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June 1, 2010

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

Re: Proposed Policy Statement Regarding Default Service and Retail Electric Markets
Docket No. M-2009-2140580

Dear Secretary Chiavetta:

On behalf of the Retail Energy Supply Association ("RESA") enclosed for filing please find the original of its Comments along with the electronic filing confirmation with regard to the above-referenced matter.

Sincerely yours,

Deanne M. O'Dell

Deanne M. O'Dell, Esq.

DMO/lww

Enclosure

cc: Elizabeth Barnes, w/enc. (via email only)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of Act 129 of October 15, 2008; Default Service	:	Docket No. L-2009-2095604
Proposed Policy Statement Regarding Default Service and Retail Electric Markets	:	Docket No. M-2009-2140580

COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. GENERAL COMMENTS REGARDING THE INTEGRATION OF ACT 129 INTO THE CHOICE ACT 4

A. The Purpose of the Choice Act Is To Develop A Competitive Retail Electric Market 4

B. Act 129 Confirms That Default Service Is Intended to Be A Back-stop To the Competitive Market And Provides Guidance On How To Structure Default Service 7

C. Transition to the End State Goals of the Choice Act 9

III. COMMENTS ON QUESTIONS RAISED BY COMMISSION IN PROPOSED RULEMAKING ORDER 13

A. Goals of Default Service Plans 14

1. Least Cost To Customers Over Time 15

a. Question No. 1: What is meant by "least cost to customers over time?" 15

b. Question No. 2: What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time 21

2. Adequate and Reliable Service 22

a. Question No. 3: In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission's default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania? 22

b. Question No. 4: If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised? 22

3. Competitive Procurement Process 23

a. Question No. 5: Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time? 23

b. Question No. 12: Should the DSP be required to hedge its positions with futures including natural gas futures because of the link between prices of natural gas and the prices of electricity? 26

c. Question No. 15: Does Act 129 allow for an after-the-fact review of the "cost reasonableness standard" in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase? 27

B. Prudent Mix of Contracts 29

1. Types of Contracts That Should Comprise the Default Service Plan 29

a. Question No. 6: What is a "prudent mix" of spot, long-term, and short-term contracts? 29

b. Question No. 10: Should there be a requirement that on a total-DSP basis, the "prudent mix" means that some quantity of the total-DSP default service load must be served through spot market purchases, some quantity must be served through short-term contracts, and some quantity must be served through long-term contracts? 29

2. Restrictions on a DSP's Procurement of the Contracts In Its Default Service Plan 34

a. Question No. 7: Does a "prudent mix" mean that the contracts are diversified and accumulated over time? 34

b. Question No. 8: Should there be qualified parameters on the prudent mix? For instance, should the regulations preclude a DSP from entering into all of its long-term contracts in one year? 34

c. Question No. 9: Should the DSP be restricted to entering into a certain percentage of contracts per year? 34

3. Allocation of Supply From The Mix Of Contracts Among Rate Classes 35

a. Question No. 11: Should there be a requirement that some quantity of each rate class procurement group's load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely on only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP? 35

b. Question No. 13: Is the "prudent mix" standard a different standard for each different customer class? 35

C. Contingency Planning 36

a. Question No. 14: What will be the effects of bankruptcies of wholesale supplier to default service suppliers on the short and long term contracts? 36

D. Role of Alternative Energy Portfolio Standards Credits 36

a. Question No. 16: How should the requirement that "this section shall apply" to the purchase of AECs be implemented? Section 2807(e)(3.5) states that " . . . the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc." 36

IV. COMMENTS ON SPECIFIC CHANGES 38

A. Changes to the currently effective regulations 38

1. Section 54.184 (Default service provider obligations) 38

2. Section 54.185 (Default service programs and periods of service) 40

3. Section 54.186 (Default service procurement and implementation plans) 40

4. Section 54.188 (Commission review of default service programs and rates) 41

B. Changes to the Policy Statement 42

V. CONCLUSION 43

I. INTRODUCTION

In 1997, the legislature concluded that the Commonwealth's residents and businesses should be given the opportunity to free themselves from their decades long need to rely exclusively on the electric distribution company ("EDC") for their electricity generation service.[1] The reason for transitioning away from the traditional monopoly supply approach was clear – "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[2] The legislature implicitly recognized that a well functioning, robust competitive market is the best way to provide the most innovative products and services at the most reasonable prices. Recognizing that breaking the well established monopoly would take time, the Electricity Generation Customer Choice and Competition Act ("Choice Act") set forth a transition plan which the Commission has been dutifully interpreting and implementing for over a decade now – including a significant proceeding to finalize the currently effective default service regulations and policy statement which became effective in 2007.[3]

Likewise, the legislature has subsequently offered refinements and clarifications regarding how to transition from monopoly EDC-provided generation service to a competitive retail electricity market. The most recent guidance was offered in 2008 pursuant to amendments referred to as "Act 129" and through which the legislature addressed how to structure default generation service for those customers who choose not to receive generation from a competitive supplier or those for whom service is not delivered.[4] In these two proceedings the Commission seeks to incorporate the guidance provided by Act 129 into its currently effective regulations and

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1 66 Pa. C.S. § 2806(a).

2 66 Pa. C.S. § 2802(5).

3 52 Pa. Code §§ 54.181-55.189; 52 Pa. Code §§ 69.1801-69.1817.

4 66 Pa. C.S. § 2807(e)(3.1).

policy statement. Importantly, nothing in Act 129 changed the goal of the Commonwealth to rely on competition and economic forces to control the costs of electricity and to promote direct access by customers to the competitive market for retail electric generation service. In implementing any regulatory changes or issuing any policy statements interpreting the Choice Act, this purpose of the statute must always maintain its rightful preeminence.

The Retail Energy Supply Association[5] ("RESA") is a trade organization of electricity generation suppliers ("EGSs") who are positioned to give consumers the benefit of the end-state goal of the Choice Act – generation supplied by the competitive market. In fact, many of RESA's members are currently providing competitive alternatives in those markets where rate caps have already expired and where the Commission has adopted policies and rules – consistent with the existing regulations and policy statement – which foster the development of the competitive market.

In this proceeding, RESA urges the Commission to stay the course in adopting regulations and policies which foster the continued development of the competitive market, as mandated by the Choice Act and Act 129. As explained below, the goal of the Choice Act – to foster a competitive market – as well as the newly identified standard of implementing default service plans that provide the "least cost to customers over time" are interrelated and complementary. Robust competition will lead to least cost over time for consumers and robust competition will be stimulated through default service plans that are properly structured to be market-reflective, market-responsive and to include all the costs of providing default service.

