COMMONWEALTH OF PENNSYLVANIA
PUBLIC UTILITY COMMISSION

Rulemaking Re Electric Distribution Companies' Obligation To Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 P.A.C.S. §2807(e)(2)
Docket Number L-00040169

Default Service and Retail Electric Markets
Docket No. M-00072009

Comments of Hess Corporation

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INTRODUCTION

Hess Corporation ("Hess") hereby submits comments on the proposed default service regulations issued by the Pennsylvania Public Utility Commission ("Commission") in its Advance Notice of Final Rulemaking Order ("ANOFR") in Docket No. L-0040169.[1] In addition, Hess submits comments on the related Proposed Policy Statement ("Policy Statement") issued by the Commission in Docket No. M-00072009.[2] Hess is a major supplier of electricity and natural gas to commercial and industrial ("C&I") end-use customers in the Mid-Atlantic, New England, Ohio Valley and Southeast regions and is a licensed and active competitive electric generation supplier ("EGS") in the Commonwealth of Pennsylvania.

As the Commission acknowledges in the ANOFR, the Pennsylvania Electricity Generation Choice and Competition Act ("Competition Act")[3] requires the Commission to promulgate regulations defining the Pennsylvania electric distribution companies' ("EDC") service obligations at the conclusion of the electric restructuring transition periods.[4] For most of the Pennsylvania EDCs, this transition period will end on December 31, 2010, when long-term generation rate caps that have kept prices artificially frozen below market prices for as long as a decade will terminate. As the Competition Act makes clear, the Commission is required to promulgate default

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[1] *See 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, Advance Notice of Final Rulemaking Order (entered Feb. 9, 2007) ("ANOFR").

[2] *See Default Service and Retail Markets*, Docket No. M-00072009, Proposed Policy Statement (entered Feb. 13, 2007) ("Policy Statement").

[3] Pennsylvania Electricity Generation Customer Choice and Competition Act, Act 138 of 1996, codified at 66 Pa. C.S. §§ 2801 *et seq.* ("Competition Act").

[4] ANOFR at 1.

service regulations that sets default service prices (i.e., the price at which a default service provider acquires electric energy) at "prevailing market prices."[5] This requirement stems from the bedrock policy of the Competition Act that "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[6]

In the draft default service regulations contained in the ANOFR and proposed Policy Statement, the Commission attempts to adhere to the statutory requirements of the Competition Act by establishing a default service structure that bases the default price on a portfolio of spot market prices, short-term procurement contracts and long-term procurement contracts. The Commission then layers upon this supply portfolio a "Price To Compare" ("PTC") rate design that refreshes the price generated from the supply procurement portfolio on a monthly or quarterly basis. Hess respectfully submits that this proposed default service plan will not meet the "prevailing market price" standard because it will fall well short of reflecting the market prices on a consistent and ongoing basis. Hess therefore makes the following recommended modifications to the Commission's proposed default service regulations and Policy Statement:

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[5] *See* ANOFR at 2 (citing Section 2807(e)(3) of the Competition Act, 66 Pa. C.S. § 2807(e)(3)).

[6] *See Default Service and Retail Markets*, Docket No. L-00070183, Statement of Commissioner Terrance J. Fitzpatrick (dated Feb. 8, 2007) ("Fitzpatrick Statement") at 2 (citing Section 2802(5) of the Competition Act, 66 Pa. C.S. § 2802(5)).

COMMENTS

I. DEFAULT SERVICE PROCUREMENT

A. The Commission Should Modify Its Proposed Default Service Structure For Medium-Sized and Large Commercial and Industrial Customers To Make Them More Consistently Market-Reflective

As the Commission acknowledges in the ANOFR, fixed-price default service that does not allow default service prices to adjust frequently to be market-reflective stifles competition and is therefore detrimental to the development of retail markets in Pennsylvania.[7] The Commission, in an attempt to balance this axiom for structuring robust and sustainable retail competition with the need to accommodate the transition of customers off long-term below-market generation rate caps, proposes default service structures that for most customers rely on a blended portfolio of spot market prices and fixed-price procurement contracts.

