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March 2, 2007

VIA OVERNIGHT UNITED PARCEL SERVICE

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

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, Docket No. L-00040169

Default Service and Retail Electric Markets, Docket No. L-00072009

Dear Secretary McNulty:

Enclosed for filing are an original and sixteen (16) copies of Comments of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company (collectively, "FirstEnergy") in the above-referenced docket. Please date stamp the additional copy and return in the enclosed postage-prepaid envelope.

FirstEnergy greatly appreciates the opportunity to provide comments regarding this important and timely issue.

Please contact me at the above phone number should you have any questions.

Sincerely,

Linda R. Evers

Linda R. Evers, Esquire

dlm
Enclosures

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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**
Default Service and Retail Electric Markets	**Docket No. L-00072009**

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).

Service via overnight United Parcel Service, as follows:

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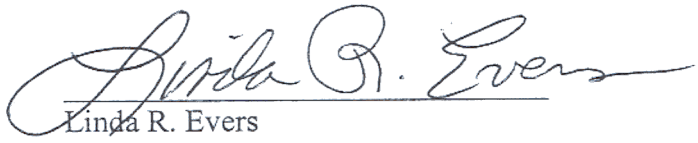
Dated: March 2, 2007



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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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**
Default Service and Retail Electric Markets	**Docket No. L-00072009**

COMMENTS ON BEHALF OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND PENNSYLVANIA POWER COMPANY

TO THE PENNSYLVANIA PUBLIC UTILITY COMMISSION:

I. INTRODUCTION

On February 9, 2007, the Pennsylvania Public Utility Commission ("Commission") entered two orders, *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)* ("ANOFR" or "Rulemaking") and *Default Service and Retail Electric Markets* ("Policy Statement"). Pursuant to these orders, Metropolitan Edison Company ("Met-Ed"), Pennsylvania Power Company ("Penn Power") and Pennsylvania Electric Company ("Penelec") (collectively, "FirstEnergy" or "the Companies") provide these comments to the ANOFR and the Policy Statement. These comments will generally follow the sections to Annex A of the ANOFR and will address the Policy Statement where relevant.

The Companies appreciate this opportunity to provide their comments and compliment the Commission and staff on the generally well-reasoned and balanced approach to a set of issues which are complex and contentious, but which are vitally important to the citizens of Pennsylvania and the future economic vitality of the Commonwealth. The Companies agree with the approach of issuing regulations supplemented by the Policy Statement by the Commission. We also agree that this is the appropriate time to finalize the default service regulations in order to minimize the uncertainty attendant to default service in Pennsylvania.

The Companies' overarching area of concern is the multiple and subjective standards of review to which the actions and costs incurred by the Default Service Provider ("DSP") will be subjected. Throughout the ANOFR and Policy Statement, in a variety of contexts, there is the use of words such as "prudent", "lowest cost", "reasonable cost", "lowest, reasonable long-term cost" in relation to default service cost recovery. The Companies are generally troubled by the perhaps unintended ambiguity created by these differing terms. More specifically, the Companies are concerned that the DSP will continually be subjected to after-the-fact second guessing, creating needless and non-productive financial uncertainty and risk for the DSP. By assigning the DSP obligation to incumbent EDCs in a manner that creates additional financial and regulatory risks, the EDCs may face increased capital costs and perhaps decreased access to the capital required for investment in the distribution infrastructure with potential consequences on reliability of service. Additionally, it appears that the DSP could be subjected to potential disallowances of costs incurred even though it followed a procurement plan approved by the Commission, creating an untenable situation for the DSP. The Companies suggest that the Commission clearly articulate in the Policy Statement that EDCs will be allowed

recovery of all reasonable costs incurred in their role of DSP when the EDC has followed its Commission approved plan.

II. COMMENTS

§54.6(a)(2) Request for information about generation supply.

The Companies suggest that the phase "except as provided in §54.32(h)" be added to the end of the sentence in this section to make it clear that an EDC acting within its certificated service territory is exempt from the license requirement. Additionally, an EDC providing service pursuant to borderline agreements should also be exempt, even though it is providing a service outside of its certificated distribution territory.

Subchapter G. Default Service

§54.181. Purpose

As mentioned at the outset of these Comments, there appears to be varying standards for cost recovery throughout this Rulemaking proposal. As the DSP, an EDC is providing an essential service and should not be subject to financial risk in the provision of such a vital service pursuant to a Commission-approved plan. As provided in 66 Pa. C.S. §2807(e)(3) EDCs "shall recover fully all reasonable costs" associated with default service. The Commission may not change this statutory recovery provision by imposing different standards such as "lowest cost" or "lowest reasonable cost". The Pennsylvania legislature in enacting the Electric Generation Customer Choice and Competition Act has in effect recognized that EDCs should not be exposed to financial risks arising from the second guessing of costs incurred to provide default service. EDCs should not be economically harmed nor advantaged for standing ready to provide a critical service to the citizens of Pennsylvania. The standard by which cost recovery

should be determined is statutorily set and is whether the costs are "reasonable". If costs are incurred under a Commission-approved plan, then the costs should be considered *de facto* reasonable. Otherwise, to have the EDC incur costs under a Commission-approved plan, and then have cost recovery denied because the costs resulting from the approved plan are not deemed "reasonable," would be unduly risky for EDCs and fundamentally unfair.

