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March 2, 2007

<u>VIA HAND DELIVERY</u>
James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street – Filing Room (2 North)
Harrisburg, PA 17105-3265

Re: Rulemaking re: Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa.C.S. § 2807(e)(2) and Default Service and Retail Electric Markets; Docket Nos. L-00040169 and L-00070183; **COMMENTS OF DOMINION RETAIL, INC. ON ADVANCE NOTICE OF FINAL RULEMAKING ORDER AND PROPOSED POLICY STATEMENT**

Dear Secretary McNulty:

Enclosed for filing with the Commission in the two dockets noted above are two sets of the original and fifteen copies of the Comments of Dominion Retail, Inc. in those dockets. As explained more fully in the Comments, Dominion Retail, Inc. believes it is more efficient to offer these Comments as a combined document rather than separately. As requested by the Commission in its orders, electronic copies of these Comments have been supplied to Mr. Shane Rooney at the Commission's Law Bureau.

If you have any questions regarding these Comments, please do not hesitate to contact the undersigned.

Very truly yours,

Todd S. Stewart
Counsel for Dominion Retail, Inc.

TSS/ajt
Enclosure
cc: Shane M. Rooney, Esquire (Via Electronic Mail)
Thomas J. Butler, Dominion Retail, Inc.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Rulemaking re: Electric Distribution Company's Obligation to Serve Retail Customers at the Conclusion of the Transition Period pursuant to 66 Pa. C.S. §280(e)(2)	:	Docket No. L-00040169
Default Service and Retail Electric Markets	:	Docket No. L-00070183

COMMENTS OF DOMINION RETAIL, INC., ON ADVANCED NOTICE OF FINAL RULEMAKING ORDER AND PROPOSED POLICY STATEMENT

AND NOW comes Dominion Retail, Inc. ("Dominion Retail"), by and through its counsel, Hawke McKeon Sniscak & Kennard LLP, and hereby offers its comments, to the Commission's Advanced Notice of File Rulemaking Order ("ANOFR") at Docket No. L-00040169 entered on February 9, 2007, as well as Commission's proposed policy statement on the Default Service and Retail Electric Markets at Docket No. L-00070183 ("Policy Statement") also entered on February 9, 2007. Because the elements of these two Orders are inextricably intertwined, Dominion Retail believes that it would be more efficient for it to address both documents in the same set of comments. Where necessary the comments will be directed either to the rulemaking or to the proposed policy statement.

Introduction

Dominion wishes to commend the Commission for its intensive efforts in promulgating the final rules for Default Service sometimes called Provider of Last Resort Service ("POLR"). It is beneficial to have final rules in place before the majority of the electric utilities in Pennsylvania are no longer subject to rate caps. Moreover, Dominion Retail commends the Commission for its obvious attempt to bring more market-based pricing to default service rates, by taking the approach of requiring the inclusion of some component, however small, of spot market energy into the portfolio of assets to be used by an EDC to provide default service.

As will become clear in Dominion Retail's comments, however, Dominion Retail is gravely concerned that the Commission perceives a need for some form of reconciliation solely because of the inclusion of real time market prices. This assumption is not true, since Dominion Retail, as an EGS, purchases its power in a mix of longer term contracts, shorter term contracts, and in the day ahead and real-time markets and it does not reconcile its pricing provided to customers. This reality begs the question of why a utility that is always presumed to be more capable and which undoubtedly has more resources than EGSs, cannot manage the same type of purchasing regimen without reconciliation. If the EDCs truly are incapable, there are more than a few wholesale suppliers that could provide the services for them.

Not only does Dominion Retail believe that reconciliation is not authorized by the *Electricity Generation Customer Choice and Competition Act* ("Competition Act"), 66 Pa. C.S. § 2801-2812, it believes that the plain language of the Competition Act, as the Commission previously recognized[1], and the well recognized principles of statutory construction prohibit the

[1] *Petition of Pennsylvania Power Company for Approval of Interim POLR Supply Plan,* Docket No. P-0005218 (Opinion and Order Entered April 28, 2006, slip op. at 100-101); *Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa. C.S. §2807(e)(2),* Docket No. L-00040169 (Proposed Rulemaking Order entered December 16, 2004).

Commission from attempting to exercise its discretion to allow for reconciliation. Perhaps more importantly, Dominion Retail believes that reconciliation of energy costs as part of default service rates would be bad public and regulatory policy.