Under the Commission's default service plan, C&I customers with peak demands between 25 kilowatts ("kW") and 500 kW will be subject to a default service based on a portfolio of blended spot market prices and fixed-price procurement contracts of up to one year in length. Large C&I customers with peak demands of 500 kW and above would be subject to either an hourly-priced or monthly-priced default service.[8] The Commission's plan for these customer groups, with some necessary modifications, has the potential for reasonably producing over time market-reflective prices that obviates the need for a convoluted PTC rate design. Hess recommends that the Commission make the following modifications to these default service provisions to ensure this result.

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[7] *See* ANOFR at 21.

[8] *See* Policy Statement, Annex A at 4.

First, the Commission should establish hourly-priced default service for customers with peak demands of 300 kW and above, consistent with the structure in place for the Duquesne Light Company ("Duquesne") service territory. The Duquesne retail market has demonstrated that a default service structure based on market-reflective price signals fosters a robust and sustainable competitive retail electric market structure providing choice and benefits to Pennsylvania's customers. According to the Commission, Duquesne's overall retail electric rates remain 15% below what they were when the Competition Act was enacted in 1996.[9] According to Duquesne, competitive EGSs are serving 98% of the load for customers with peak demands of 300 kW and higher.[10] These results, which are consistent with the Competition Act's core policy vision, warrant replication in Pennsylvania's other EDC territories. No compelling reason exists for not subjecting this group of highly sophisticated energy customers to price signals that empower them to shop for the product best tailored to their specific energy needs.

Second, the Commission should allow for the exploration of expanding the hourly-priced default service threshold to 200 kW before the expiration of most of the generation rate caps in 2010. This will allow for a reasonable expansion depending upon the outcome of ongoing Commission metering and demand response proceedings that would enable customers as low as 200 kW to adequately receive and respond to hourly price signals.

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[9] *See* ANOFR at 21, n. 10.

[10] *See Petition of Duquesne Light Company For Approval of Default Service Plan For The Period January 1, 2008 Through December 31, 2010*, Docket No. P-00072247, Petition of Duquesne Light Company For Approval of Default Service Plan (dated January 25, 2007) at 5.

Third, the Commission should carefully calibrate the supply portfolio mix for customers between 25 kW and Hess' proposed 300 kW threshold to ensure gradual customer exposure to and experience with market-reflective price signals. Specifically, Hess recommends that the Commission require the EDCs' default service supply portfolio for this customer group to begin with an evenly split blend of spot market prices and fixed-price contracts of up to one year in length on a 50/50 basis for the first year of the EDCs' plans. In subsequent years, the Commission should require the gradual shift of the portfolio blend to spot market prices over a three-year timeframe (e.g., shift the portfolio blend to 70% spot market prices/30% fixed-price contracts in 2012, 80% spot market prices/20% fixed-price contracts in 2013, and 100% spot market prices in 2014). This sliding-scale approach to the supply portfolio blend for the 25 to 300 kW customer group will accommodate the transition of this group off the long-term generation rate caps and promote customer education through gradual exposure of and orderly acclimation to more market-reflective price signals.

In addition, this approach will obviate the need for a less efficient and accurate PTC rate design. As discussed in more detail in Section II, the PTC rate design can never produce an accurate comparison between an EDC default service product and EGS products, many of which are a blend of spot market prices not known at the time of the calculation of the monthly or quarterly PTC. A sliding-scale supply portfolio of spot market prices and fixed-price contracts of up to one year for 25 kW to 300 kW customers is a more direct, accurate and orderly method for balancing the movement to market-reflective price signaling with the need for an orderly transition from long-term generation rate caps.

B. Pennsylvania EDC Default Service Procurement Plans Should Be Reviewed And Modified On An Annual Basis

In the ANOFR and its proposed Policy Statement, the Commission recommends an initial two to three year term for the first Pennsylvania EDC default service plans followed by a standard duration of two years for subsequent plans.[11] Hess respectfully submits that such program durations are too long and run the risk of leaving ensconced in such programs design flaws that could, if not timely fixed, hinder retail competition.