§54.182. Definitions

The definition of competitive bid solicitation process differs from the one provided in §69.1803 of the Policy Statement. The definition in the Policy Statement implies that the contract must be awarded to qualified suppliers who submit the *lowest* bids whereas the Rulemaking does not have the lowest bid requirement. Both require a fair, transparent and non-discriminatory process. FirstEnergy concurs with this general requirement. However, the Companies believe that the definitions should be reconciled and the one contained in the Rulemaking is the more appropriate one.

By imposing a requirement that the bid must always go to the lowest bidder, the Commission is not taking into account the risks with this approach. For example, even after the financial qualifications have been met, a supplier can still go bankrupt; or events can occur within that organization such as the disclosure of accounting irregularities or other unforeseen scenarios that call into question the bidder's ability to perform. Under these situations, the DSP should have the discretion to award the contract to another supplier even if it is not the lowest bidder. Of course, this discretion can not be exercised without constraint. As provided for in §54.186(c) (3), the Commission and the third party evaluator will oversee all such decisions.

§54.184. Default service provider obligations

In regards to paragraph (c) of this section, FirstEnergy believes the incumbent EDC may be in the best position to provide the universal service programs. When the EDC provides these programs, the cost of these programs should remain non-bypassable and recoverable from all residential customers through a §1307 mechanism as the Commission has recognized in its Order of October 19, 2006 in Docket No. M-00051923, regarding *Customer Assistance Programs: Funding Levels and Cost Recovery.*

§54.185. Default service programs and periods of service

(a) The Companies believe the requirement that a DSP file a default service plan at least 15 months prior to the conclusion of its current plan should be changed to 12 months. While initial programs may be two to three years, according to §69.1804 of the Policy Statement, subsequent programs should be filed every two years unless directed otherwise. The 15-month lead time would mean that within a month or two of implementing one plan, the DSP would begin developing the next one. This does not provide adequate time for the EDC to analyze and benefit from the experience of the current plan before the EDC would have to submit another plan. Additionally, §54.188(b) requires the Commission to issue an order within six months of a program's filing so that the 12-month period still provides sufficient time to implement the Commission-approved plan. FirstEnergy believes EDCs should file their default service plans no later than 12 months prior to the conclusion of its current plan.

(d)(7) FirstEnergy recommends that the requirement to file a schedule identifying generation contracts greater than two years with their load size and end date be

amended to recognize that the confidentiality provisions of these contracts should not be compromised.

(e) FirstEnergy appreciates the Commission providing DSPs with the opportunity to consolidate their procurement activities with other DSPs. The Companies believe that there are definite advantages to multiple, simultaneous generation solicitations by Pennsylvania DSPs. Generally, larger volumes will attract more bidders thus yielding a more competitive result. Administrative fees will also be lower as DSPs can share the costs of a third party administrator. If DSPs individually conduct their own separate solicitations at different points in time, disincentives are created for suppliers to bid their best prices. For example, assume that DSP-A will be conducting a solicitation during one week and two weeks later DSP-B will be conducting its solicitation and another two weeks later DSP-C, its solicitation. A supplier may not offer its best price in the DSP-A solicitation, because the supplier knows that if it doesn't secure business with DSP-A, there will be two more opportunities. Alternatively, if suppliers have secured their desired level of business in the DSP-A and DSP-B solicitations, will DSP-C's solicitation suffer from lack of participation? Also, multiple, simultaneous solicitations may avoid the problem of customers who live only a block away from each other paying dramatically different rates for the similar service simply because they are located in different service territories and the procurement happened at different times in different market conditions. Because the market is always changing the only way to avoid this is to have the procurements at the same time. FirstEnergy endorses multiple, simultaneous solicitations for energy supply of different durations to avoid the potential negative impact of soliciting power supplies through a single annual solicitation.

