSs to compete for business. For the most part, the Companies have addressed these possible deficiencies, as explained below. But, more can be done, as described in response to Question No. 7, *infra.*

First, many customers still do not understand the shopping process or how to determine their price to compare ("PTC")[2]. In response, the Companies have engaged in significant consumer education and now include a customer's PTC on its monthly bills, on the Companies' website and, for residential customers, at www.papowerswitch.com. Additionally, price transparency is provided with the posting of the Companies' retail tariffs on their website.

Second, some customers may have been reluctant to shop for fear that they would be unable to switch to another EGS, or switch back to default service, on a timely basis. The Companies have tried to address this concern by eliminating "minimum stay" periods. As a result, customers are free to switch whenever they wish and without limitation.

Third, some EGSs complained that they were at a competitive disadvantage vis-a-vis the EDC default service providers in providing service to residential and small commercial

[2] Defined by 52 Pa. Code § 54.182 to be "...equal to the sum of all unbundled generation and transmission related charges to a default service customer for that month of service".

customers because they had no way to recover uncollectible accounts expense and therefore had to shoulder the risk of non-payment. In response, each of the Companies has implemented a purchase of receivables program for the residential and small commercial classes, which allows EGSs that utilize consolidated billing to sell their receivables to the Companies at little or no discount.

Finally, EDCs, as a general rule, do not currently include a profit margin in the provision and pricing of default service. Assuming all other variables to be equal (such as the generation fuel source, timing of the generation procurement, portfolio mix, etc.), it has been suggested that an EGS may not be able to effectively compete against the default service price because there is insufficient "headroom". As discussed *infra*, the Companies believe the Commission should consider authorizing default service providers to include an "adder" in their PTCs to address this issue.

3. What are the economic and managerial costs associated with electric distribution companies ("EDCs") fulfilling the default service role? Are the EDCs accurately passing those costs along to default service customers? Do default service rates include any elements that are not cost-based? Is an examination of distribution rates needed to ensure proper cost allocation? Are there barriers to competition as a result of having EDCs provide default service?

The Pennsylvania Public Utility Code[3] and the Commission's regulations[4] specify the costs that EDCs are to recover through default service rates. In addition to the cost of generation, such costs include supply management costs and administrative costs. Supply management costs include the cost of supply bidding, contracting, hedging, risk management, any default service–specific scheduling and forecasting services, and applicable administrative and general expenses related to these activities. Administrative costs include such costs as

[3] 66 Pa. C. S. § 2807(e)(3.9)
[4] 52 Pa. Code §§ 54.187 and 69.1808

billing, collection, customer education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service.

The Companies are currently recovering all of the foregoing costs that are not incurred to support shopping and non-shopping customers through the default service rates established in their respective default service plan proceedings. These default service rates are cost-based and have been approved by the Commission. Because those rates were carefully reviewed before being placed in effect, there is no need for a separate and additional examination of distribution rates to ensure proper cost allocation. In short, default service costs are being recovered by customers through default service rates and are not included in distribution rates.

4. Are there unintended consequences associated with EDCs providing default service, and related products, such as time-of-use rates?

Whether consequences are "unintended" depends upon the ultimate goal of default service. If the ultimate goal of default service is a plain vanilla offering provided only as a last resort, then products such as time-of-use rates arguably compete with offerings from retail EGSs. If, however, the ultimate goal of default service is to provide customers with the "least cost" option "over time", then products such as time-of-use rates can provide customers an alternative to lower their costs beyond what could normally be achieved through a flat price default service offering. That said, EDCs, as a general matter, have not sought to develop services or "related products" that inhibit the ability of EGSs to compete.

5. Should default service continue in its current form? Does default service impede competition or otherwise prevent customers from choosing electricity products and services tailored to their individual needs? Does default service provide an advantage to the incumbent EDC and/or its generation affiliate(s)?

A large portion of the framework of default service is dictated by the Public Utility Code and the Commission's regulations. As such, any significant changes to the default service model in Pennsylvania would likely require legislative and regulatory reform. The Companies have already effectively addressed several potential barriers that might impede competition by expanding consumer education, eliminating minimum standards for stay, and implementing purchase of receivables programs. However, the Companies are fully prepared to work with interested stakeholders on any additional areas of concern that the Commission determines need to be addressed. Certain enhancements may provide customers the tools they require to leave default service and choose electricity products and services tailored to their individual needs. That assumes, however, that EGSs are willing and able to provide such individually tailored electricity products and services, which only the EGSs can answer.