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5 RESA's members include ConEd Solutions; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Gexa Energy; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; PPL EnergyPlus; Sempra Energy Solutions LLC. The comments

Any changes to the Commission's regulations and, to the extent necessary, its policy statement, therefore, should be clear that only those default service plans that are structured to produce market-reflective and market-responsive rates which incorporate all the costs to provide the service will be approved. The Commission should refrain from setting any specific "bright-line" rules in its regulations or policy statement as to what this structure (i.e. the "prudent mix" of contracts) should look like for each and every default service plan due to the differences among EDCs and the continuously evolving markets. Rather, the Commission's regulations and policy statement should recognize the goal of the default service plan which is to be structured so as to stimulate competition, view each plan holistically in terms of the contract mix and allocation among classes and decide whether that specific plan for that specific territory is reasonably likely to result in default service rates against which competitors can compete.

These comments are divided into three sections. The first section provides an analysis about the impact of Act 129 and how the newly identified standards of Act 129 are achieved through default service plans that are market-reflective, market-responsive and include all the costs of providing default service. The second section provides answers to the Commission's sixteen questions set forth in its rulemaking docket. The final section comments address the specific regulatory changes identified by the Commission for both its regulations and its policy statement.

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expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

II. GENERAL COMMENTS REGARDING THE INTEGRATION OF ACT 129 INTO THE CHOICE ACT

A. The Purpose of the Choice Act Is To Develop A Competitive Retail Electric Market

Prior to the Electricity Generation Customer Choice and Competition Act ("Choice Act"), the generation, transmission and distribution of electricity was managed and provided by the electric distribution companies ("EDCs"). Through the Choice Act, however, the legislature determined that "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[6] The Commission too has recognized that "customers will receive the lowest rates when multiple EGSs are competing for their business, as is the case for any good or service that consumers need."[7] To transition to this end state, the Choice Act set forth a plan to restructure the prior monopolistic electric industry where EDCs had (and still continue to have) all of the generation customers.

First, the Choice Act removes the authority of the Commission to economically regulate the rate for generation service after an EDC's rate caps expire.[8] Second, the statute mandates that all retail customers be provided with "direct access" to the competitive retail market so that they are given the "opportunity to purchase electricity from their choice of electric generation suppliers."[9] To enforce its goal of ending the monopoly stronghold of the EDC over electric

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6 66 Pa. C.S. § 2802(5).

7 *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 Final Rulemaking Order entered May 10, 2007 ("*Default Service Final Rulemaking Order*") at 33.

8 66 Pa. C.S. §2806(a).

9 66 Pa. C.S. §§ 2802(3), (12), 2804(2); 2806(a)

generation service, the Choice Act gives the Commission broad power to ensure that EDCs do not engage in anticompetitive, discriminatory conduct, or unlawful exercises of market power.[10]

Finally, for those consumers who either choose not to receive generation from an alternative electric generation supplier ("EGS") or for whom electric energy is not delivered pursuant to an agreed-to contract, the Choice Act requires the EDCs, or a Commission-approved alternative supplier, to provide "default service" to that consumer as the default service provider ("DSP").[11] In other words, default generation service is a "back-stop" to the competitive market and – unless the Commission determines otherwise – the EDC continues to maintain the responsibility to provide default service for those customers who do not select another competitive option.[12] The Commission is charged with oversight of the DSP's procurement of generation supply for this default service and was directed by the Choice Act to promulgate regulations to define the obligations of the EDC to provide default service.[13]

In interpreting the Choice Act, the Commission has concluded that it has been given "broad authority [by the Legislature] to ensure that customers will have the ability to make meaningful choices among competing suppliers of electricity."[14] Further, the Commission has determined that the means to accomplish the goals of the Choice Act is through developing a

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10 66 Pa. C.S. §§2806(a); 2811(a),(b), (d).

11 66 Pa. C.S. § 2807(3)(e), *deleted and replaced by* 66 Pa. C.S. § 2807(e)(3.1).

12 66 Pa. C.S. § 2807(e)(3); 52 Pa. Code § 54.183(b).

13 *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, Advanced Notice of Final Rulemaking Order entered February 9, 2007 at 2.

14 *PPL Electric Utilities Corporation Retail Markets*, Docket No. M-2009-2104271, Tentative Order entered May 15, 2009.

robust competitive market and not through administrative regulation.[15] In May 2009, the Commission promulgated final regulations pertaining to an EDC's obligation to serve retail customers at the conclusion of the restructuring transition period.[16] These regulations were adopted as result of a five year process that involved over forty parties filing numerous comments on all aspects of the regulations. In the end, the Commission properly concluded that "customers will receive the lowest rates when multiple EGSs are competing for their business, as is the case for any good or service that consumers need."[17] The Commission also recognized "that there were practical limits to its regulation of large, complex energy markets" and that "[r]equirements that might seem very appropriate today could be rendered obsolete by changes in markets, applicable law, or advances in technology."[18] Therefore, the Commission chose to adopt a policy statement to provide "guidance to the industry as opposed to strict rules," with the intent that such guidance could be reevaluated and reshaped as markets changed and developed.[19] Since the implementation of the regulations and policy statement, the Commission has approved default service plans for several EDCs including Allegheny Power, PPL, PECO,

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15 *Request for Proposals Compliance Filing for Fixed Price Service to Large Commercial and Industrial Customer for the Period June 1, 2006 through May 31, 2007; RE: Duquesne Light Company*, Docket No. P-00032071, Order entered August 23, 2004, at 7.

16 52 Pa. Code § 54.181, et. seq.; *Default Service Final Rulemaking Order* at 1.

17 66 Pa. C.S. § 2807(e)(2), *deleted* by 2008, Oct. 15, P.L. 1592, No. 129, § 3, effective Nov. 14, 2008; 52 Pa. Code § 69.1801, et. seq.; *Default Service and Retail Electric Markets*, Final Policy Statement, Docket No. M-00072009 entered May 10, 2007 (*"Default Service Policy Statement"*) at 33.

18 *Default Service Policy Statement* at 2.

19 52 Pa. Code § 69.1802; *Default Service Policy Statement* at 2, 4.

Met-Ed, Penelec, and Duquesne.[20] All of these plans, with the exception of Allegheny were also adopted after the enactment of Act 129.

B. Act 129 Confirms That Default Service Is Intended to Be A Back-stop To the Competitive Market And Provides Guidance On How To Structure Default Service

A year and a half after the Commission implemented its final regulations and policy statement regarding implementation of the Choice Act, the legislature amended the Choice Act through "Act 129" which made the following changes:

- removed Section 2807(e)(2) (requiring Commission to promulgate regulations);
- revised Section 2807(e)(3) (relating to an EDC's procurement of supply);
- added Section 2807(e)(6)(relating to pre-Act 129 default service plans);
- added Section 2807(f) (related to smart meter technology and time of use rates);
- added Section 2807(g) (defining smart meter technology).

