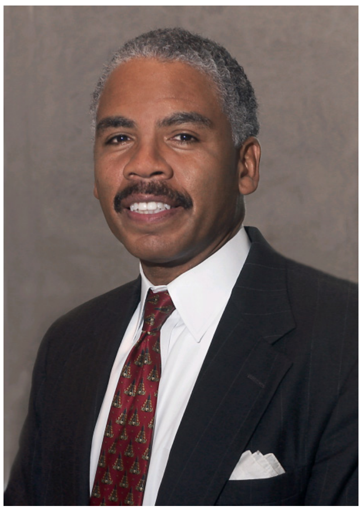
Keystone Competition

Competition News in Pennsylvania

A newsletter published by the Pennsylvania Public Utility Commission regarding competition in the telecommunications and energy markets.

Autumn 2004

Governor Rendell Appoints Wendell F. Holland as PUC Chairman



Chairman Wendell F. Holland

On Sept. 30, Gov. Edward G. Rendell appointed Wendell F. Holland as Chairman of the Pennsylvania Public Utility Commission (PUC). He replaces Terrance J. Fitzpatrick, whose term ended on Sept. 30.

The Governor made the following statement regarding Chairman Holland: "I am pleased to announce the appointment of Wendell F. Holland as Chairman of the Pennsylvania Public Utility Commission. His professional credentials and previous service to the PUC will allow him to be an effective Chairman for an organization charged with establishing and maintaining reasonable rates and safe, adequate service in the regulation of the state's public utilities. Mr. Holland is considered to be an expert in public utilities and will do an outstanding job for Pennsylvania."

Chairman Holland has said his priorities for the office will center around the theme, "Rates, Reliability and Choice."

Chairman Holland recently completed his first year as a Commissioner. Holland previously served the Commission from 1990-93 as a Commissioner and from 1988-90 as an Administrative Law Judge.

Energy Policy Expert Joins Chairman's Staff

To focus on the reliability and affordability of electricity service to Pennsylvanians, Chairman Holland is pleased to announce the addition of Rajnish Barua,

Holland Appointed Chairman *Continued on Page 7.*

PUC Approves POLR Plan for Duquesne

The Commission approved a provider of last resort (POLR) plan for the Duquesne Light Company in an order entered on Aug. 23, 2004. Under the terms of the plan, Duquesne will provide electric generation service to all of its retail distribution customers who do not select or are unable to obtain generation service from an alternative supplier. Consistent with the provisions of the Electricity Generation Customer Choice and Competition Act, the Commission was obligated to approve POLR rates that reflected prevailing market prices and which allowed Duquesne to recover all reasonable costs for this service.

The PUC approved the portion of the plan for fixed rate service for residential and small business customers for the period from Jan. 1, 2005, through Dec.

Duquesne POLR Plan *Continued on Page 3.*

Competition in Pennsylvania

Welcome to the fifth issue of Keystone Competition, a quarterly publication of the Pennsylvania Public Utility Commission (PUC) that gives a "snapshot" view of the energy and telecommunications competitive markets and the major issues that affect each industry.

In addition to showing aggregated basic market data, this publication summarizes key Commission decisions affecting competition and discusses legislative activities at the federal and state levels. Additionally, it highlights notable developments at federal agencies, as well as state and federal courts.

The PUC ensures safe, reliable and reasonably priced electric, natural gas, water, telephone and transportation service for Pennsylvania consumers, by regulating public utilities and by serving as responsible stewards of competition. Industry monitoring is a crucial part of this mission.

ON THE INSIDE

Sustainable Board Holds Annual Meeting

On June 29, the Pennsylvania Sustainable Energy Board (PASEB) held its annual meeting in Harrisburg. The Commission created PASEB in 1999 to provide guidance and assistance to the regional sustainable energy boards that were established to administer funds made available during the restructuring settlements for several major electric companies in Pennsylvania. The regional boards share a mission of supporting renewable and clean energy technologies, energy conservation and efficiency.

The PASEB's annual meeting offered a forum at which interested parties could learn more about the way funds have been spent by each of the regional boards. For instance, representatives of the boards referred to grants and loans that have been provided for solar photovoltaic projects, renewable energy education, green-smart buildings, energy system upgrades, smart thermostats and agricultural biodigester projects. In addition, the boards explained how they have collaborated to provide funding for the development of wind power in Pennsylvania.

Department of Environmental Protection (DEP) Secretary Kathleen A. McGinty discussed Governor Edward G. Rendell's environmental initiatives and the importance of DEP, the PUC and the sustainable boards closely working together. Other presenters furnished information about the market status of sustainable energy technologies.

Currently, the PASEB is working on developing a best practices model that will promote uniformity among the regional boards in various areas including the application, appeal, and nomination processes. The PUC will be reviewing that model later this fall.

DEP Secretary Kathleen A. McGinty was the keynote speaker at PASEB's annual meeting.

Demand Side Response Working Group Examines Ways to Increase Deployment

On Sept. 8, the Demand Side Response (DSR) Working Group convened to discuss reports circulated at the end of July by four subgroups gathering specific information about different aspects of deploying demand side response programs to more consumers in Pennsylvania. The working group is facilitated by Commission staff and is comprised of various participants representing diverse interests, including residential, small business and large industrial consumers, the electric utilities, technology associations and wholesale suppliers.

Demand side response is a tool that allows consumers to reduce or shift their consumption of electricity when they receive signals of higher prices during peak periods. In a competitive electricity market, access to such tools can give consumers the ability to control their electricity costs. When prices are higher than normal, they can either decide to use less electricity or shift their consumption to lower cost periods.

One subgroup examined the current status of technology deployment and cost estimates to achieve full deployment. Specifically, the subgroup gathered estimates of the costs that would be incurred to upgrade systems and equipment to provide all customers with the opportunity to access DSR tools by 2010. According to the subgroup's report, the cost estimates for six of the major electric distribution companies ranged from $1.2 million to over $327 million.

A second subgroup identified several potential mechanisms that might be used to recover incremental costs incurred by the electric distribution companies. Some of the options considered by the subgroup are distribution rates, participating customer fees and system benefits charges. The group also provided details about the way other states fund such programs.

The third subgroup collected existing information from various sources to determine whether customers are interested in DSR tools if given the opportunity, as well as what types of programs are the most attractive to consumers. Additionally, this subgroup described characteristics of a DSR participant and offered the results of consumer satisfaction research with such programs in other states.

A fourth subgroup identified various potential benefits that might accrue to customers, utilities, society and the market. Recognizing that some benefits are non-direct and non-quantifiable, the group considered how to measure the cost-effectiveness of DSR programs and determined what data is needed to conduct such an analysis.

As a next step, Commission staff plans to draft a proposed policy statement for circulation to the working group. The PUC is expected to review staff's recommendations later this year.

PPL Rate Case Progress

On March 29, 2004, PPL Electric Utilities' (PPL) filed a request for a $164.4 million increase in its distribution base rates. This is PPL's first rate increase since 1995, and the first rate case since the passage of Pennsylvania's electric competition act in 1996. This case only considers costs involved in electric distribution base rates and does not include electric generation costs.