As EDC default service programs evolve following the expiration of the generation rate caps, the Commission and stakeholders must be constantly vigilant for flaws in the program design both before and after its implementation. Annual reviews of the program in a Commission proceeding in which all stakeholders can meaningfully participate will be essential for ensuring that the Commission's key goals of enhancing retail competition and protecting consumers are met on an ongoing basis beyond 2011. In addition, annual reviews of the EDC procurement plans accommodate adjustments of the spot market/fixed-price contracts blend of default service portfolios such as Hess' proposed annual changes to portfolio blends.

Hess therefore recommends that the Commission modify its proposed default service regulations and Policy Statement to allow for an annual review of and, where necessary, modifications to each EDC's default service plan.

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[11] *See* ANOFR at 3, Policy Statement at 11-12, Annex A at 9.

C. Small Pennsylvania Default Service Providers Should Be Encouraged To Join Larger Pennsylvania Default Service Provider Supply Procurement Programs

In its prior comments in this docket, Hess detailed its concern with the balkanization of default service terms and conditions for the different Pennsylvania EDC territories.[12] Specifically, Hess pointed out that such balkanization would create barriers to entry by preventing competitive EGSs from benefiting from economies of scale. Unfortunately, this scenario played out to the detriment of Pike County and Light & Power Company ("Pike County") customers in their 2005 default service procurement for their 2006-2007 supply. To its credit, the Commission has suggested a remedy that can encourage rather than create barriers that discourage optimal EGS participation.

As the Commission details in the ANOFR, the results of Pike County's default service procurement, held in October 2005 for default service supply for 2006-2007, stem from a series of unique and unfortunate events.[13] The default supply procurement was conducted two months after Hurricane Katrina disrupted wholesale energy markets, which resulted in very high wholesale electric prices. The default supply procurement for a two-year period (2006-2007) was held at a single point in time (October 2005), locking customers in at October 2005 prices for 2006 and 2007 even though wholesale prices subsequently lowered from their late 2005 peaks. The Pike County service territory is a very small service territory – geographically and in composition of residential, commercial and industrial customers within the territory –

[12] *See 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, Comments of Amerada Hess Corporation (dated April 26, 2005) at 9-10.

[13] *See* ANOFR at 20.

thereby making it difficult to attract both wholesale energy suppliers and a wide cross-section of EGSs. All of these factors combined to produce a total bill increase of 75% and generation rate increase of 129% for Pike County customers in 2006.

Many of the factors that led to the Pike County increase are best resolved though a default service structure that is not heavily reliant on long-term fixed-price procurement contracts bearing no consistent relationship to market-reflective price signals. The Commission, however, has devised an additional remedy for Pike County and other small Pennsylvania EDCs with loads of 50 MW or less that Hess supports – exploration of combining their default service procurement with neighboring larger Pennsylvania EDCs. The combination of default service procurement structures between smaller, sub-50 MW Pennsylvania EDCs with more sizable neighboring EDCs, while not by itself a cure-all remedy, can potentially go a long way towards removing barriers discouraging entry by wholesale suppliers and a wider cross-section of competitive EGSs.

Hess therefore supports the general concept of the Commission's proposal to combine default service procurements of smaller Pennsylvania EDCs such as Pike County with those of neighboring larger Pennsylvania EDCs.