As a result of the statutory changes implemented by Act 129, the Commission initiated this proceeding to address how to incorporate the new statutory directives into both the Commission's regulations and final policy statement.[21] Act 129 deleted the prior Section

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20 *Petition of West Penn Power Company d/b/a Allegheny Power for Approval of its Retail Electric Default Service Program and Competitive Procurement Plan for Service at the Conclusion of the Restructuring Transition Period*, Docket No. P-000723342, Opinion and Order entered July 25, 2008; *Petition of PPL Utilities Corporation for Approval of a Default Service Program and Procurement Plan for the Period January 1, 2011 Through May 31, 2014*, Docket No. P-2008-2060309, Opinion and Order entered June 30, 2009; *Petition of PECO Energy Company for Approval of its Default Service Program and Rate Mitigation Plan*, Docket No. P-2008-2062739, Order entered June 2, 2009; *Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of their Default Service Programs*, Docket Nos. P-2009-2093053 and P-2009-2093054, Order entered November 6, 2009; and, *Re: Petition of Duquesne Light Company for Approval Of Default Service Plan for the Period January 1, 2011 Through May 31, 2013*, Docket No. P-2009-2135500, Plan approved at Public Meeting of May 20, 2010, *order pending.*

21 *Implementation of Act 129 of October 15, 2008; Default Service*, Docket No. L-2009-2095604, Proposed Rulemaking Order entered January 19, 2010 ("*Act 129 Proposed Rulemaking Order*"); *Proposed Policy Statement Regarding Default Service and Retail Electric Markets*, Docket No. M-2009-2140580, Proposed Policy Statement entered January 19, 2010 ("*Act 129 Proposed Policy Statement*").

2807(e)(3) requiring EDCs to acquire electric energy at "prevailing market prices."[22] In its place, however, new Section 2807(e)(3.1) confirms that default service is a back-stop to the competitive market:

> " ... if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide the service or if a customer does not choose an alternative electric generation supplier, the default service provider shall provide electric generation supply service to that customer pursuant to a commission-approved competitive procurement plan."[23]

Thus, the statute continues to make clear, the competitive market is the preferred choice for electricity supply, over default service. The Commission has a duty to ensure that retail electricity customers in the Commonwealth have properly functioning and workable competitive retail electricity markets.[24] The Commission is mindful of this obligation and has stated that it is:

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22 In both the *Act 129 Proposed Rulemaking Order* and the *Act 129 Proposed Policy Statement*, the Commission states that "Act 129 explicitly repealed the prevailing market prices standard, and declared instead that the utilities' generation purchases must be designed to ensure adequate and reliable service at the least cost to customers over time. 66 Pa. C.S. § 2807(e)(3.6)." *Act 129 Proposed Rulemaking Order* at 4; *Act 129 Proposed Policy Statement* at 3. RESA respectfully asserts that this is not accurately stated. Act 129 is an amendatory statute that neither explicitly nor impliedly repealed any statute or statutory language. Act 129 does not even contain a generic general repealer, which nonetheless "is not typically considered an implied repeal." *HSP Gaming, L.P. v. City of Philadelphia*, 954 A.2d 1156, 1176 (Pa. 2008). "[An implied repeal of a legislative enactment] can arise only where the language used in the later statute necessarily discloses an irreconcilable repugnancy between its provisions and those of the earlier statute so inconsistent as to not admit of any fair consonant construction of the two." *Id.*, quoting *Pennsylvania Turnpike Commission v. Sanders & Thomas, Inc.*, 336 A.2d 609, 614 (Pa. 1975). As set forth in these comments, the change in statutory language from "prevailing market prices" to "least cost to customers over time" does not divorce default service procurement from prevailing market prices but ensures that default service procurement will result in rates that are as close as possible to the market price of energy available for default service customers. Clearly, there is no "irreconcilable repugnancy" between these two standards, as they both provide the means to the same end.

23 66 Pa. C.S. § 2807(e)(3.1).

24 66 Pa. C.S. § 2811(a), (b).

> ". . . charged with providing standards and procedures necessary to accommodate the creation of a competitive electric generation market, ensuring that the safety and reliability of the electric system for all parties is maintained during the transition to a competitive market, and preventing anticompetitive or discriminatory conduct and the unlawful exercise of market power that will prevent customers from obtaining the benefits of a properly functioning and workable market."[25]

In addition to confirming the role of default service in the restructured electricity market, Act 129 provided guidance, in nine new subsections, regarding how DSPs must procure energy to provide default service that would fulfill the goals of the Choice Act. Specifically, Act 129 requires DSPs to enter into a "prudent mix of contracts" designed to ensure (i) adequate and reliable service, (ii) the least cost to customers over time; and, (iii) compliance with the requirements of paragraph (3.1)(requiring a competitive procurement process).[26] Interpretation and implementation of these requirements is the focus of this current proceeding.

C. Transition to the End State Goals of the Choice Act

As noted, the implementation of Act 129 did not change the "end state" goal of the Choice Act which is consumers receiving their generation services from the competitive market with little to no reliance on default service (whether provided by an EDC or a Commission-approved alternative generation supplier).[27] Act 129 did provide more specific guidance about the DSP's provisioning of default service in the interim period by requiring the Commission to ensure that the DSP procures a "prudent mix" of resources through a competitive process that seeks to ensure (1) adequate and reliable service and (2) the least cost to customers over time.[28]

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25 *Petition for Approval of PECO Energy Company's Market Share Threshold Bidding/Assignment Process*, Docket No. P-00021984, Opinion and Order entered May 1, 2003 at 12.

26 66 Pa. C.S. §§ 2807(e)(3.1) – (3.9).

27 66 Pa. C.S. § 2807(e)(3.1).

28 66 Pa. C.S. § 2807(e)(3.4).

As evidenced by the Commission's questions, two significant issues arising from Act 129 are the meanings of: (1) "least cost to customers over time;" and, (2) a "prudent mix" of contracts.

For a variety of reasons, ensuring that the default service plan will promote the development of a fully competitive market should be viewed as the primary way of achieving the goal of providing "least cost" generation service for customers. First, competition is the way to ensure least cost service for individual customer situations in the long term because competition enables customers to shop for products and services that best meet their individual needs. As the Commission has noted, "competition among utilities and independent suppliers of generation is the best means available to keep the cost of electricity down."[29] This is because many suppliers will be competing to serve the same customers and their presence will – over the long term – drive prices as low as possible. There are numerous studies which demonstrate the economic benefits of competition.[30] Relying on competition as the best way to provide least cost service is consistent with the goals of the Choice Act to develop retail competition and the Commission's "duty to establish reasonable conditions to support a competitive retail market for generation."[31] It is further consistent with the Choice Act's clearly stated preference that default service should be a back-stop to the competitive market as its entire purpose is to fulfill the supply needs for consumers who are otherwise unable (or not willing) to obtain supply from a competitive provider.[32]

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29 *PPL Electric Utilities Corporation Retail Markets*, Docket No. M-2009-2104271, Opinion and Order entered August 11, 2009 at 1.