The Companies do not believe EDCs enjoy any material advantage by virtue of their role as default service providers. By definition, EDCs are distribution companies and merely serve as conduits for generation procured under the auspices of an independent, third-party administrator and subject to the Commission's review and approval. Moreover, default service plan proceedings are transparent and all interested parties are able to participate. In fact, most default service plan proceedings have been resolved through settlements that have included essentially all interested parties – representatives of consumer groups, EGSs, and default service bidders.

Nor does an EDC's status as default service provider convey any advantage to its non-regulated generation affiliate. Rather, such a relationship is governed closely by a Commission-imposed Code of Conduct, which requires that all EGSs (including affiliates of an EDC) be treated in an equal and fair manner. Since a generation affiliate is treated the same as any other wholesale supplier or EGS, there is no residual advantage for an EDC or its generation affiliate.

Furthermore, any brand recognition between the Companies and their generation affiliate is non-existent largely because the retail generation affiliate does business under the brand name of FirstEnergy Solutions, or FES, which bears absolutely no similarity to the local brand names of the EDCs – Met-Ed, Penelec, Penn Power and West Penn Power.

6. ***Can/should the default service role be fulfilled by an entity, or group of entities, other than the EDC? If the default service role should be filled by an entity other than an EDC, what mechanisms could be employed to transition the default service role away from the EDC and onto competitive electric generation suppliers ("EGSs")? Are different approaches appropriate for different customer classes? What criteria should be used to ensure that EGSs are qualified to assume the default service role and maintain reliable service?***

The Commission's regulations at 52 Pa. Code § 54.183 already allow another entity, or group of entities, to provide default service subject to certain eligibility requirements being met. However, the Companies are open to any changes to the existing default service process that could provide increased benefits to customers and the competitive marketplace, so long as any additional actions or changes do not place any undue risk on or cause financial harm to EDCs. Further, the decision of whether another entity, or group of entities, should provide default service logically will be driven by the ultimate goal of default service (such as whether default service should be a plain vanilla service and/or result in a low price) since understanding such goals is key for eligible entities to determine whether they wish to assume the obligation to provide default service. Any and all such decisions, and the impact of those decisions, should be thoroughly considered and evaluated to determine whether the transfer of the obligation to provide default service to another entity, or group of entities, results in increased benefits to customers while ensuring that customers are provided adequate, safe and reliable default service and EDCs are not financially harmed by any changes. Moreover, and as discussed next, no matter who provides the default service, a return adder should be considered for the default service provider in order to facilitate a larger pool of entities than would be willing to provide such a service with little or no margin.

7. ***How can Pennsylvania's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electricity market? Are there additional market design changes that should be implemented to eliminate the status quo bias benefit for default service?***

As described in response to Question No. 2, *supra*, the Companies have taken several steps to promote a more robust competitive retail electricity market (e.g., elimination of "minimum stay" periods, the implementation of purchase of receivable programs). The Companies believe that the EDCs should continue to educate customers on their options and recover any increased costs through their existing customer education charges. Moreover, the Companies submit that the competitive posture of EGSs could be enhanced if additional "headroom" were created by permitting EDCs to include an "adder" in their default service rates.

Notably, other state models permit a default service provider to include an adder or profit margin in its rates. For example, such a return adder for default service is authorized in Maryland Code Section 7-510(c)(3)(ii)(2) for residential and small commercial customers. Although the Maryland Code does not set forth the amount and means by which the return adder is applied, these details were worked out in a comprehensive settlement agreement between Maryland Public Service Commission Staff, EDCs, consumer advocates, customers, wholesale suppliers and retail suppliers, which was approved by the Maryland Public Service Commission without modification.

In its simplest form, the shareholders of any company, regulated or otherwise, expect some type of return for providing default services. Indeed, absent the allowance of a return, such entities would logically choose not to provide such services voluntarily. The regulatory and/or legislative obligation for an entity to provide a product and/or service from generation assets it does not own should not deny it the opportunity to earn a return. To the contrary, the same opportunity should be provided to all default service providers, including EDCs that fulfill that role. An analogy may be drawn from the services offered by power marketers, who typically are not heavily invested in physical assets since their core business relies primarily on their employees' ability to purchase electricity from one entity for eventual sale to another. If power marketers were unable to earn a return, such services offered by power marketers would certainly be dramatically reduced, or eliminated altogether.

The inclusion of a return adder would make a default service product comparable to a competitive offering, thereby allowing EGSs a better chance to compete. Although some may argue that the inclusion of a return adder may be inconsistent with the principle of providing "the least cost to customers over time", it could actually work to help lower costs to customers over time since an increase in competition among EGSs will result in downward pressure on prices. Moreover, the full amount of the return adder need not necessarily be retained by the default service provider. For example, a portion of the return adder could be used to provide additional education to customers regarding shopping alternatives, to expand services to low income residential customers, or to provide an incentive for customers to choose an alternative supplier. Although the Companies do not propose a specific level of return adder at this time, the inclusion of such an adder would noticeably enhance the ability of EGSs to effectively compete against default service.