II. DEFAULT SERVICE RATE DESIGN AND COST RECOVERY

A. The Proposed "Price To Compare" Default Service Rate Design Should Not Be Adopted

In both the ANOFR and proposed Policy Statement, the Commission recommends implementation of a "Price To Compare" ("PTC") mechanism to be adjusted quarterly for customers with peak demands below 500 kW and adjusted monthly for customers with peak demands equal to or greater than 500 kW.[14] Under the Commission's plan, default service customers will receive a PTC, which would reflect a blend of the generation and transmission costs associated with the EDCs' provision of default service. The PTC is then to adjust frequently (quarterly or monthly) in order to reflect changes within the EDCs' default service portfolio and to enable the EDCs to reconcile default service costs and revenues.[15]

The Commission should reject adoption of the proposed PTC rate design because it conveys to customers an artificial and inaccurate price signal. First, the PTC attempts to produce an apples-to-apples calculation between two products – the EDC default service product and EGS competitive products – that are inherently apples-to-oranges. The EDC default service is a bundled generation and transmission service product provided to customers as a last resort service to customers. EGS supply products are unbundled generation products that vary in composition, with some products being fixed-price, some variable price and some a hybrid of fixed and variable prices.

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[14] *See* ANOFR, Annex A at 14-15; Policy Statement at 7-8.

[15] *See* Policy Statement at 7.

Second, no method exists for calculating an accurate PTC on a monthly or quarterly basis for EGS products that contain variable pricing components. This is because variable prices adjust with the spot market and therefore are not and cannot be accurately captured on a monthly or quarterly basis, as the PTC would attempt to do. In other words, a monthly or quarterly adjusted PTC can never capture on an apples-to-apples basis a variable or fixed-and-variable priced EGS product because the variable price component of that EGS product will be subject to changes on a much more frequent basis than monthly or quarterly. Even with cost and revenue adjustment mechanisms such as those proposed by the Commission, this misalignment between the EGS product prices and the PTC – which is merely a monthly or quarterly reflection of a supply portfolio containing a blend of fixed-price contracts – is constant and enduring.

Hess therefore recommends that the Commission reject adopting a PTC rate design in favor of a default service structure that will introduce customers with peak demands of 300 kW and above to hourly price signals and customers between 25 and 300 kW to a supply portfolio that gradually exposes them to more market-reflective default price signaling. This structure is more compatible for establishing a robust and sustainable retail market structure than adoption of a synthetic and fatally flawed PTC mechanism.

III. COMPETITIVE RETAIL MARKET ISSUES

A. The Retail Markets Working Group Should Address All Possible Issues Impacting The Development Of Retail Competition

The Commission devotes, to its credit, an entire subchapter of its proposed Policy Statement to a number of issues affecting development of retail competition and customer choice in the Commonwealth.[16] The Commission proposes the creation of a Retail Markets Working Group to study these issues and develop policy recommendations for Commission implementation prior to the expiration of the generation rate caps.[17] Among the issues specifically cited in the proposed Policy Statement are: (1) access to customer information and data; (2) establishment of an EGS purchase of receivables program; (3) adoption of uniform supplier tariffs; and (4) creation of a Retail Choice Ombudsman at the Commission and each EDC.[18]

Hess strongly supports the creation of the Retail Markets Working Group as well as the incorporation of the above issues into the proposed Policy Statement. The Commission should, however, should provide additional sections within the Policy Statement that clarify that the public interest will be served by consideration of: (1) more efficient EDC-EGS operational rules, including the shortening of customer enrollment and drop periods; and (2) the strengthening of existing Code of Conduct provisions, primarily with respect to affiliate relationships and transactions. Both of these issues are critical to the development of retail markets as they promote efficiency, customer choice, and the creation of a more level playing field between

[16] *See* Policy Statement at 9-10, Annex A at 8-9.

[17] *Id.* at 10.

[18] *Id.*, Annex A at 8-9.

EGSs affiliated with a Pennsylvania EDC and non-affiliated EGS. These issues therefore warrant inclusion in the Policy Statement and the Retail Markets Working Group. Hess welcomes and looks forward to participating in the Retail Markets Working Group.