30 Studies conducted on behalf of the Alliance for Retail Markets have shown that retail competition in Texas has applied downward pressure on the price of electricity for residential customers. See http://allianceforretailmarkets.com/studies-reports

31 *PPL Electric Utilities Corporation Retail Markets*, Docket No. M-2009-2104271, Opinion and Order entered August 11, 2009 at 4.

32 66 Pa. C.S. 2807(e)(3.1)

Second, only the individual customers themselves can best decide what constitutes the "least cost" for the electric generation product or service that best suits their particular needs. For example, the least cost for someone valuing green energy may be different than someone who is mostly concerned about price. Individual customers are also best suited to take into account any benefits of price stability in comparing a variety of competitive offers. Customers have varying risk tolerance levels and value different things when shopping for goods and services, including electricity. The "least cost" for a customer that highly values environmental responsibility may be quite different from the "least cost" for a customer that is only concerned about the bottom line price. Similarly one customer may be more willing to pay more for a stable fixed priced electric rate, while another may accept more volatility in exchange for the chance to save money. Because default service, by its very nature, is a "one-size only" product, it alone cannot ensure "least cost" service while accounting for diversity in customer situations, usage patterns and preferences. Thus, the best way to ensure least cost service is to implement a default service procurement plan that will enable and sustain a vibrant competitive retail market, empowering customers to decide for themselves what constitutes the "least cost" for the customer's specific needs and circumstances.

Additionally, the end product of a default service plan, the default service rate, cannot possibly represent the lowest absolute cost for each and every individual customer because the default service rate results from an average of the cost to procure supply needed to serve the broader customer group. For example, a customer with an attractive load shape can likely find a better price by being served individually rather than as a part of a broad default service procurement group. Because of this reality, the competitive market is the best place for that customer to find the lowest priced offer and the focus of approving default service plans should

be on evaluating whether or not the proposed plan will encourage development of the competitive market.

In crafting a default service procurement plan that will result in default service rates that encourage the development of the competitive market, the Commission is required to approve a "prudent mix" of competitively procured contracts. RESA submits that the "prudent mix" of contracts standard is satisfied when the proposed default service plan produces default service rates that are market-reflective and market-responsive, include all the costs of providing default service into the default service rate and, therefore, results in a sustainable competitive retail market. Because the Commonwealth is in its early stages of transitioning to a fully competitive retail market where reliance on default service is phased out, the Commission's default service procurement policy must evolve over time to reflect the actual market. Thus, while the use of more fixed price, short to medium term contracts and some long term contracts in early default service plans may be appropriate in recognition of the fact that nearly all of the generation customers are receiving service from the EDC, such reliance should not be necessary as more and more customers receive generation service from the competitive market. In fact, a default service plan that may be "prudent" today may not be "prudent" in the future.

For these reasons, RESA urges the Commission to remain focused on the goals of the Choice Act, to ensure that the default service plans it approves are reasonably tailored to comply with those goals based on current market information and remain open to the need to be flexible regarding this process as the competitive market matures in the Commonwealth. RESA members look forward to continuing to be active members of the Pennsylvania market and appreciate this opportunity to provide their perspective in the context of this rulemaking.

III. COMMENTS ON QUESTIONS RAISED BY COMMISSION IN PROPOSED RULEMAKING ORDER

RESA appreciates the opportunity to comment on the questions asked by the Commission in its proposed rulemaking order.[33] However, to the extent the Commission decides to deviate from the regulatory language proposed in the *Proposed Rulemaking Order* based on answers it receives from interested parties to the identified questions, RESA suggests that the Commission provide an additional public comment period for interested parties to address any such proposed language changes. The basis for RESA's suggestion is the procedure under the Regulatory Review Act ("RRA"). The RRA requires the Independent Regulatory Review Commission ("IRRC") to provide its comments to a proposed rulemaking no later than thirty days after the close of the public comment period.[34] In the current proposed rulemaking, the Commission makes minor language changes to its regulations and asks interested parties to provide comments in response to sixteen questions. Since the RRA also requires the Commission to respond to all comments in its final form rulemaking,[35] the potential result of this process could be that IRRC and the parties are denied an opportunity to respond to the any future specific language changes the Commission may propose to make to its regulations after it reviews the parties' comments if the changes are submitted in a final form rulemaking. To avoid this result, the Commission should permit an additional public comment period to the extent it proposes to make significant language changes to its regulations after reviewing the comments received in response to its questions.

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33 *Act 129 Proposed Rulemaking Order* at 16-17.

34 71 P.S. § 745.5.

35 71 P.S. § 745a(a).

A. Goals of Default Service Plans

The purpose of the default service plan is to set forth how an EDC will procure energy to provide default service to customers who do not choose an alternative supplier in a manner consistent with the Choice Act and Act 129. In tackling this issue in the development of the current default service regulations, the Commission recognized that "there [was] relatively little consensus on most of the key issues" and opted to "craft[] a regulatory framework that d[id] not unreasonably advance one objective to the extent that it obstruct[ed] others."[36]

Now, Act 129 specifically requires EDCs to enter into contracts to procure energy which are designed to ensure: (i) adequate and reliable service; (ii) the least cost to customers over time; and, (iii) compliance with the requirements of paragraph (3.1)(requiring a default service provider to provide a back-stop, default service pursuant to a competitive procurement process).[37] By law, all of these standards must be equally assessed when analyzing a default service plan and RESA urges the Commission, as it did in the prior rulemaking proceeding, to ensure that its policies and final rules do not unreasonably advance one objective at the expense of or by obstructing others. Thus, for example, while "least cost to customers over time" is a stated standard of the default service plan, another stated standard is ensuring that default service remains a back-stop to the competitive market and not a replacement of the competitive market and that the contracts used to provide default service are competitively procured and reflect all the costs of providing service. Further, all of the stated standards must be read in context and reconciled with the original and unchanged purpose of the Choice Act which is to promote competition.

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36 *Default Service Final Rulemaking Order* at 7.

37 66 Pa. C.S. § 2807(e)(3.4).

1. Least Cost To Customers Over Time

Pursuant to the Choice Act, generation (whether provided by EDC or EGS) is not a public utility service or function and it is not regulated by the Commission pursuant to its ratemaking authority in Chapter 13.[38] Therefore, the actual default service rate is not specifically determined by the Commission to be "just and reasonable." Rather, the Commission approves the plan by which an EDC procures default supply and the default service *plan* is what must meet the "least cost to customers over time" standard (in addition to the other standards) of the statute.[39]

a. Question No. 1: What is meant by "least cost to customers over time?"