Reconciliation of default service rates will, at the threshold, return the setting of those rates to an administrative process complete with prudence review and the risk associated with disallowances. In short, it would be a return to the bygone days of divisive and costly ECR cases—a course clearly not envisioned by the Competition Act's mandate that prices be set by the market, and that purchases at prevailing market prices are inherently prudent. On an operational level, reconciliation would allow an Electric Distribution Company ("EDC") to develop default service rates without including (or without fully pricing) the cost of certain risks, including switching risk and weather related usage risk, without any financial repercussion to the utility. In fact, under the §1307(f) style regimen proposed in the ANOFR, the EDC would earn interest on under-recoveries. As has been repeatedly demonstrated in the natural gas market, such incentives lead to consistent under-recovery in a flat or rising market. Not only does reconciliation create a distortion between the real market price and the default service rate by allowing after-recovery of the costs of risk, it deprives customers of the ability to know the costs of the risks in real-time so that customers can act to lessen the impact of those risks. That is, reconciliation has the perverse effect of insulating customers from true prices in almost all circumstances so that customers have no signal to reduce consumption when prices are high, and because of the after-collection of costs, customers may in fact reduce consumption when wholesale prices are lower. In short, reconciliation will erase any benefit that may accrue to the competitive market by the addition of even a small amount of actual market priced spot market energy into the price-to-compare.

Dominion Retail urges the Commission to resist the temptation to focus the ANOFR almost entirely on trying to mitigate rate increases that will occur, if at all, no matter what rules eventually are adopted, and instead focus on developing a competitive marketplace, now, as the best hedge against future rate shock concerns. Dominion Retail offers its specific Comments in the order that the issues appear in the ANOFR and the Policy Statement:

1. Scope: §§ 69.1801 & 1802 (Policy Statement)

In the statement of the scope and purpose of the Policy Statement, the Commission states "it would be unwise to craft a one size fits all approach at this time to every aspect of the default service." While Dominion Retail agrees that each EDC should be allowed a certain degree of flexibility in crafting an individual approach, it also believes that the Commission may have gone too far the other direction by eliminating the need for any conformity on a statewide basis. The result will be a patchwork of approaches across the state that will make it more difficult and costly for Electric Generation Suppliers ("EGS") such as Dominion Retail to enter markets. Moreover, while the policy statement and ANOFR correctly state that competition is better suited to controlling retail rates than regulation, both documents fail to include any standard of review of default service plans ("DSP") to judge the impact of a DSP on the competitive market. Dominion Retail believes that all DSPs must be judged upon their impact on customers, the competitive market as well as on an EDC. Moreover, plans that are too complex may be difficult for customers to understand, and may cause customer apathy. In short, Dominion Retail believes that the Commission must enforce some uniformity across DSPs and must include some standard of review that includes customer understandability, customer benefit, including whether the plan sends correct price signals to customers, as well as how the plan will impact the competitive market. Plans that will harm the customers or competition should be rejected.

2. **Definitions: § 69.1803 (Policy Statement), § 64.182 (ANOFR).**

The Commission's definition of "prevailing market price" stands out as not providing much clarity or guidance as to what the Commission believes the prevailing market price to be. In short, prevailing market price is a price that predominates the market place in real time, according to the plain language of the statute, as the product is being used. 66 Pa. C.S. § 2807(e)(3). The proposed definition would eliminate the requirement that a prevailing market price be linked in time to when the product is being used, which is contrary to the plain requirement of the statute.

3. **Plan Duration: § 69.1804 (Policy Statement).**

In the policy statement, the Commission represents that it is not possible to ascertain the optimal duration for a default service plan. Dominion Retail wishes to clarify that while a "plan" may be two years in duration, once an EDC submits a particular purchasing regimen for approval, the pure structure of that regimen should remain stable on a going forward basis absent compelling reasons for change. If EDC's are permitted or required to change the fundamental rules of how they provide default service on a bi-annual basis, the resulting chaos will drive competitors from the market and will confuse customers. Program rules must be stable over time, that is, the pure structure of the plan should be stable and not subject to change on a regular basis absent compelling reasons.

4. **Procurement: § 69.1805 (Policy Statement), § 64.186 (ANOFR).**

At the outset, Dominion Retail commends the Commission for seeking to bring more market based pricing into the default service rates. The proposal to require some spot market purchases can assist in reaching the goal of default service rates that send real time price signals to customers and thus encourage conservation. However, Dominion Retail cautions that requiring utilities to purchase from the pure spot market, that is, the daily or day ahead market, may inject unnecessary volatility into the pricing and may not be in the best interest of the customers or utilities. Dominion Retail suggests that the Commission consider requiring EDC's to purchase a large percentage (approximately 50%), of their full requirements based upon monthly index market prices, essentially on a month ahead basis. These prices can then be passed on to customers in real time so that customers see the true variability in the market place without being exposed to the full variability of the market place. That is, such an approach would allow customers to experience the market but retain the price mitigation effect of the balance of the portfolio. Moreover, such an approach would add transparency to the development of the default service rate, or the price to compare ("PTC") because suppliers would have a reasonable opportunity to discern the forward monthly PTC in real time and develop offers accordingly.