B. The Commission Should Require The Availability Of *Both* Bill-Ready And Rate-Ready Consolidated Billing Options In Each Pennsylvania EDC Service Territory

In section 69.1813 of the proposed Policy Statement, the Commission states: "[T]he public interest would be served by consideration of the availability of rate ready [consolidated] billing in each service territory."[19] The Commission's finding is only partially correct. In Hess' experience as a retail electric supplier for C&I customers in the Mid-Atlantic and New England regions, the rate-ready practice has discouraged rather than encouraged marketer utilization of consolidated billing for large C&I customers. Conversely, the bill-ready practice has encouraged marketer utilization of consolidated billing for large C&I customers. For these reasons, Hess strongly recommends that the Commission modify this section to state: "The public interest would be served by consideration of the availability of *both bill ready and* rate ready consolidated billing in each service territory."

Currently, bill-ready and rate-ready comprise the two consolidated billing practices employed by Pennsylvania EDCs. The bill-ready practice requires EGSs, after receiving customers' usage data, to calculate the customers' charges and send this calculation along with billing information and bill messages to the EDC through an EDI transaction in a format compatible with the EDC's bill format. The rate-ready

[19] *Id*, Annex A at 8

practice requires EGSs to furnish to the EDC in advance of the billing cycle the rates, rate codes or prices (fixed and/or variable), billing information and bill messages. The EDC then uses this information to calculate the EGS's charges.

The Pennsylvania EDCs currently vary in their approach to consolidated billing practices. The Pennsylvania Electric Company ("PECO") and Pennsylvania Power and Light Company ("PPL") employ bill-ready only consolidated billing. Duquesne and UGI Energy Service ("UGI") employ rate-ready only consolidated billing. Allegheny Power Company ("Allegheny") and First Energy employ both bill-ready and rate-ready consolidated billing options.

Rate-ready consolidated billing is an incompatible consolidated billing practice for EGSs when serving large C&I customers because many of the EGS products used to serve these customers are at least partially based on a variable price. In Hess' experience, large C&I customers tend to be highly sophisticated energy users who desire custom-fit tailored hybrid products that are partially fixed-price and partially based on variable, spot market prices. The incompatibility of the rate-ready practice occurs where the EGSs must provide the prices to EDCs in advance of the next billing cycle. In this situation, EGSs will not know what the variable price component of the hybrid product will be at the date of the next meter read. The price information provided to the EDC on the due date ahead of the meter read is therefore stale and inaccurate because the variable price on the submission date to the EDC is not the same price on the day of the meter read. This situation creates a substantial disincentive for EGSs in serving large C&I customers through consolidated billing.

Conversely, bill-ready consolidated billing is more compatible for serving large C&I customers on consolidated billing. This is because this practice enables the EGS to take the up-to-date variable price component of the hybrid product, utilize this fresh variable price in calculating the customer's charges, and send the calculated charge to the EDC in a timeframe almost immediately prior to the meter read date via an EDI transaction. In this situation, the variable portion of the price of the hybrid product is fresh, more accurate, and the benefits of ensuring an accurate customer charge calculation far outweighs any cost of the EGSs "doing the math" and providing the customer charge calculation.

In sum, it is Hess' experience that the bill-ready method is a preferable mechanism for EGS facilitation of large C&I customers on consolidated billing where the rate-ready method actually stands as a barrier to such facilitation. Hess is cognizant, however, that EGSs serving smaller commercial and residential customers may generally prefer rate-ready consolidated billing because it allows EDCs to "do the math" and calculate the customer's charges. Given the Commission's mandate to establish robust competition and ample customer choice in conformance with the core principles of the Competition Act, the Commission should encourage the availability of *both* bill-ready and rate-ready consolidated billing for EGSs in all Pennsylvania EDC territories in addition to the two EDCs that currently provide both options.

CONCLUSION

Hess thanks the Commission for the opportunity to present its views on the Commission's proposed default service regulations and Policy Statement. For the foregoing reasons, Hess recommends that the Commission modify the proposed default service regulations contained in the ANOFR and its proposed Policy Statement to better align the default service structure with the core requirements and policy goals of the Competition Act. Hess looks forward to working cooperatively with the Commission to achieve a robust and enduring competitive retail electric market structure to benefit customers throughout the Commonwealth of Pennsylvania.

Respectfully submitted,

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