RESA submits that the least cost to customers over time standard is satisfied by default service plans which result in a sustainable, competitive retail market. Adopting policies that promote the development of a robustly competitive generation market will, over the long term, drive both competitively priced generation prices and default service rates as low as possible to ensure that all consumers are able to purchase electricity at the "least cost" in compliance with the statute. To ensure that default service plans stimulate competition, the Commission should only approve default service plans that will result in default service rates that are as close as possible to the market price of energy available for those customers who choose not to receive generation from an alternative supplier. Moreover, attempting to define what is "least cost" for

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38 66 Pa. C.S. § 2804(10).

39 66 Pa. C.S. § 2807(e)(3.1)("Following the expiration of an electric distribution company's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide the service or if a customer does not choose an alternative electric generation supplier, **the default service provider shall provide electric generation supply service to that customer pursuant to a commission-approved competitive procurement plan**.") (emphasis added).

each and every consumer in each and every situation and then trying to craft a default service plan to accommodate that specific consumer in that specific situation would be inconsistent with the Choice Act and nearly impossible to do. Because default service, as mandated by the Choice Act, is a "one-size only" product, it alone cannot ensure "least cost" service. It can, however, be structured to encourage competition in the retail electricity market which will, through a variety of competitive offers, provide the "least cost" generation service. To do so, the Commission must ensure that a default service plan: (1) is reasonably likely to result in a market-reflective and market-responsive default service rate; and, (2) includes all the costs related to the provisioning of default service in the default service rate.

Some parties may overemphasize the "least cost" goal embodied in Act 129 by supporting a highly regulated procurement process in which the EDC is expected to pursue complex managed portfolio procurement and hedging strategies in an attempt to "beat the market." This view of default service should be rejected. An overzealous pursuit of an EDC managed procurement process as the means to produce "least cost" service for customers is contrary to the continuing policy of the Commonwealth to rely on competitive market forces to control the cost of electricity and will inevitably have the opposite effect of stifling the competitive market and robbing customers of the very tool—retail competition—that can actually deliver "least cost" service to customers. If the primary goal of Act 129 was to deliver "least cost" service for all customers in all instances through a regulated procurement process, the question becomes why have retail competition at all? Under this theory, the default service rate would be expected to be the "least cost" option in all circumstances and customers would have no need for competitive alternatives. In passing the Choice Act in the first place, and in renewing the commitment to competition in Act 129, the General Assembly has recognized that

such an outcome is impossible, and that competitive alternatives are necessary to promote the goal of providing "least cost" service to customers.

Additionally, market-reflective default service rates convey accurate price signals to default service customers so customers will be aware of the real costs of their electric usage and can plan accordingly (which may include engaging in energy efficiency and conservation behaviors). In creating new policies to promote energy efficiency and demand reduction, Act 129 recognized that the goal of "least cost" service cannot be achieved without an increased focus on the demand side of the equation. However, these efficiency and demand management programs cannot be effective without exposing customers to accurate price signals. Market-reflective default service rates also benefit consumers by encouraging EGSs to come into the market and provide alternative choices that can be specifically tailored to meet the needs of the consumer – which is consistent with the goals of the Choice Act. Default service rates that do not accurately track changes in market prices over time will lead to default service rate that are not based on the market price for the commodity. This creates, at best, intermittent opportunities for competitive suppliers to attract customers. Such a market design is not sustainable and presents too much risk for retail suppliers to enter the market. Similarly, if default rates do not fully reflect all of the costs of providing generation service (for example due to misallocated costs and cross-subsidization) then EGSs are at an unfair competitive disadvantage compared to the EDC's default service rate.

Likewise, market-responsive default service rates, those which are regularly adjusted to reflect changes in default service costs as they occur, will result in lower rates over the long term. When finalizing its current default service regulations and policy statement, the Commission recognized that default service rates should be market-responsive in order to

promote retail market development. For example, the Commission stated, "The practice of regular adjustment with the use of spot market energy supply products will ensure that rates more closely track prevailing wholesale energy prices..."[40] Also, in response to IRRC's comment that the Commission should retain the prohibition against reconciliation "to keep the EDCs on a more equal competitive footing with EGSs,"[41] the Commission concluded that "parity between EDCs and EGSs can be maintained through the regular adjustment of rates, the gradual increase in spot market products, and the limitation on the use of long-term contracts, and several other measures. With these elements, *the default service rate will more closely track the market prices offered by EGSs.*"[42] This sentiment of preferring market-responsive procurement and pricing is well established Commission policy and nothing in Act 129 justifies a departure from it.

Indeed, the recent statements of Chairman Cawley and Commissioner Gardner concerning Duquesne's 29-month fixed price for residential customers in Duquesne's Default Service Plan for the period beginning January 2011 confirm the continuing applicability of market-reflective and market-responsive default service rates under Act 129:

- "The residential default service fixed price offered to residential customers under the Settlement relative to actual purchase costs—is of concern. Such an approach eliminates much of the transparency and price discovery that exist under more traditional default service programs."[43]

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40 *Default Service Final Rulemaking Order* at 5.

41 IRRC Comments, Section 9, publicly available at http://www.irrc.state.pa.us/Regulations/Comments.cfm, 7/28/05, PaPUC Regulation #57-237, and http://www.pabulletin.com/secure/data/vol35/35-32/1494.html, 35 Pa.B. 4502 (August 6, 2005).

42 *Default Service Final Rulemaking Order* at 29 (emphasis added).

43 *Re: Petition of Duquesne Light Company for Approval Of Default Service Plan for the Period January 1, 2011 Through May 31, 2013*, Docket No. P-2009-2135500, Public Meeting: May 20, 2010, Statement Of Chairman Cawley, p. 1.

- "While Duquesne's goal to provide its customers with price stability is noble, I do not believe it is rational. Duquesne's proposal to assume the risk of generation increases and decreases effectively shields customers from the true cost of electricity generation. Also, the $78.60 per MWH price was an estimate created when this case was filed in October 2009, and was based on forward market conditions available at that time.
- Additionally, the 'least cost over time' standard for default service generation procurement mandated by Act 129 means, least cost for customers, not least cost for the utility. If the market fluctuates down from $78.60 per MWH when Duquesne enters into a supply contract for its customers, those customers will not be offered supply that was procured at the 'least cost.'"[44]

On the contrary, default service rates that are divorced from the market price – whether they are higher or lower – force customers to pay whatever is charged because they have no other alternatives. While some may argue that it does not matter so long as the default service rate is as low as possible, this view ignores the clear and express intent of the Choice Act to utilize the competitive market to ensure least cost generation over time as well as the serious long term consequences that would result from generation rates held artificially below (or above) the market. As explained above, the Choice Act continues to require that the Commission approve plans which will lead to competitive alternatives. Even with the Act 129 changes and the removal of the "prevailing market price" language, the statute is clear that encouraging competitive alternatives remains a goal of the Choice Act.