Without such transparency, there can be no comparability, and customers and competition suffer. Such transparency also must extend to communication with customers – that is, customers must know that the price for default service is variable and the basis upon which it will vary.[2] Dominion Retail believes that such an approach is the best method of insuring that the competitive market forces are allowed to effectively regulate the price of energy.

Finally, such an approach would encourage conservation because it would pass through, in real time, the price signals that are necessary for customers to curb their consumption in periods of high demand. That is, if the customers do not see that summer rates are generally higher than in the Spring or Fall, customers have no financial incentive to curb their use of air conditioning and, in fact, may lead to over consumption. As customers become educated over time, through accurate price signals, that electricity is more expensive in the summer, they can

[2] The Commission's regulations require this type of disclosure for EGSs that offer variable rates.

take steps other steps to reduce their demand by installing more efficient appliances and better insulating their homes.

The quarterly projected price mechanism suggested by the Commission's ANOFR, will not allow for the impact of market-based type of price signal to be felt by customers in a manner that will allow them to manage their usage, because the utility will be able to delay recovery, with interest, of any underestimation for demand or usage. When those cost components are collected in later months, the collection is divorced from the true market signal, or worse yet, sends an incorrect or confusing price signal. For example, a quarterly price adjustment with reconciliation would have customers paying default service rates in the fall or spring that recover the excess costs of the energy they use in the summer or winter and would confuse customers into thinking possibly that electricity is more expensive in the spring or fall than in the summer or winter, which is not true. In short, sending prices to customers in real time is the only means to effectively extend to all customers the ability to participate into the most effective demand side management program that exists, things cost more when they are in higher demand.

Dominion Retail continues its opposition to the laddering of contracts which tend to eliminate the impact of market forces on default service rates, and because such mechanisms are more akin to a regulatory approach to default service rate setting.

5. Default Service Cost Elements: § 69.1808 (Policy Statement).

With regard to default service rate cost elements, Dominion Retail suggests that the Commission consider requiring that transmission rates be designed on a projected basis if those charges are to be included in the PTC. As transmission rates change on a perspective basis, those prospectively changed rates should be included in the price to compare as the utilities adjust that price to compare, so that customers pay increases in transmission rates as those rates are increased. Adjusting rates in this manner will eliminate any lag in the actual transmission rates charged by the RTO and those paid by customers. Moreover, such a policy will keep the pricing in line with those included in offers by competitive suppliers who likewise are charged transmission rates in real time.

6. Price Adjustment and Reconciliation: § 69.1809 (Policy Statement), § 64.187 (ANOFR).

Dominion Retail agrees with the Commission's intention to simplify of the PTC and agrees that the PTC should be modified more frequently than annually under most circumstances. However, Dominion Retail vehemently disagrees with the Commission's proposed intention to encourage reconciliation of the PTC. Apart from Dominion Retail's well founded belief that allowing reconciliation of such charges is prohibited by the Competition Act, Dominion Retail believes that it is bad policy for the Commonwealth of Pennsylvania. Allowing for reconciliation allows the deferred collection of the costs of certain risk elements, prominent among these switching risks and weather related usage risks, until months or a year after the fact. With the quarterly adjustments, as outlined in the Commission's policy statement and ANOFR, customers would not see cost impacts of underestimated usage for the high usage summer months until the fall of the year. Under the § 1307(f) requirements proposed by the Commission, those utilities would be entitled to interest for under-collections similar to the gas industry and would pay interest on over collections. Such a scheme provides an incentive to underestimate. Moreover, there is no consequence to the EDC for being inaccurate in its projections. Even without intentional manipulation, reconciliation separates the actual timely market price from the rates, and is contrary to the expressed intention of the Commission in providing a more frequent price adjustments.

Dominion Retail believes that there is a better approach to setting default service rates that can eliminate the need for reconciliation. That is, as discussed above, in the Section on procurement, Dominion Retail believes that if the utilities were to acquire a fairly large percentage of their needs based upon a monthly index price, it would not only provide transparency, if the default service rate was adjusted monthly as well, it would eliminate any reasonable need for reconciliation. Utilities still would face some switching risk and consumption risk, but with the more frequent adjustment of the default service rate, the impact of those risks can be minimized.

Dominion Retail, like all competitive suppliers, faces the risk for variance between its customer's actual consumption and its projections of consumption, and also faces switching risk (the sudden loss of customers) – with no opportunity for reconciliation. Accordingly, Dominion Retail believes that it is not unreasonable to expect utilities to assume those risks and factor such risks into the default service rates, even if that means the utilities are permitted earn a profit on energy costs. One common misconception is that risk premiums are a pure cost, that is, that there is no concomitant benefit. That common assumption simply is not true. A risk premium is the cost of providing a stable price. Those who had longer term contracts, i.e. those that included a risk premium, were glad for those contracts post-Katrina when prices increased dramatically. A monthly variable price based upon actual market prices, and one that includes the costs of risk management, will send appropriate signals to customers, will encourage conservation, will allow marketers to offer comparable prices or products based upon transparent market prices and will insulate the utilities from most risk.