8. What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?

The Companies do not believe that EDCs enjoy any inherent procurement or other cost advantages over EGSs or other entities that may wish to provide default service. While some have suggested that EDCs be stripped of their billing and customer care functions or that such costs be reallocated to default service, the Companies do not believe this would be desirable or cost-effective. Each of the Companies provides billing services (rate ready and bill ready) to EGSs at no cost to the EGS; therefore, the billing and customer care functions are being provided in a competitively neutral manner. To furnish distribution service, an EDC must make the necessary capital investment, and incur on-going operation and maintenance ("O&M") expenses, to provide customer care functions. Such capital costs are then recovered over the depreciable life of the assets in question. Any attempt to reallocate such capital costs to default service could result in a stranded investment, thereby creating a disincentive for the default service provider to promote shopping. Likewise, on-going O&M expenses do not necessarily stop when a customer selects an EGS since the EDC must continue to maintain the necessary customer care infrastructure to support its obligation to provide distribution service.

In short, capital and O&M expenses associated with customer care functions are not eliminated when a customer selects an EGS. Consequently, such costs are appropriately recovered in distribution rates. In contrast, those costs that are incurred solely to provide default service are already included in the Companies' default service rates.

9. What changes, to Regulations or otherwise, can the Commission implement on its own under the existing default service paradigm to improve the current status of competition in Pennsylvania?

The Companies are open to regulatory changes to the existing default service process that could enhance competition and provide increased benefits to customers. However, it is critical that any such changes adopted by the Commission not place any undue risk or cause financial harm to EDCs serving as the incumbent default service providers.

In addition to the Companies' recommendation that the Commission should consider authorizing default service providers to include an "adder" in their PTCs as described in response to Question Nos. 2 and 7, *supra*, the Companies offer an additional suggested revision to the composition of the PTC. Specifically, the Companies recommend that all costs billed by PJM Interconnection in accordance with rates approved by the Federal Energy Regulatory Commission and are not able to be "hedged" should not be included in the PTC and should instead be collected as non-bypassable charges. For example, such costs would include Network Integration Transmission Service ("NITS"), Regional Transmission Expansion Plan ("RTEP") charges, and Expansion Cost Recovery charges. These costs are natural utility charges and are not market-based costs; therefore, they cannot be hedged, and the inclusion of such costs in the PTC puts unnecessary risk on EGSs. These costs should instead be provided as a utility service on a competitively neutral basis to all distribution customers.

10. What legislative changes, including changes to the current default service model, should be made that would better support a fully workable and competitive retail market?

The Companies are open to legislative changes to the existing default service process that could enhance competition and provide increased benefits to customers. However, it is critical that any such changes adopted by the Pennsylvania General Assembly not place any undue risk on or cause financial harm to EDCs serving as the incumbent default service providers.

11. Are there, or could there be, potential barriers being created by the implementation of the EDC Smart Meter plans?

EDC smart meter plans should not negatively impact the competitiveness of the retail electricity market. Theoretically, smart meters will provide the EDC and EGSs with additional information that will enable them to offer customers products and/or services tailored to their individual needs. Such products or services may be provided by the default service provider if it is determined to be within the scope of the provision of default service, or by the competitive marketplace via an EGS. However, due to the significant investment involved, the Companies believe that the deployment of smart meters should be revisited so that only cost-effective implementation and deployment of smart meters occurs. If the deployment of smart meters cannot be cost-effective, the Companies suggest that such deployment simply be eliminated. Such action would save consumers significant amounts of money in the future. The Companies therefore would encourage the Commission to support legislative action to amend Act 129 of 2008, and specifically Section 2807(f) of the Public Utility Code, to require that any future smart meter deployment must be shown to be cost-effective for customers before the Commission can approve EDC smart meter deployment plans.

III. CONCLUSION

Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company share the Commission's objective to foster retail competition throughout their service territories and the Commonwealth and appreciate the opportunity to participate and submit comments in this important proceeding. The Companies are open to potential changes to the existing default service process that could enhance competition and provide increased benefits to customers. However, it is absolutely imperative that any such changes adopted by the Commission or the Pennsylvania General Assembly not place any undue risk on or cause financial harm to EDCs serving as the incumbent default service providers. The Companies look forward to working with the Commission and other interested parties on this important matter.

Respectfully submitted,

Dated: June 3, 2011

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electricity Market	: :	**Docket No. I-2011-2237952**

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true and correct copy of the foregoing document upon the individuals listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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Dated: June 3, 2011

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