Further, it is important that all costs associated with providing default service be recognized and recovered in the default service rate. The Choice Act expressly provides that all reasonable costs of providing default service in the post transition period shall be fully recovered by the DSP.[45] It also requires that charges for generation, transmission and distribution be fully unbundled.[46] Likewise, the default service regulations require the default service rate to include

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44 *Id.*, Dissenting Statement Of Commissioner Gardner, p. 1.

45 66 Pa. C.S. § 2807(e)(3).

46 66 Pa. C.S. § 2804(3); *Lloyd v. Pa. P.U.C.*, 904 A.2d at 1010, 1013-14 (Pa.Cmwlth. 2006).

the sum of all generation and transmission related default service costs.[47] While the Choice Act expressly provides for the recovery of certain costs through nonbypassable charges on all customers, both non-shopping and shopping, there is no such express authorization for the recovery of default service costs through nonbypassable, distribution service type charges.[48] This means that the costs of providing default service must be included in the rates paid by default service customers, and not shopping customers.[49] As the Commonwealth Court has observed, "distribution companies perform a default service referred to as 'provider of last resort' to retail customers who decline to shop for an electric generation supplier or who have returned to their distribution company."[50] This default service is not provided to shopping customers and, therefore, all the costs of providing default service, including the financial risk of any distorted pricing mechanisms, should be included in the default service rate. If all the costs of providing default service are not included in the default service rate, the EDC as the DSP will be given an unfair competitive advantage to create an artificially subsidized lower default service rate with which EGSs will never be able to compete. Again, while some might support such a result (i.e. an artificial low default rate), the entire purpose of the Choice Act is to foster an environment

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47 *Default Service Final Rulemaking Order* at 26; 52 Pa. Code § 54.187(a).

48 66 Pa. C.S. § 2804(9) ("Universal service and energy conservation policies, activities and services . . . shall be funded in each electric distribution territory by nonbypassable, competitively neutral cost-recovery mechanisms. . . . ") (emphasis added); 66 Pa. C.S. §§ 2808(a), 2812(a)(2)(iii) (competitive transition costs ("CTC") and intangible transition costs ("ITC")).

49 *Popowsky v. Pa. P.U.C.*, 869 A.2d 1144 (Pa.Cmwlth. 2005), *appeals denied* 895 A.2d 552 (Pa. 2006) (PUC interpretation that 66 Pa. C.S. § 1307(g) authorizes wastewater utility to establish distribution system improvement charge violates maxim *expressio unius est exclusio alterius* (inclusion of a specific matter in a statute implies the exclusion of other matters.); *Susquehanna Area Regional Airport Authority v. Pa. P.U.C.*, 911 A.2d 612 (Pa.Cmwlth. 2006), *appeals denied* 923 A.2d 412 (Pa. 2007) (PUC's position that it has implicit power to review contract excluded from PUC review under 66 Pa. C.S. § 508 "does violence to principle *expressio unius est exclusio alterius* . . . (inclusion of a specific matter in a statute implies the exclusion of other matters.)").

wherein competition can flourish in satisfaction of the "least cost to customers over time" standard.

b. Question No. 2: What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time

As stated above, the Commission approves the default service plan submitted by the DSP as in compliance with the Choice Act.[51] After the plan is approved, the DSP conducts the solicitations for energy pursuant to the plan. The confidential results of the procurement process are then submitted to the Commission so the Commission can ensure compliance with the approved procurement plan. If the results appear to have been conducted in accordance with the previously approved process, the results are "approved" by way of a Secretarial Letter. An average of the results of all of these bids is used to calculate the default service rate that is ultimately charged to customers by the EDC and included in a tariff page of the utility.

RESA supports this current approval and review process. This is a reasonable approach which provides a degree of certainty for which both EDCs and EGSs can plan. Injecting regulatory uncertainty into the process may result in additional risk premiums passed on to default service customers or EGSs not willing to invest in a "risky" market. Either of these results would be harmful to consumers and neither is necessary as the current approval and review process gives the Commission and other interested stakeholders an opportunity to ensure that the proposed default service plan is in compliance with the Choice Act and then gives all stakeholders the time necessary to implement and prepare for implementation of the plan.

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50 *Green Mountain Energy Co, v. Pa. P.U.C.*, 812 A.2d 740, 742 (Pa.Cmwlth. 2002) (emphasis added), *appeal denied* 833 A.2d 145 (Pa. 2003).

51 66 Pa. C.S. § 2807(e)(3.1).

2. Adequate and Reliable Service

Pursuant to Section 2807(e)(3.4)(i), a DSP is required to entered into contracts that are designed to ensure adequate and reliable service. The Commission sought comment on the following two questions related to this statutorily identified goal:

a. **Question No. 3: In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission's default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania?**

b. **Question No. 4: If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised?**

RESA does not support implementing regulations that require EDCs to ensure the construction of generation capacity in Pennsylvania as contemplated by Question No. 3. First, any provision that would direct construction of generation capacity is outside the authority of the Commission. The Choice Act specifically determined that the generation of electricity is no longer regulated as a public utility.[52] Any attempt by the Commission to order EDCs to begin construction of generation would clearly contravene this provision. Further, mandating the construction of electric generation would mandate the structure of the wholesale electricity market which is regulated by the Federal Energy Regulatory Commission and, therefore, outside the jurisdiction of this Commission.[53] As the Commission has no authority to do what the question suggests, it should not be pursued.

Second, the Choice Act makes clear that its ultimate goal is a properly functioning and workable competitive retail electricity market.[54] This is based on the finding that "competitive

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52 66 Pa. C.S. § 2806(a).

53 16 U.S.C. § 824

54 66 Pa. C.S. § 2811(a),(b), (d).

market forces are more effective than economic regulation in controlling the cost of generating electricity."[55] The Commission has determined the means to accomplish the goals of the Choice Act is through the development of robust and sustainable competitive markets and not through administrative regulation.[56] Implementing a requirement that EDCs construct generation capacity in Pennsylvania would contravene this goal. Moreover, such a requirement could return Pennsylvania to the days of generation monopoly and massive excess capacity debates, with EDCs seeking cost recovery for investments, cost overruns which may or may not have been economically justified from its ratepayers and place the financial risk of building generation squarely on the backs of Pennsylvania ratepayers. For all these reasons, RESA does not support any revisions to the current regulations requiring EDCs to construct generation capacity in Pennsylvania.

3. Competitive Procurement Process

Pursuant to Section 2807(e)(3.4)(iii) and 2807(e)(3.1), a DSP is required to procure electric power through competitive procurement processes which must take the form of an auction, request for proposal or a bilateral agreement. Question numbers 5 and 12 specifically relate to this requirement because they each seek comment on the process that the DSP will use to procure power.

a. Question No. 5: Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time?

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55 66 Pa. C.S. § 2802(5); *Green Mountain Energy Company, et al. v. Pa. P.U.C.*, 812 A.2d 740, 742 (Pa. Cmwlth. 2002.