Under the proposal, the average monthly bill for a residential customer using 900 kilowatt-hours of electricity would increase approximately $7.62, from $77.47 to $85.09. The increase would affect 1.3 million customers in 29 counties.

The Pennsylvania Public Utility Commission (PUC) has held public input hearings in six locations, to receive public comment from customers on the request. Formal hearings involving testimony and cross examination were held in July and August before an administrative law judge (ALJ). The ALJ will issue a recommendation on the case to the PUC this fall. The Commission is expected to decide this case in December and may accept, reject or modify the ALJ's recommendation.

Duquesne Light POLR Plan

Continued from Page 1.

31, 2007. Generation rates will increase by 11.5 percent on Jan. 1, 2005, but Duquesne's overall rates remain lower than existed at the onset of restructuring. However, the Commission found that Duquesne failed to meet its burden of proof in demonstrating that its proposal for the period from January 2008 through December 2010 reflected prevailing market prices.

The PUC also approved a plan for large customers that begins on Jan. 1, 2005. The proposal will involve the acquisition of energy through competitive wholesale auctions with service provided at hourly prices. In this order, the PUC approved an optional fixed rate for large customers that expires in May 2006.

Finally, the Commission approved Duquesne's membership in the PJM Interconnection LLC. Duquesne will transfer operational control of its transmission system to this regional transmission organization and have access to its energy markets by the end of 2004.

Duquesne filed a petition for reconsideration in response to this order on Aug. 27, in which it asked the Pennsylvania Public Utility Commission to approve its original proposal. The Commission denied this petition in an order entered on Sept. 30, 2004. The Commission did modify its prior order, however, to extend the optional fixed rate service for large customers for an additional 12 months.

FirstEnergy Reliability Investigation

On Jan. 16, 2004, the PUC entered an investigation order at Docket No. I-00040102 that directed Law Bureau prosecutory staff (LBPS) to participate in a formal investigation examining the level of service reliability provided by the Metropolitan Edison Company (Met-Ed), Pennsylvania Electric Company (Penelec), and Pennsylvania Power Com-pany (Penn Power), collectively referred to as FirstEnergy. The investigation was assigned to Administrative Law Judge (ALJ) Larry Gesoff to conduct hearings and issue a recommended decision by Sept. 30, 2004.

The investigation was initiated based upon the PUC's review of reliability data filed by FirstEnergy, additional monthly reports, and other reliability data. After its review, the PUC became concerned that FirstEnergy was not meeting the reliability standards established in the Commission's Dec. 16, 1999, order at Docket No. M-00991220. The investigation focused on whether the service reliability performance of any of the FirstEnergy companies has fallen below the level of service reliability that existed prior to restructuring.

Public input hearings were held from April 6-15 in Dillsburg, York, Lebanon, Reading, Easton, Clark, Erie, Dubois and Altoona. Evidentiary hearings were held in Harrisburg on Aug. 3, 4 and 5, during which testimony was presented by LBPS, FirstEnergy, the Office of Consumer Advocate, and the Pennsylvania Rural Electric Association and Allegheny Electric Cooperative Inc.

The testimony focused on several service reliability areas, including:

- reliability indices and Service Quality Index data;
- Circuit Reliability Index data;
- customer complaints;
- call center issues;
- inspection and maintenance cycles;
- vegetation management;
- capital and operating expenditures;
- line workers and staffing;
- service center closings;
- age and loading of facilities;
- storm management processes; and
- emergency management evidence.

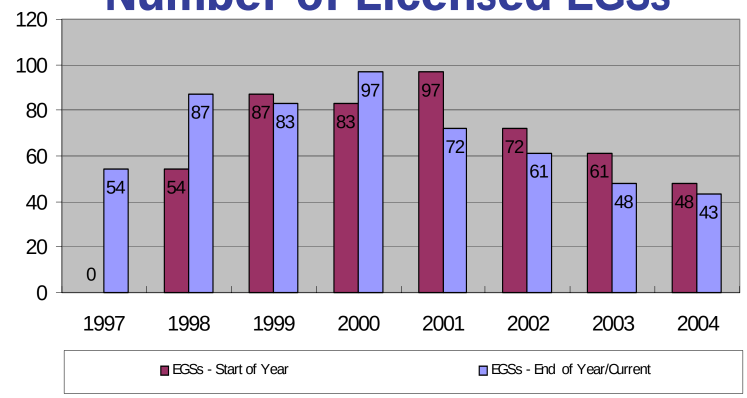
On Sept. 30, the parties submitted a Joint Petition for Settlement, which outlines commitments by FirstEnergy to improve service reliability. Also, FirstEnergy agreed to specific measures to improve reliability to rural electric cooperatives and the customers served by them. The settlement also includes a process to closely monitor FirstEnergy's progress and an expedited process for the PUC and other parties to address future performance problems. On Oct. 13, ALJ Gesoff issued a recommended decision advising the PUC to approve the settlement.

Electric Supplier Licensing

Quarterly activity from to April 1 to June 30, 2004.