§54.186. Default service procurement and implementation plans

(b)(1) This section requires that DSPs' plans be designed to acquire electric generation supply at the "lowest reasonable long-term costs." First, as stated earlier, the Companies believe this standard contradicts the statutory standards for cost recovery in 66 Pa. C.S. §2807(e)(3) and subjects DSPs to a moving target. Second, the Commission has determined not to define "long-term" and, therefore, that term can mean a duration as short as 2-3 years or as long as 25-30 years depending on circumstances and perspective. Also, the lowest reasonable long-term cost will change at different points in time even in the view of the same person or entity. When viewed by different persons and entities, the lowest reasonable long-term costs will very likely not be perceived to be the same regardless of the timing of their review.[1] The Companies believe that this standard is fraught with such difficulty that endless litigation will result, potentially paralyzing procurement activities at worst or increasing the EDC's cost of capital at best. Once a DSP has received the Commission's approval of its plan, which include the costs to be incurred under the plan, the DSP's plan should not be subjected to further review other than whether the DSP followed the approved plan.

(b)(4) FirstEnergy recommends adding "except as required by law or regulation" to the end of this sentence to allow for purchases that may be required by future Federal or State laws. For example, EDCs are required to purchase power from certain small generator renewable technologies that are connected at distribution voltages. As written, *all* electric generation supply must be acquired through a competitive bid process or the spot market.

[1] At one time the pricing of NUG contracts in Pennsylvania was perceived to represent a reasonable long-term cost. By 1997, the same contracts were viewed as stranded costs.

(c)(1)(vii) As to the load data requirements, this information is usually in the data room on the EDC's website and it is made available during the actual solicitation process. While a DSP's plan can and should be descriptive of the type of data which will be made available to suppliers, it will be premature to submit the data requested in this section at the time of filing since the data will vary from the time a DSP files its plan and when a solicitation actually occurs. The Commission should make it clear that while it expects the DSP to provide this information, the DSP does not have to do so at the time it files its plan. Suppliers are accustomed to analyzing the data room at the appropriate time.

(c)(3) FirstEnergy agrees with the Commission monitoring the solicitation process and suggests that the Commission specifically designate a department and title such as the Director of Fixed Utility Services, for DSPs to communicate with during the procurement process. This will ensure consistency in communications between the DSPs and the Commission. As this section currently reads, it is not clear whether a DSP should send a letter to the Commission's Secretary Bureau or elsewhere within the Commission regarding the monitoring of the solicitation process. The Companies suggest that this should be addressed in the Policy Statement rather than the Rulemaking to provide future flexibility.

The reference to §54.186(b) (2) (vi) contained in the last line should be §54.186(c) (1) (vi).

FirstEnergy applauds the Commission for its flexibility and agrees that a DSP should be allowed to modify its procurement plan due to unforeseen circumstances. However, absent a major catastrophic event which gives rise to a force majeure type of claim,

such as a September 11 type of attack or disruption of energy markets due to natural disasters, DSPs should not have their plans subject to constant scrutiny and hindsight review. Once a DSP's plan receives Commission approval, absent evidence of wrongdoing, the procurement and its resulting prices should be considered *per se* reasonable and the DSP should be allowed complete and current cost recovery. As currently written, this section would require DSPs to change their plans monthly, weekly or even daily with the constant changes in the wholesale market. What is reasonable on June 1 may not be reasonable on June 15. DSPs' plans should not be subjected to second guessing after they have received Commission approval.

§54.187. Default service rate design and the recovery of reasonable costs

(g) The Commission should make it clear that the retail rates designed to recover the costs to provide these demand-side services and programs are not bypassable and should be paid for by all customers. As explained in a recent report prepared for PJM and MADRI[2], many demand side programs result in benefits for all participants in the marketplace and all retail customers paying rates based on the wholesale market. Since all customers will receive benefits, it logically follows all customers should pay the costs through a non-bypassable charge.

§54.188. Commission review of default service programs and rates

(d) The Companies believe that the Commission's statement that it will not approve or disapprove a DSP's spot market purchases means that it will not act regarding specific spot purchases. At the same time, the Companies fully expect that the Commission will specifically approve or disapprove the portions of their procurement plans that deal with their

[2] "Quantifying Demand Response Results in PJM", The Brattle Group, January 29, 2007, a report prepared for PJM Interconnection LLC and the Mid-Atlantic Distributed Resources Initiative (MADRI).

plan(s) for spot purchases. To the extent that a DSP's plan contains use of the spot market, the Commission should make a definite decision regarding its use. After having followed the Commission's procedures for submission of its default service programs and having received approval of those programs, a DSP should not have the uncertainty that an element of its plan will not be considered appropriate some time later. DSPs should have definitive decisions by the Commission regarding their plans and should be able to take action to implement those decisions without the risk of being second guessed.

This concludes the Companies' comments regarding the ANOFR. Below are additional comments relating to the Policy Statement that were not incorporated above.