56 *Request for Proposals Compliance Filing for Fixed Price Service to Large Commercial and Industrial Customer for the Period June 1, 2006 through May 31, 2007*; *RE: Duquesne Light Company*, Docket No. P-00032071, Order entered August 23, 2004, at 7.

While the least cost over time is one of the identified standards that needs to be addressed and, as RESA explained above, the standard is satisfied by approval of a default service plan that will lead to market-reflective and market-responsive default service rates, the default service plan must also result in procuring power through the competitive procurement process. RESA supports a full requirements approach for supply procurement as satisfying the competitive procurement standard as well as the least cost to customers over time standard. If structured properly, without an over-reliance on long-term contracts and with procurement close to delivery date, a full requirements, load following approach is the best way to achieve the stated goals of the Choice Act – including producing the least cost to customers over time. Under a full requirements, load following contract, the wholesale supplier bears the migration risk and load variation risk associated with weather and economic activity. The wholesale supplier factors in the cost of these risks through risk premiums associated with the load following contracts. If the risk premium is not sufficient to cover what ultimately occurs, the wholesale supplier does not seek any additional recovery from the DSP or its customers. This approach properly accounts for all the costs and financial risk associated with providing default service. A competitive wholesale supplier bidding to provide a full requirements, load following product, has no incentive or ability to cross subsidize costs or risks.

On the other hand, an actively managed portfolio approach places all the management and market timing risk on customers and reflects the cost of bearing that risk in the default service rate. While an actively managed approach does mean that the utility need not buy fixed, load following products that contain risk premiums to compensate the wholesale supplier for bearing risk, it is virtually impossible to assume that the utility's portfolio manager will consistently outperform the wholesale supply managers (i.e. beat the market). And, when the

utility manager miscalculates, customers may end up paying much more than they would have paid in a "risk" premium that would have been included in the supplier bid for the full requirements, load following contracts. This can occur because the manager bought too much or too little of a "block" product or because regulatory changes create additional unanticipated costs, as they did for Duquesne Light[57] or because an outage creates increased congestion that spikes up congestion costs as occurred for Wellsboro.[58] In all these instances, not only can customers pay more than they would have if the utility had utilized full requirements contract, but the additional payments may be charged to customers at some point in the future, resulting in a default service price that fails (except by chance) to follow the market; i.e., lower than it should have been when the risks should have been incorporated into the price, and higher when the chickens come home to roost and the additional costs are flowed through to customers. The result is a default service rate that does not respond to the market – but to the portfolio manager and regulatory fiat.

As explained further below in response to Question No. 12, wholesale market changes are beyond the control of all the market players and, thus, there is no guarantee that the decisions made by the DSPs are the most appropriate from the perspective of the default service customer who will be forced to pay the consequences. Further, any actively managed portfolio approach with a main purpose and reason for being to attempt to produce the lowest, most unchanging

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57 While Duquesne eschewed using competitively procured load following products in favor of managing its own energy procurement through its wholesale affiliate, Duquesne underestimated the value of its RPM obligation and now claims it would cost its customers *$450 million*. While Duquesne is not allowed to pass this additional cost on to its retail customers because of the promise of Duquesne and its wholesale affiliate to bear this risk and cost, retail customers would potentially be on the hook for this huge cost, if the same miscalculation happened to a utility using an "actively managed portfolio" default service plan.

58 *Pennsylvania Public Utility Commission v. Wellsboro Electric Company*, Docket No. P-2008-2020257, Order entered February 28, 2008.

rates possible is inconsistent with the goal of default service supply procurement in Pennsylvania which is to create a portfolio of products which will encourage the development of the competitive market by producing default service rates that will be market-reflective, market-responsive and include all the costs of providing default service to customers.

While RESA has a clear preference for full requirements contracts, it is possible to construct a "managed" portfolio plan to address the concerns identified above. Such a plan would incorporate products that minimize the amount of risk the customer is asked to bear by focusing on shorter term, block purchases and spot market purchases, and requiring that all direct and indirect procurement costs are timely and accurately reflected in default service rates. If a plan included more frequent and shorter term scheduled block purchases and significant spot purchases, the DSP would achieve more market-responsiveness in default rates and would reduce migration and other risks. This would mitigate the likelihood of purchasing too much block power. To the extent a managed portfolio plan is under consideration, however, it must be carefully scrutinized based on its proposed structure to ensure that it will lead to default service rates that are market-reflective, market-responsive and include all the costs of providing default service. For example, the Commission should not entertain extraordinary rate treatment when portfolio management decisions go awry. Approving rate deferrals or other extraordinary rate treatment requests distorts the true costs associated with a managed portfolio plan and places competitive suppliers, who must always reflect all of their costs of providing service in a transparent manner, at a competitive disadvantage compared to default service rates.

b. Question No. 12: Should the DSP be required to hedge its positions with futures including natural gas futures because of the link between prices of natural gas and the prices of electricity?

RESA does not support permitting DSPs to "hedge" its positions because doing so is a risky gamble and, when it fails (which it surely will at least some of the time) consumers will be

forced to pay the consequences. After weighing the evidence in over 200 separate filings over a three-year period during the proceedings ultimately resulting in the current default service regulations, the Commission agreed that wholesale market prices are responsive to factors (such as weather, global energy demand, and war) "completely beyond the control" of DSPs, competitive suppliers and regulators, and concluded that there was no evidence presented that DSPs can anticipate market price changes or take advantage of market price change information "to obtain consistently lower prices through long-term contracts compared to short-term and spot market purchases."[59] The Commission specifically stated that it is "generally skeptical of the DSP's ability to beat the market over periods of time greater than one year," and concluded that the evidence showed "customers will save more money as DSPs gradually increase their utilization of short-term fixed price contracts and spot market products."[60] In short, the Commission has embraced increasing reliance on shorter term procurements and competitive market forces as the way to develop the competitive retail market to arrive at the "end state" in Pennsylvania, with customers being served by competitive suppliers as the rule and by DSPs as the exception. In such an end-state, the DSP need not attempt to try to outguess the market and, in moving in this direction, there is no need to permit such guesswork to occur now.

c. Question No. 15: Does Act 129 allow for an after-the-fact review of the "cost reasonableness standard" in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase?

Consistent with all the reasons set forth in the preceding section, RESA does not support approval of default service plans that give the EDC, as the DSP, "substantial discretion"

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59 *Default Service Final Rulemaking Order* at 25.