43 Active Licenses
3 licenses canceled
0 licenses approved
3 applications pending

Number of Licensed EGSs

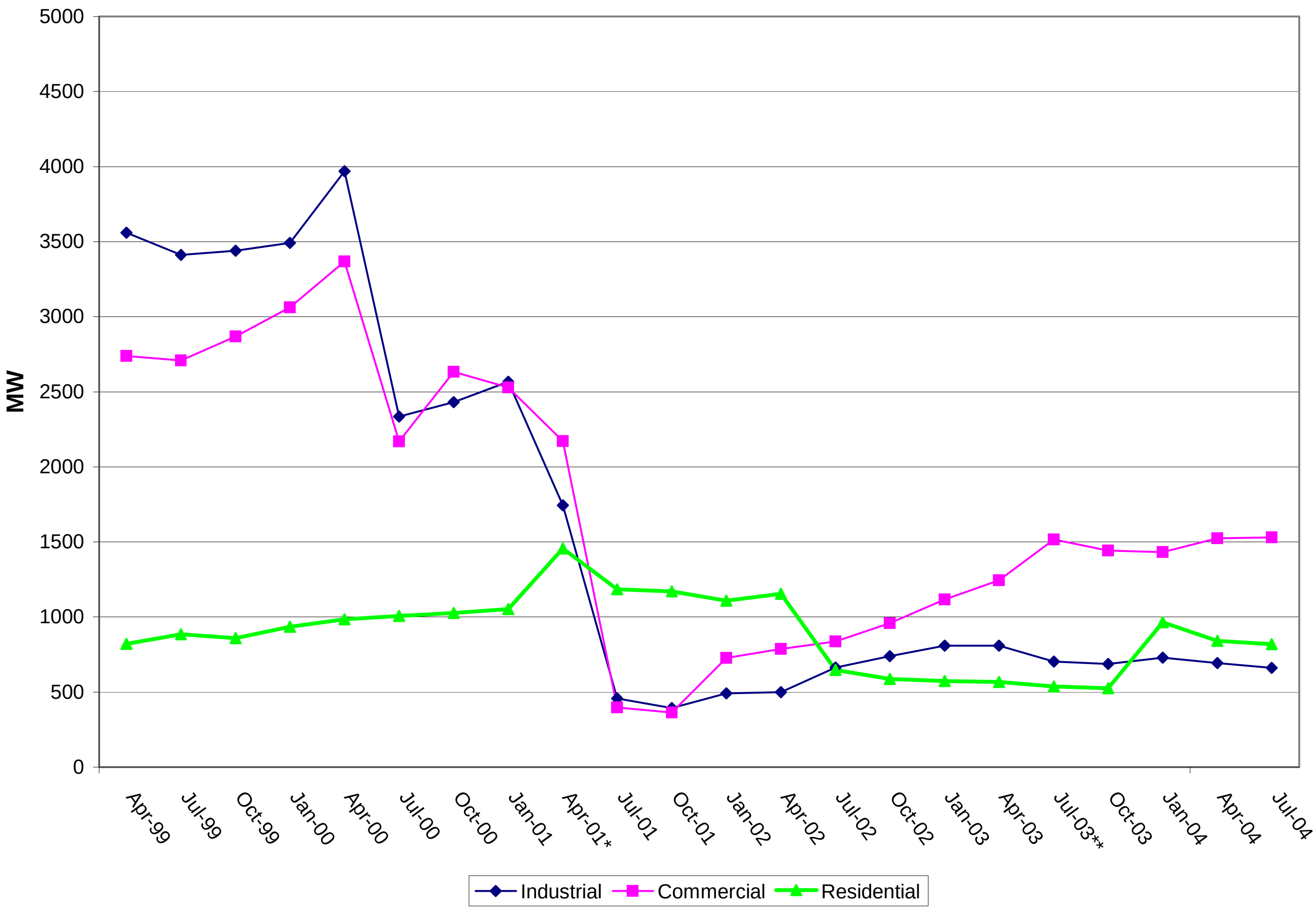


Commercial Customers Lead in Shopping for Electricity

Pennsylvania commercial customers continue to lead in shopping for electricty in the competitive energy market. Commercial customers are mostly small business customers. Shopping is still down from the year 2000 peak, but commercial customers are increasingly turning to competitive suppliers for their energy needs.

Electric Shopping Load by Customer Class

From the Office of Consumer Advocate Quarterly Reports

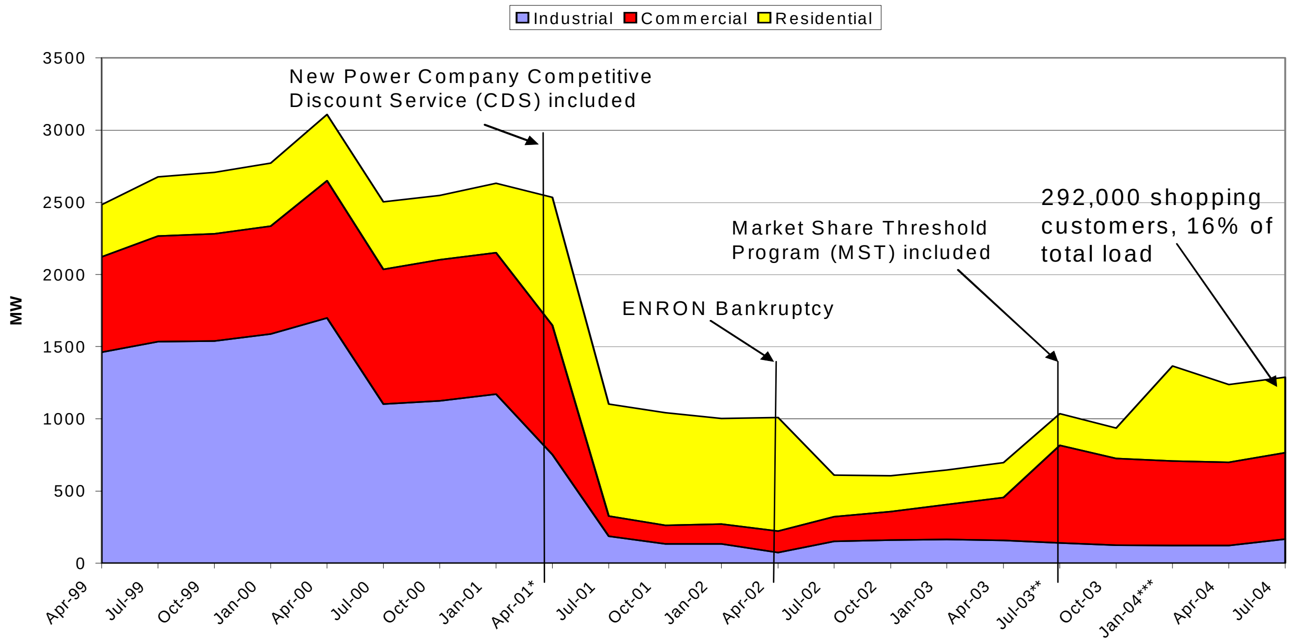


Duquesne Light and PECO Customers are Leaders in Customer Choice

The Office of Consumer Advocate's July 2004 electric shopping statistics show that approximately 140,000 Duquesne Light customers and 293,000 PECO customers are buying electricity from alternative suppliers. The number of Duquesne customers shopping for electricity has been increasing since the beginning of electric competition. The failure of Enron and Enron subsidiary New Power pushed down the number of PECO shopping customers from higher early peaks. PECO's market share threshold program, which went into effect in 2003, has resulted in an increase in customer shopping.

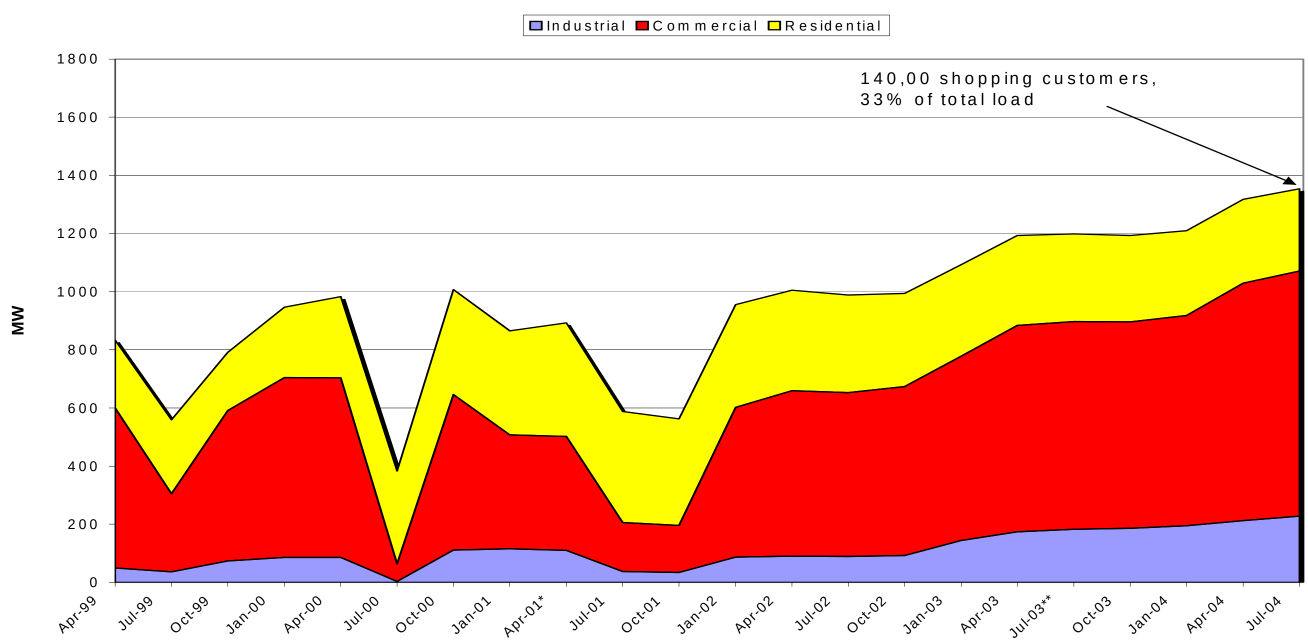
PECO Load Supplied by Competitive Suppliers