Comments Specific to Policy Statement

§ 69.1804. Default service program terms and filing schedules

The Companies agree with the adoption of a two-year horizon for individual default service programs and the recognition that the initial programs may deviate from this time horizon in order to synchronize with RTO planning years. In addition to this exception, the Companies suggest that the Commission recognize that time horizons different from two years may be desirable in order for separate EDCs/DSPs to implement simultaneous solicitation processes as provided for in §69.1807(5) and §54.185(e).

§69.1808. Default service cost elements

(b) FirstEnergy believes that the Commission's desire for any generation related costs to be removed from distribution rates and properly placed in generation rates, can be accomplished in an EDCs next base rate case after the effective date of this policy statement

or in a cost allocation proceeding as part of default service filings. This would be more efficient than initiating a separate cost allocation case on for this narrow purpose. Additionally, we agree with the Commission that for EDCs still under generation rate caps, the results of this examination should not take effect until the expiration of their generation rate caps.

§69.1809. Interim Price adjustments and cost reconciliation

FirstEnergy agrees with the addition of this section and commends the Commission for taking this important step to ensure that EDCs receive cost recovery through a reconciliation mechanism. The Companies' belief is that the EDC should neither make a profit nor incur a loss due to its obligations as Default Service Provider. Achieving this outcome is impossible without the reconciliation of revenues and expenses provided for in this section.

§69.1810. Retail rate design

Under current wholesale market conditions, elimination of declining block rates and demand charges in generation rates is appropriate. However, it is possible that pricing characteristics in the wholesale market could change dramatically and it may be desirable to have the flexibility to reflect these changes in retail rate designs. For example, capacity represents a relatively small percentage of a combined capacity and energy product in today's wholesale market. But in the future, if the capacity market price increases dramatically and persistently, it may provide more appropriate price signals to retail customers and be more consistent with cost of service principles to incorporate a demand charge in the retail rates.[3]

[3] The Companies interpret the proposal to eliminate demand charges as applying only to the generation component of retail rates. If this is incorrect, and the intent is to eliminate the demand charge component of retail distribution and transmission rates, the Companies strongly oppose doing so. For distribution rates in particular, the demand charge is a critical component of the rate, as demonstrated by decades worth of cost of service studies and testimony.

§69.1811. Rate change mitigation

FirstEnergy believes that any phase-in of market price increases following the expiration of rate caps must be carefully considered from a number of very important perspectives. First and foremost, EDCs must be allowed full and timely recovery of all amounts deferred under any deferral plan. In the Rulemaking, the Commission has proposed to allow customers to defer paying a portion of their electric bills for up to three years following rate cap expirations. As currently proposed, the deferral is optional because customers with the means to pay may elect to not defer their payments. However, the Companies believe that there is a great deal of uncertainty whether customers with the ability to pay presumably higher electric bills will actually elect to pay the full amount of the increase.

Regardless of which types of customers decide to accept a deferral option, the amounts deferred should be recovered fully over a reasonable period of time. Administratively, the ability for customers to individually defer an increase and then to pay the deferral at a later point in time creates substantial logistical concerns over collection of the deferred amounts if they must be recovered from the specific customer who elected the deferral. Moves within and outside the EDC's service territory as well as name changes and final bills will make it extremely difficult for EDCs to accurately track and collect the deferred amounts from specific customers. The Companies' preferred approach to providing for full cost collection of default service deferrals is through the default service reconciliation mechanism, or other appropriate method. While FirstEnergy appreciates the Commission's desire to allow a transition to market-based rates, reasonable provisions need to be in place that allow the DPS to fully recover the costs it incurs to provide default service, particularly any amounts which customers elect to defer. As stated earlier, §2807(e)(4) specifically requires full recovery.

§ 69.1814. Purchase of receivables

The Companies believe the endorsement of programs under which EDCs will purchase the receivables of EGSs is not good public policy. The purchase of an EGS's receivables will require diversion of an EDCs capital for purposes not directly related to a primary business activity of the EDC – the reliable delivery of electricity through the distribution system. The Companies recommend this section be deleted.

§69.1815. Customer referral program

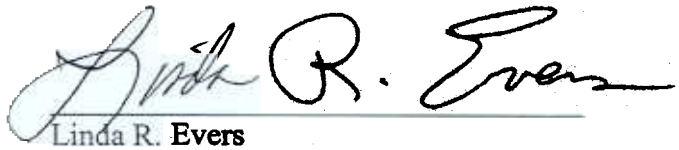
The Companies believe this section could conflict with the Competitive Safeguards. Most EDCs have an affiliate that is an EGS. Therefore, the Commission should provide detailed instructions regarding the mechanics of a referral program so that the Competitive Safeguards are not compromised.

III. CONCLUSION

The Companies again commend the Commission for its generally carefully considered approach and appreciate the opportunity to provide comments on this very important subject.

Respectfully submitted,

Dated: March 2, 2007



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