Dominion Retail believes that if the Commission were to allow for reconciliation, which Dominion Retail strongly opposes, the Commission must eliminate any incentive to under-collect, and enforce accurate estimation by requiring a very narrow tolerance band within which the utility must project both prices and consumption. If the EDC's projections fall outside of those parameters, on the positive or the negative side, the utility should suffer some financial consequence, because the customers will certainly suffer financial consequence as a result of the failure to receive appropriate price signals. Dominion Retail recommends a bandwidth of plus or minus 2%. Moreover, the Commission must require that any reconciliation e-factor be included in the price to compare, should require that rates be adjusted monthly nonetheless and require that the e-factor be calculated to collect the reconciliation balance within the next succeeding month; no month to month carry-over can be permitted. Finally, the Commission should not allow for interest on under or over-collection.

Finally, Dominion Retail takes issue with the Commission's suggestion in the ANOFR that "if EGS' know that the PTC will be adjusted consistent with the DSP's incurred cost as a wholesale market has changed, they will invest more time and money in establishing presence in Pennsylvania. . ." Dominion Retail believes that variable price alone will not encourage participation, particularly where the Commission proposes to include the ability to reconcile. Rather, if the current proposal is adopted, it is unlikely that marketers will participate at all because of the risk that reconciliation brings. Allowing for reconciliation allows the price to compare to be separate and apart from the actual market experience without any financial risk to the utility for doing so. Being subject to that type of a risk will likely be too great a risk for EGSs to bear.

7. **Rate Design: § 69.1810 (Policy Statement).**

Dominion Retail commends the Commission on encouraging the elimination of declining block rates. This elimination will increase incentives for conservation and is the right thing to do to encourage conservation and allow for competition.

8. **Rate Change Mitigation: § 69.1811 (Policy Statement).**

In the section "Rate Change Mitigation," the Commission suggests that EDCs may find it necessary to allow customers to avoid paying the full amount of the expected rate increases that will occur when rate caps are removed and to defer the payment of that increase, as a loan of sorts, and to repay that loan (with interest) to the utility over time. At the outset the Commission should first consider whether rate mitigation is needed based a comparison of projected rates versus total generation rate today, that is, commodity plus transition costs. Viewed in this light the potential rate increase for many utilities will be less dramatic.

Dominion Retail believes that such programs are ultimately bad for customers because they allow customers to insulate themselves from the market price. Moreover, customers end up paying more over the long term for the same energy than if they had just paid the full rate upfront--similar to the self-delusion of a consumer using a credit card for an expensive purchase because use of the card makes the purchase seem less expensive through relatively small monthly payments.

However, if the Commission is going to allow such programs, the ability to avoid the full rate increase which is essentially a loan from the EDC, should be available to all customers, regardless of whether those customers choose competitive suppliers. All customers should be able to receive a deferral loan from the utility at the same rate. Otherwise, such a program would be discriminatory and would inhibit the development of competitive market.

Finally, if any such program were going to be implemented, it must be accompanied by a relatively large amount of consumer education to explain to customers in real terms what their electricity would cost over the long term if they paid for the deferral and the interest; similar to the type of disclosure required for any other loan.

9. Retail Market Issues: §§ 69.1812 - 69.1818 (Policy Statement).

Dominion is encouraged by the Commission's proposal to implement several programs to aid the development of the competitive market. But, while Dominion Retail believes that such things as rate-ready billing, purchase of receivables and customer referral programs are helpful, those programs will not spur competition if EGSs cannot compete on price. If the Commission continues down its present course with its proposed procurement methodology and the proposal to allow for reconciliation, these programs will be mere window dressing. That is, if EGS's are not able to compete on reasonably equal terms with EDC's default service rates, these proposed programs, while thoughtful, will be of no consequence to the development of a competitive market. The market structure must be right before these other items will have any real impact.

Conclusion

Dominion Retail wishes to thank the Commission for what it believes to be the Commission's good intentions in developing default service rules. If the Commission truly desires to promote competitive markets as the best hedge against unreasonable electric rates, it simply cannot allow for the continual injection of administrative rate-setting principles, such as reconciliation, in the development of default service rates. Otherwise, competition cannot happen and customers will find them selves with no option other than default service—a result that is contrary to the clear intent of the Competition Act. As a final point, Dominion Retail submits that it would be far more productive and far wiser for the Commission to base its rules on the success of the Duquesne POLR process that affects over 500,000 customers, and not based upon over-reaction to one obvious failure--Pike County--with comparably few customers.

Respectfully submitted,

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