Data Supplied by the Pennsylvania Office of Consumer Advocate



Duquesne Load Supplied by Competitive Suppliers

Data Supplied by the Pennsylvania Office of Consumer Advocate



Rural Access Update

The Federal Communications Commission (FCC) is continuing the process of reforming rural access rates (CC Docket 94-95) and recently extended the deadline to file reply comments on a recommendation by the Federal-State Joint Board on Universal Service that proposes to limit high-cost support in rural areas. The Joint Board recommendation is part of the FCC's inquiry to determine what support mechanisms should be in place for rural areas once the current support mechanisms expire in June 2006.

The FCC's Joint Board suggests limiting support to one primary line per household. Until now, federal support was not limited to one line. This proposal comes after the FCC and the PUC previously reformed rural access rates by replacing the support from access charges in toll calls with surcharges. The FCC extended the reply comment deadline to Sept. 21, because of the complexity and volume of the record. The FCC is also

Rural Access Update *Continued on Page 9.*

Focus on Phones

On July 22, the Council for Utility Choice, the PUC and the Office of Consumer Advocate helped consumers in York to read and understand their local phone bills and look at their choices for a local phone provider.

The event provided consumers learning stations that included the "PA TeleChoice" shopping information tool and the program's website (www.utilitychoice.org).

The York "Focus on Phones" event is part of a series of consumer-education outreach events taking place across the state.

PUC Commissioner Kim Pizzingrilli (left) was interviewed live at York's Focus on Phones event by WHTM Channel 27's Consumer Reporter Dennis Buterbaugh.

PUC Grants Settlement in Verizon Access Charge Investigation

Remands Certain Matters to ALJ

At the July 28 public meeting, the PUC approved a settlement petition filed by Verizon PA, Verizon North, the Office of Small Business Advocate (OSBA) and the Office of Consumer Advocate (OCA) on Feb. 26, 2004, at Docket No. C-20027195. The settlement petition resolved several of the outstanding access charge issues for Verizon PA and Verizon North.

This proceeding had its genesis in the Sept. 30, 1999, Global Order (Docket Nos. P-00991648 and P-00991649), which established a schedule for further access charge reductions for all incumbent local exchange carriers. As a result, the PUC initiated a generic access charge investigation (Docket No. M-00021596) in January 2002. The PUC subsequently bifurcated the generic access charge investiga-tion so that all Verizon matters, and all matters relating to access charge parity between Verizon North Inc. and Verizon PA, would be litigated at Docket No. C-20027195.

Specifically, the settlement petition establishes parity in the Veri-zon companies' carrier charge and traffic sensitive access charges. In addition, the Verizon companies agree to align their access rate structure with the interstate structure.

All access charge reductions resulting from the settlement petition will be made on a revenue-neutral basis with no more than $40 mil-lion being recovered through increases to basic local residential rates on a combined Verizon North and Verizon PA basis. The re-maining offsetting rate changes would be applied to basic local busi-ness rates on a combined Verizon North and Verizon PA basis. Such increases will be less than $1 per residential and business line based on recovery across the combined Verizon companies' custo-mer base. The Commission also permitted Verizon PA to use the remaining $243,517 from its 2003 price change opportunity (PCO) filing and $15,138,517 from the Verizon companies' combined 2004 PCOs to offset the access reductions from this proceeding.

In addition to granting the settlement petition, the PUC reversed the administrative law judge's recommendation to close the instant proceeding. Instead, the instant docket will remain open and certain matters that were unresolved in the first phase of this proceeding (*i.e.*, removal of any remaining implicit subsidies in access charges, whether access charges should be reduced to cost, and whether the carrier charge should be eliminated) will be remanded to the Office of Administrative Law Judge for further development of the record and the issuance of a recommended decision.

On Aug. 9, 2004, the Verizon companies filed a petition for reconsideration with regard to the Commission's remand directive. This petition is pending before the Commission.

Update on the Triennial Review Order

On Aug. 20, the Federal Communications Commission (FCC) released a notice of proposed rulemaking in which it solicits comment on alternative unbundling rules that will implement the obligations of 47 U.S.C. § 251(c)(3) in a manner consistent with the United States Court of Appeals for the District of Columbia Circuit's recent decision in *USTA v. FCC*. The FCC also issued an order designed to avoid disruption in the $127 billion local telecommunications market while the new rules are being written.

The regulations set forth a 12-month plan consisting of two phases to stabilize the market. First, on an interim basis, it requires incumbent local exchange carriers to continue providing unbundled access to mass market switching, enterprise market loops, and dedicated transport under the same rates, terms and conditions that applied under their interconnection agreements as of June 15. These rates, terms and conditions shall remain in place until the earlier of the effective date of final unbundling rules promulgated by the FCC or six months after Federal Register publication of its order, except to the extent that they are or have been superseded by: (1) voluntarily negotiated agreements; (2) an intervening FCC order affecting specific unbundling obligations; or (3) (with respect to rates only) a state public utility commission order raising the rates for network elements.

Second, it set forth proposed transitional measures for the next six months. Under the plan, in the absence of a FCC holding that particular network elements are subject to the unbundling regime, those elements would still be made available to serve existing customers for a six-month period, at rates that will be moderately higher than those in effect as of June 15, 2004.

The one-year transitional regime is designed to provide a reasonable timeframe for the FCC to complete its work while interim protections remain in place. The FCC repeated that its primary goal in implementing section 251 is to advance the develop-ment of facilities-based competition by providing incentives for both incumbents and competitors to innovate and invest.

A group of competitors has filed a petition with the FCC seeking clarification that interim network unbundling rules would freeze existing interconnection agreements, including change-of-law provisions for six months. The competitors further seek clarification that rates may be reduced at the discretion of a state commission during the six-month period.

The Pennsylvania PUC decided at its Sept. 30 public meeting that the new rates established in the Verizon Generic UNE Rate proceeding should go into effect as scheduled on Oct. 1. The PUC determined that its order establishing the rates constituted an order raising rates, therefore, the June 15 freeze does not apply in Pennsylvania.

Verizon and other incumbents are challenging the FCC's order in federal court. Verizon argues that the FCC has reimposed the prior unlawful unbundling regime. The challenge describes the FCC action as a part of a "strategy of recalcitrance and delay." Verizon wanted an order of court requiring the FCC to have effective, permanent rules by the end of this year or be deemed to have found no impairment for mass market switching and high-capacity facilities, but the federal appellate court in Washington has put consideration of the matter on hold until at least January 2005.

The National Association of Regulatory Utility Commissioners and others had petitioned the United States Supreme Court to review the underlying *USTA v. FCC* decision of the District of Columbia federal appellate court. On Oct. 12, the Supreme Court denied review.

Wendell F. Holland Appointed PUC Chairman

Ph.D. to the PUC. Dr. Barua is a nationally recognized energy expert, who joins Chairman Holland's team as his policy advisor on energy issues.

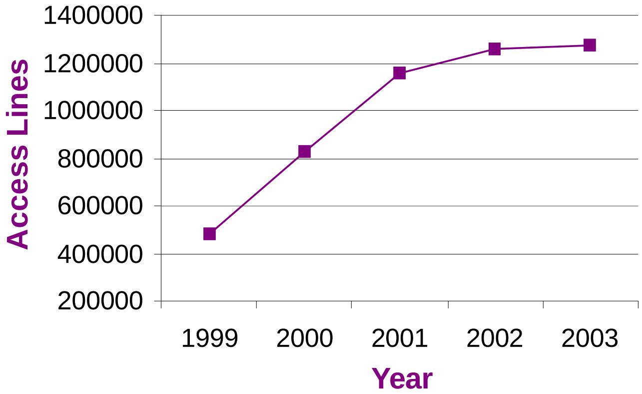
Dr. Barua joins Carol Kozloff, Teri Mathias, Verdina Showell, Esq. and Frank Sparrow on the Chairman's staff.

"I am very pleased to welcome Raj to my team," Chairman Holland said. "He will be an asset not only to me, but to our Commission and our Commonwealth. Raj has direct experience in matters related to the Provider of Last Resort (POLR) issue; our regional transmission operator, PJM Interconnection; and economic development. Moreover, he has been very active in energy matters involving the Mid-Atlantic Conference of Regulatory Utility Commissioners and monitoring federal energy legislation."

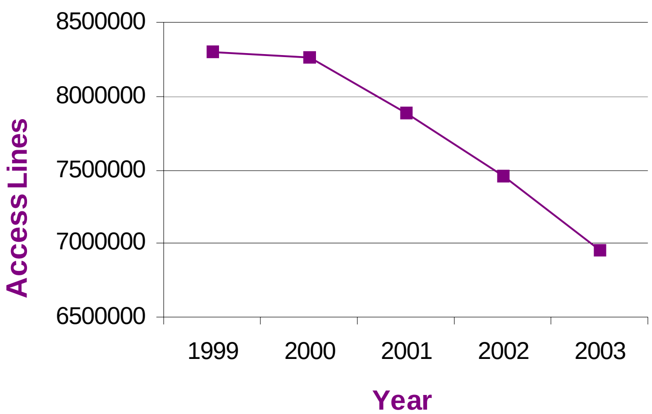
Dr. Barua has nearly 20 years of experience in the energy field, most recently having been Director of Integrated Resource Planning at the Maryland Public Service Commission.

Dr. Barua specialized in energy policy and received a doctorate from the University of Delaware, and taught a graduate-level course in electricity regulatory policy and technology planning. He is currently a member of the National Association of Regulatory Utility Commissioners' Electricity Staff Sub-Committee and Vice-Chair of the International Relations Staff Sub-Committee. He has also interacted with international delegations and participated in technical conferences on electricity regulation in several developing nations.

CLEC Access Line Growth



ILEC Access Line Decline



Lifeline Review

On April 29, the Federal Communications Commission (FCC) released a *Report and Order and Further Notice of Proposed Rulemaking In the Matter of Lifeline and Link-Up*, at CC Docket No. 04-87, WC Docket No. 03-109. The FCC modified its rules (most of which became effective July 22, 2004), to increase the national telephone penetration rate above the current level of 94.7 percent and make phone service affordable to more low-income households. The order expanded the federal default eligibility criteria to include an income-based criterion. Whereas before a customer had to have an income level at 100 percent or below federal poverty guidelines to qualify, this has been changed to 135 percent or below federal poverty guidelines for the customer's household. Thus, more households nationwide arguably will qualify for the federal default program.

In order to combat fraud, the FCC added a proof of eligibility provision placing an additional administrative burden on the carriers to get their customers to certify in writing under oath their household incomes, and their participation in social assistance programs that are qualifying programs. The FCC Lifeline Order added the National School Lunch Program's free lunch program as a qualifying social assistance program.

In a related matter, on July 23, the PUC tentatively approved the settlement agreement regarding the *Petition of the Frontier Companies for approval under Chapter 30 of the Public Utility Code for Approval of an Alternative Regulation and Network Modernization Plan* at P-00951005. The order tentatively allowed the Frontier companies to expand their lifeline programs to allow for two vertical services as opposed to the normally allowed one vertical service. Commission staff has until Nov. 3, to make a recommendation to the Commission regarding how Pennsylvania's Lifeline Program should be structured as a result of the recent FCC Lifeline Order.

Pennsylvania Telephone Company Access Lines 1999-2003

The chart shows the trends in access line counts over the last several years. An access line is defined as a telephone line reaching from the telephone company's central office to a point usually on the customer's premises.

As can be seen, access lines for the local incumbent carriers have declined in this period, while access lines for the local competitive carriers have increased. However, total overall access lines have decreased. The numbers are as reported by the companies.

Year	Competitive Local Exchange Carrier (CLEC)	Incumbent Local Exchange Carrier (ILEC)	Total for All Carriers
1999	479,012	8,295,531	8,774,543
2000	831,052	8,265,178	9,096,230
2001	1,153,781	7,887,594	9,041,375
2002	1,257,849	7,455,906	8,713,755
2003	1,274,039	6,957,460	8,231,499

PUC Adopts New Wholesale UNE Rates

On July 16, 2004 the Commission entered a compliance order establishing Verizon Pennsylvania's wholesale unbundled network elements (UNE) rates at Docket Number R-00016683. By order entered Aug. 31, 2001, the Commission began the proceeding to consider whether existing, tariffed rates for Verizon's UNEs continued to be just and reasonable. This compliance order culminated over three years of investigation and deliberation in deciding what rates Verizon will charge for leasing parts of its network to other competitive local exchange carriers (CLECs) to provide competitive local telephone service. Fundamental considerations in determining these rates were depreciation, cost of capital, growth and methods of calculation. Verizon's cost model was used to calculate recurring costs while AT&T's was used for nonrecurring costs.

These new wholesale UNE rates reflect substantial decreases and increases from the rates currently in effect. Most notable, there have been significant decreases in loop and switching rates and in nonrecurring rates, while interoffice facility and dark fiber rates have seen substantial increases. On an overall rate-by-rate basis, the new rates reflect a percentage increase over current rates. However, the net effect to the carriers will only be determined over time due to the differing volume of activity for each rate category.

Verizon filed a complaint for declaratory and injunctive relief on Aug. 13, with the United States District Court for the Eastern District of Pennsylvania challenging these rates. Verizon objects to the Commission's decisions regarding depreciation, the nonrecurring cost model, switch rates, the port rate structure, disallowance of certain rates and makes the claim that the new rates are so low as to be confiscatory. Additionally, Verizon has filed a revised tariff which freezes over sixty rates at current levels based on the Federal Communications Commission's (FCC) interim order which is discussed in the Triennial Review Order Update on page 7 of this publication. Ultimately, Verizon seeks to enjoin the Commission from enforcing the compliance order and to vacate and remand the compliance order back to the Commission for further action.

At the public meeting of Sept. 30, the Commission ordered the new UNE rates to go into effect on Oct. 1, finding that the rates, being an overall increase and having been established by final order prior to June 15, 2004, were in compliance with the FCC's interim order.

State Legislative News

LB&FC Studying PUC's Reporting Requirements for Telco Providers

The Pennsylvania House of Representatives passed House Resolution 786 on June 29, 2004, calling for a study by the Legislative Budget and Finance Committee (LB&FC) of the filing and reporting requirements imposed by the Commission on local exchange carriers. In directing the study, the House described significant changes in the telecommunications industry as shifting the PUC's statutory responsibilities from the regulation of rates and services toward an oversight role through rulemaking and enforcement.

Noting that the Commission requires the filing of numerous reports containing a broad range of information, House Resolution 786 suggested that some of these requirements may be outdated and could be eliminated or reduced without impairing the ability of the Commission to monitor local exchange carriers and ensure adequate service. The House also found that far fewer reporting requirements are imposed on new competitive companies than are required of incumbent carriers.

For several weeks, PUC staff has been working with LB&FC to provide information about the various requirements, as well as the sources and reasons for them.

Rural Access Update

Continued from Page 6.

asking for comment on the federal guidelines that the states should use when they determine which telephone companies should be classified as eligible telecommunication carriers so that they can then receive federal universal service support.

The Senate Appropriations Committee voted on Sept. 15 to prevent the FCC from limiting universal service to only a primary line. Also in September, Congress formed a Telecommunications Task Force to focus on rural telecommunications in the event Congress rewrites federal law next year. The PUC continues to monitor the proceeding given the importance of universal service and rural telecommunications to Pennsylvanians.

Feedback

We welcome any feedback on Pennsylvania Public Utility Commission's quarterly newsletter, *Keystone Competition.*

For media inquiries or to share ideas, feel free to contact Cyndi Page of the Communications Office at (717) 787-5722.

Hearing Held on Natural Gas Competition Investigation

The PUC held an en banc hearing on Sept. 30, as part of its investigation of competition in Pennsylvania's natural gas service supply market. *Investigation into Competition in the Natural Gas Supply Market*, Docket No. I-00040103. This investigation was initiated by the PUC on May 27, 2004, in accordance with the Natural Gas Choice and Competition Act that directed the PUC to investigate the level of competition in natural gas supply five years after the Act went into effect. The Act also directed the PUC to report its findings to the General Assembly. If, as a result of its investigation, the PUC concludes that effective competition does not exist in natural gas supply services, it must reconvene the stakeholders to explore options for increasing participation.

The PUC has already begun collecting information for its investigation. It has directed that natural gas distribution companies and natural gas suppliers file specific data relating to the natural gas sales and transport, and has invited other interested parties to provide comments or written testimony relevant in assessing the level of competition to evaluating the level of competition in the natural gas supply market. The deadline for filing reply comments is Oct. 12, 2004.

En banc hearing testimony can be found on the PUC's website (www.puc.state.pa.us) under the natural gas issues section.

PUC Hosted Winter Reliability Meeting

The PUC held a winter reliability meeting on Oct. 12, in Harrisburg. At this meeting, which was open to the public, interested parties heard presentations from various organizations, such as the Energy Association of Pennsylvania, the American Petroleum Institute and individual gas distribution companies and wholesale suppliers. Topics covered during the meeting included supply and demand forecasts, storage levels, anticipated prices and service reliability issues.

The information shared at this meeting provided a snapshot of conditions that may affect supply, price and service reliability of natural gas over the upcoming winter. These details will assist consumers and market participants in preparing to meet their natural gas needs. The presentations are available www.puc.state.pa.us.

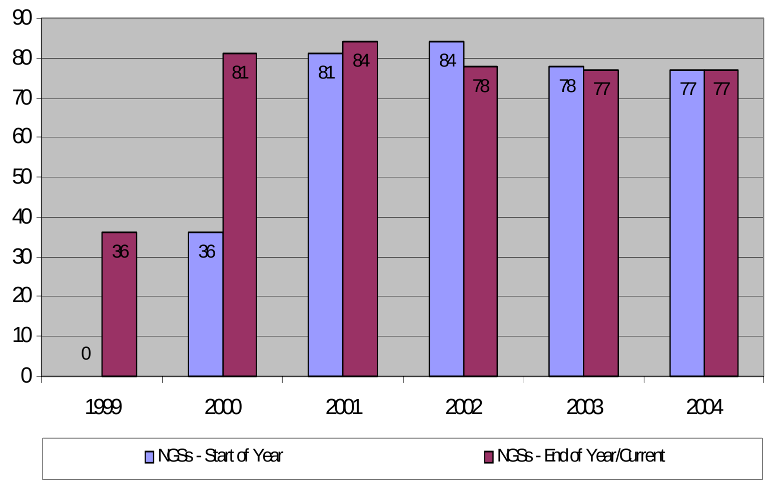
Natural Gas Supplier Licensing

Quarterly Activity from April 1 to June 30, 2004.

77 Active Licenses

2 licenses canceled
2 licenses approved
6 applications pending

Number of Licensed NGSs



PGW Investigation Concludes

The Pennsylvania Public Utility Commission (PUC) concluded its investigation of Philadelphia Gas Works' (PGW) financial and collections issues on Sept. 30. The PUC had previously entered an order on June 2, initiating this investigation in response to PGW's persistent financial problems. The scope of the investigation included PGW's collections practices, universal service issues, and a means tested senior citizen discount.

The Commission was also asked to consider multiple waivers of Chapter 56 regulations, which PGW asserted were necessary to improve its financial position. As part of this investigation, the Commission had previously denied PGW's request to impose a new surcharge on its customers to recover expenses associated with uncollectible expenses on July 8.

In the Sept. 30 decision, the Commission acted to address the remaining issues. First, the Commission denied PGW's proposed Senior Citizen Discount, finding that the costs could not be justified in light of PGW's financial difficulties. Second, the Commission granted four of the waivers it requested as part of a two-year pilot period. Finally, the Commission ordered PGW to retain an outside expert to study its universal service and energy conservation programs, with a report including recommendations due by Dec. 31, 2005.

EIA Revises Energy Price Forecast

The Energy Information Agency's (EIA) June *Short Term Energy Forecast* projected that the average United States price for crude oil in the third quarter would be about $36.20 per barrel. The forecast also warned that, "Potential price spikes are still quite possible given the uncertainties surrounding Middle East instability, terrorism, Iraq and the fact that oil inventories worldwide are still low". The $36.20 per barrel part of the forecast did not come true but the second part about price spikes was right on the mark. West Texas Intermediate Oil (WTI) prices reached the mid $40s per barrel level in early August and peaked at above $49. In the September forecast, crude oil prices are expected to be above $40 until May 2005.

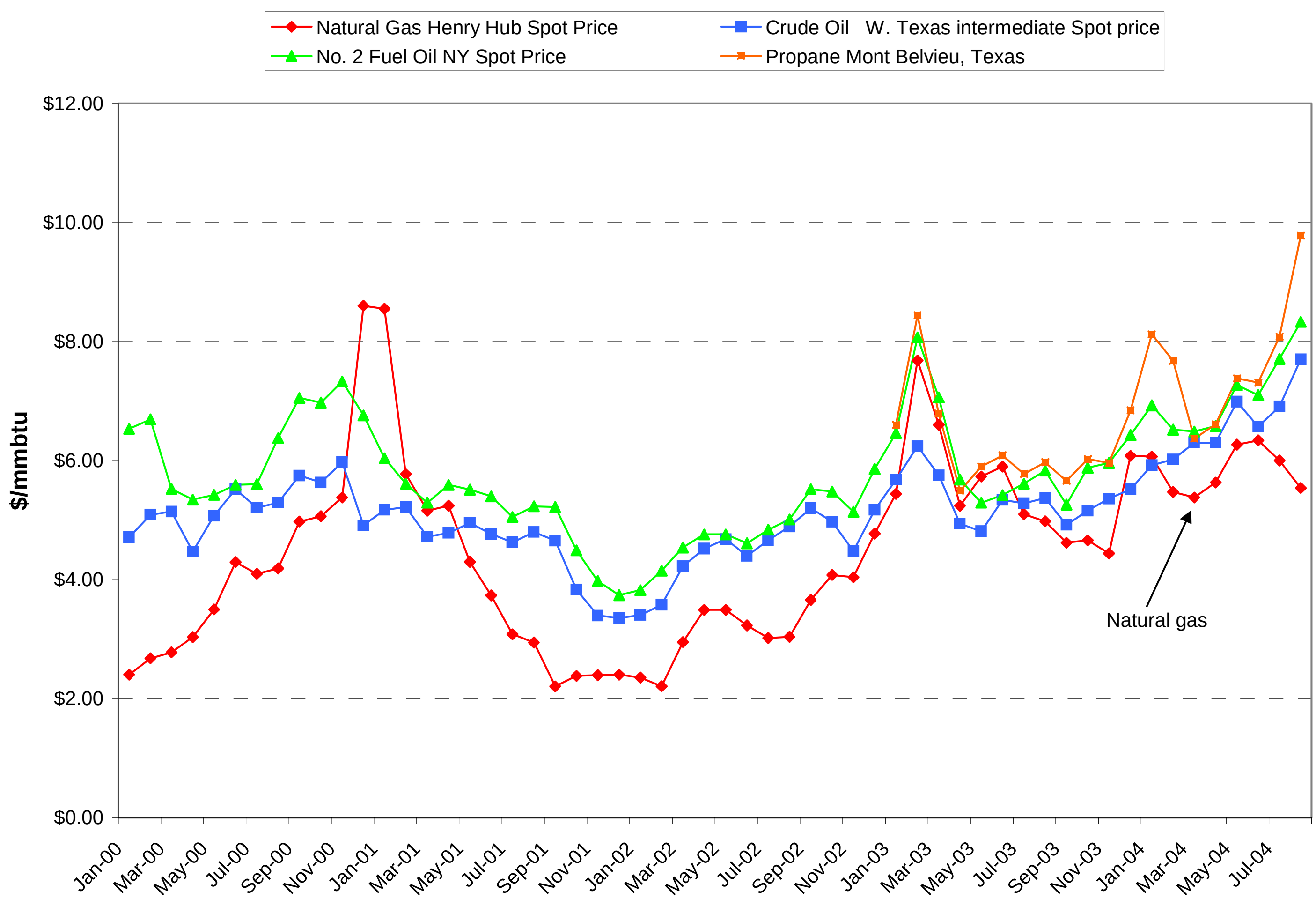
Natural gas spot prices at the Henry Hub moved lower in August as storage levels continued to track well within th normal range and summer demand remained at manageable levels. May prices were above $6 per thousand cubic feet (Mcf) and remained there through the end of July. August natural gas prices dropped to a monthly average of $5.56 even as crude oil prices have hit new highs in July and August. September prices have continued to drop and went below $4.50 per Mcf. EIA notes that Henry Hub prices averaged $5.80 per Mcf in 2003 and are expected to average $5.96 in 2004 and $6.14 in 2005.

EIA predicts that gasoline markets will remain tight and prices are likely to remain high. Pump prices for gasoline have varied since the third week of June between the upper $1.80s and low $1.90s per gallon, a bit below the historical weekly high of $2.06 per gallon for regular on May 24, 2004. Spot prices for gasoline have weakened recently as gasoline inventories shifted to the top of their normal range at the end of August. Average pump price for regular gasoline may dip below $1.80 per gallon by the end of the year.

EIA expects heating fuel costs for the fall and winter to be significantly higher. Last winter heating oil prices in the northeast averaged $1.35 per gallon. EIA predicts heating oil prices to average $1.50 per gallon for 2004-05 heating season.

Wholesale Fuel Prices by Heat Content

Data from EIA's *Weekly Gas Report* and *Weekly Petroleum Status Report*



FCC Highlights

The Federal Communications Commission (FCC) recently isued several important orders that impact Pennsylvania.

Competition and Network Elements

The FCC issued an order on unbundled network elements (UNEs) on Aug. 20, 2004, at FCC 04-179 that creates the rules and rates for UNEs and UNE-P in a Triennial Review Order. The order is divided into three periods - interim, transition and final. During the interim period, which lasts for six months from the time the Federal Register publishes the order or final rules become effective in the rulemaking started in the order, incumbent phone companies must provide switching, enterprise market loops, and dedicated transportation to competitors at rates in effect in agreements as of June 15, 2004. During the transition period, which lasts for six months after the interim period, the incumbent telephone companies must provide switching at the June 15, 2004, rate plus one dollar or at a state commission rate in effect on June 16, 2004, plus one dollar. After the transition period, the incumbent phone company must only offer UNEs required by the final rules and a company's interconnection agreement. The PUC filed comments on Oct. 4.

Universal Service in Rural Areas

On Aug. 16, the FCC issued a public notice in FCC 04J-2 asking for comment on the Report of the Federal-State Joint Board on Universal Service relating to the high-cost universal support mechanisms for rural carriers and the appropriate rural mechanism after expiration of the five-year plan adopted in the rural task force order. The FCC seeks comment on:

- whether the Commission should continue to use the statutory definition of "rural telephone company" to determine which carriers are rural carriers for high-cost universal service support purposes; and
- the appropriate structure of universal service support mechanisms in areas served by rural carriers, including the cost basis of support and the method of calculating support; and whether the Commission should retain, modify, or eliminate rules governing high-cost universal service support for exchanges transferred from one company to another.

This rulemaking will determine how the federal government will support the cost to provide service in rural areas with high costs to serve customer. The FCC set Oct. 15, as the deadline for comments and Dec. 14, as the deadline for reply comments.

The PUC is examining the matter given the importance of universal service to Pennsylvanians.

Payphone Rates

On Aug. 12, (order FCC 04-182), the FCC adjusted the compensation rate a caller is charged for dial-around calls made from payphones. The rate increased from $.24 to $.494 per call. The FCC increased the rate after five years, because a decline in payphone usage required the increase so that the fixed costs of payphone service are supported by a declining number of customers.

Wireless Carriers

On Aug. 26, 2004, in CC Docket No. 96-45, DA 04-2667, the FCC has granted a petition for designation as an eligible telecommunications carrier in Pennsylvania for Nextel, a wireless carrier. This is the first time that a wireless carrier other than an incumbent local telephone company became eligible to receive the federal funding provided to carriers to support local telephone rates.

Penalties for Slamming and Do-Not-Call

The FCC continues to fine carriers for slamming customers and recently signed a consent decree in FCC 04-169 in which AT&T Communications Inc. will pay $490,000 and do more training to stop violation of federal rules that prohibit telemarketing calls to customers that place their name on the FCC's Do-Not-Call list.

Wireless Telephones and Commercial Pornography

On August 12, in Order FCC 04-194, the FCC implemented the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act). This order adopts a general ban on sending commercial messages to Internet addresses unless a customer consents to receive such solicitations. Wireless service providers must submit domain names to the FCC for listing in a public database although no individual's address will be collected or placed on the list. The FCC defined wireless messages (MSCMs) to mean commercial messages sent to an electronic email address used for a wireless customer's phone. Messages sent by wireline telephones do not come within these rules since those calls are covered by the do-not-call lists maintained under the Telecommunications Privacy Act.

FERC's Enron Decision

On July 22, 2004, the Federal Energy Regulatory Commission (FERC) held that Enron violated its market-based rate authority and ordered the forfeiture of $32.5 million in unjust profits. This decision came as a result of an investigation into wholesale power transactions occurring from 1997 to 2003. FERC concluded that Enron failed to disclose the degree of control it had over transactions made by the El Paso Electric Company, a wholesale supplier.

The $32.5 million will be deposited in an already existing fund managed by the United States Treasury and will later be disbursed to customers as refunds. FERC will continue its investigation of Enron's wholesale energy transactions and could order additional refunds in the future.

FERC Clears Obstacles to PJM Expansion

The Federal Energy Regulatory Commission (FERC) recently issued several orders that will allow the American Electric Power Service Corporation (AEP) to join the PJM Interconnection by Oct. 1, 2004. FERC had approved the merger of AEP with the Central and Southwest Corporation in 2000, on the condition that AEP transfer operational control of its transmission facilities to a regional transmission organization such as PJM. The Commonwealths of Virginia and Kentucky, which questioned the benefits of the move, had passed laws blocking this transfer. Other states served by AEP had supported its integration into PJM.

FERC referred the matter to administrative hearings. In March 2004, the presiding judge found that Virginia and Kentucky did not have the legal authority to block the integration of AEP into PJM. Specifically, it was found that under Section 205(a) of the Public Utilities Holding Company Act of 1978, FERC could exempt utilities from state laws in certain circumstances. Subsequent to that decision, Kentucky reached a settlement agreement in which it withdrew its objections to AEP's joining PJM. FERC approved that settlement on June 17, 2004. On the same day, FERC issued an order affirming the decision of the administrative law judge, concluding that Virginia did not have the authority to block AEP's integration into PJM.

Virginia has advised FERC that it is currently negotiating with the parties to bring the litigation to an end. FERC has stayed the effect of its order until Sept. 2, to provide the parties with additional time to reach a settlement, but has advised that AEP is still required to transfer control of its transmission asserts to PJM by Oct. 1, 2004.

Legislation Adopting Renewable Portfolio Standards

The Pennsylvania General Assembly has introduced bills that, if enacted, would establish renewable portfolio standards (RPS). The RPS would require that a set percentage of all generation sold in Pennsylvania be derived from renewable sources. The bills differ on the timing of implementation, ranging from 10 to 15 years, with varying annual phase-in periods. In June, Chairman Fitzpatrick testified before committees of the Pennsylvania Senate and the House of Representatives, urging the General Assembly to give serious consideration to explicitly providing for cost recovery by electric utilities. He also noted that the Commission should be given flexibility to administer such a program, explaining that the PJM Interconnection LLP is presently developing a credit tracking system to support the RPS in other states.

PUC Initiates Investigation of Identity Theft

Identity theft takes place when one person uses another's personal information such as name, Social Security number, credit card number or other identifying information to commit fraud or other crimes. Identity theft results in losses for both utilities and their customers, and last year alone, utility fraud made up 21 percent of identity theft cases reported in Pennsylvania, according to the Federal Trade Commission (FTC). The FTC reports that nearly 10 million people have been victims of some form of identity theft, resulting in nearly $48 billion in losses to businesses and nearly $5 billion in losses to its victims. In Pennsylvania, phone or utility fraud is second only to credit card fraud.

On July 23, 2004, the PUC opened a proceeding (*Investigation In Re: Identity Theft*, Docket No. M-00041811) to examine the extent of the problem of identity theft for utility companies and their customers, and to determine whether the agency's current regulations and policies adequately protect against identity theft.

As a first step in the investigation, the PUC has solicited information and comments on how identity theft impacts and affects utility service in Pennsylvania from the public, the Office of Consumer Advocate, the Office of Small Business Advocate, Attorney General's Office and utilities. Responses and comments are due in November 2004.

CashPoint Update

On May 27, 2004, the PUC unanimously adopted a motion to open a proceeding relating to the bankruptcy of CashPoint, a money transmitter in Pennsylvania and other states in the Northeast. The motion asked major jurisdictional fixed utilities a series of six questions relating to CashPoint and payment methodology. The questions were intended to gather information about how utilities are responding to the bankruptcy and to better understand CashPoint's role in the flow of funds from consumer to utility. All the relevant utilities have responded.

CashPoint's bankruptcy resulted in a large volume of consumer complaints with the PUC's Bureau of Consumer Services (BCS). Several months have passed since the bankruptcy filing, and it appears the number of consumer complaints has plateaued at about 114. BCS is currently in the process of deciding those complaints as the PUC separately determines the next appropriate step to take in the information gathering proceeding.

Pennsylvania's Department of Banking formally revoked CashPoint's license to operate as a money transmitter in Pennsylvania on Aug. 18.