60 *Id.*

regarding purchases for default service supply. No default service plan should be approved if it requires a process for the regulators to review and second-guess the DSP to determine whether, even if the DSP acquires the lowest price from the market, the procurement process was really the most "reasonable." Such an approach is not market-based or market-reflective, it is re-regulation – attempting to replace market forces with regulatory directives – a strategy that was the norm in Pennsylvania for years until it was rejected as a dismal failure with the passage of the Choice Act which deregulated generation rates.[61]

Moreover, the Choice Act does not appear to contemplate granting EDCs, as DSPs, substantial discretion in this regard. While Section 2807(e)(3.9) permits an EDC to recover "all reasonable costs" incurred under an approved competitive procurement plan, Section 2807(e)(3.6) requires the Commission to approve the plan "considering the standards" of the Act "before the competitive process is implemented." If a DSP is given the ability to decide – without any pre-approval from the Commission – when and how it is going to procure energy for default service, then the Commission would be failing to ensure that the process complies with the Choice Act as it is required to do pursuant to Section 2807(e)(3.6).

RESA does not support such an outcome as approval of the default plan which the Commission has ensured is reasonably likely to produce default service rates that comply with the Choice Act is critical to the ability of competitive suppliers to provide alternative generation service. In this process, there is no need for additional after-the-fact review which would only serve to inject unnecessary regulatory uncertainty into the market.

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[61] 66 Pa. C.S. § 2802(14).

B. Prudent Mix of Contracts

Section 2807(e)(3.2) requires that the EDC procure power through a "prudent mix" of spot market purchases, short-term contracts and long-term purchase contracts. The Commission seeks comments on several issues related to this requirement.

1. Types of Contracts That Should Comprise the Default Service Plan

a. Question No. 6: What is a "prudent mix" of spot, long-term, and short-term contracts?

b. Question No. 10: Should there be a requirement that on a total-DSP basis, the "prudent mix" means that some quantity of the total-DSP default service load must be served through spot market purchases, some quantity must be served through short-term contracts, and some quantity must be served through long-term contracts?

A "prudent mix" of spot, long-term, and short-term contracts is one which – when considered holistically – is the mix which is most reasonably likely to result in a sustainable, competitive retail market, which will ensure that all consumers receive the least cost generation over time. While any procurement strategy carries uncertainty and risks, approving a plan that will promote retail competition empowers consumers to assess these risks for themselves and choose the product that best meets their individual needs and risk tolerance levels. To stimulate competition, the default service plan must produce default service rates that are market-reflective, market-responsive and reflect all of the relevant costs incurred by the EDC in providing default service. Because determining what mix of contracts will lead to this result in the context of each proposed default service plan is a fact specific determination, the Commission's observation that "it would be unwise to craft a one size fits all approach. . . to every aspect of default service" is particularly instructive and should be followed.[62] Further, as discussed previously, the transition to a fully sustainable, competitive retail market will be an

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[62] *Default Service Policy Statement* at 4; see, 52 Pa. Code § 69.1802.

ongoing process and default service plans should reflect a gradual transition to the desired "end-state" where all customers rely on competitive retail service instead of default service. Thus, the "prudent mix" of contracts needed to support this goal will vary depending on where the EDC and the specific market segment is along this transition.

The most ideal supply contracts to accomplish the goal of transitioning to the desired "end state" of retail competition is by increasing reliance on short-term contracts and spot market purchases. This is because these types of contracts are as close in time as possible to the delivery of the energy and will, therefore, produce market-reflective and market-responsive default service rates to keep default service rates in line with competitive offers from EGSs. As the market evolves, and competition becomes the norm with the majority of consumers in the EDC's territory receiving generation supply from an EGS using default service as the back-stop to the competitive market, default service should be procured through spot market purchases only. This situation currently exists in the service territory of Pike County Power and Light ("PCL&P"). Because substantially all of the supply load is being served by the competitive market, the Commission specifically rejected PCL&P's proposal to use a web-based declining price auction to set the prices for its default service needs for three years.[63] Instead, the Commission required PCL&P to acquire all of its default service needs using spot market purchases.[64] PCL&P has been operating with this default service plan since January 1, 2008 and it is scheduled to continue through May 31, 2011.[65] Further, many of the initial default service

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63 *Petition of Pike County Light & Power Company for Expedited Approval of its Default Service Implementation Plan*, Docket No. P-00072245, Opinion and Order entered August 16, 2007 at 14.

64 *Id.* at 25.

65 *Re: Petition of Pike County Light and Power Company for Expedited Approval Of Its Default Service Implementation Plan*, Docket No. P-2008-2044561, Opinion and Order entered March 23, 2009.

plans in place for other EDCs recognize that spot market pricing is the "prudent mix" of contracts for the large commercial and industrial market. This is in recognition of the fact that retail competition in the large customer market is likely to develop very rapidly after the expiration of rate caps (as has been the case in PPL, Duquesne and other markets). The high migration levels for this market segment makes a procurement mix based on long-term, fixed price contracts imprudent.

Until such an end state exists, RESA recognizes that long-term contracts may be appropriately used in the context of a default service plan. For example, the inclusion of long-term contracts for a small portion of default service supply during the initial post-rate cap period may be appropriate to address concerns about stable rates. Also, as explained below in response to Question 16, long-term contracts may be reasonable to help satisfy Alternative Energy Portfolio Standard ("AEPS") requirements.

As a general principle, however, an over-reliance on long-term contracts will mean that, across the default service program term, a substantial percentage of supply will be based on prices that are substantially "out of date" and do not reflect current market prices or conditions. For example, assume that during the last year of a proposed program term, nearly 70 percent of the default service supply is comprised of contracts greater than 1-year in duration for the residential class. Also assume that for the majority of delivery months (i.e. 29 out of 41), more than 50% of the supply portfolio is from contracts procured greater than one year prior to the delivery month. The result of this would be that for more than half of the program term, prices will be more than one-year "out of date" with respect to current market prices. Such a procurement design virtually guarantees that prices will be substantially out of line with current market conditions and will not sustain retail market development.

Default service rates based on out of date long term contracts rob customers of price decreases in a time of declining prices because the default service rate that the customer is paying has no relation to the cost of the commodity at the time the customer is paying. While it may be tempting to think that locking in a lower price in a time of rising prices would provide benefits to default service customers, even this scenario has negative consequences. First, under such a scenario, retail competition cannot develop so customers are denied the long-term benefits that robust competition brings, such as increased innovation and greater choice. Second, customers may face rate shock when the long-term contract expires and is replaced with a new contract reflecting current market prices. Additionally, customers will have inaccurate price signals during the time of rising prices and are likely to consume more than they would if they had better price signals. Finally, as the Commission has already correctly determined, "customers will save more money as DSPs gradually increase their utilization of short-term fixed price contracts and spot market products."[66]

Even if long-term contracts are used, they should not be structured as fixed priced contracts for several reasons. First, long-term fixed price contracts impede the legislative goal of promoting retail competition. An EGS evaluating its prospects for a viable business could not reasonably conclude that a default service rate which includes five year fixed priced contracts will follow market prices. This anticipation that future rates will be divorced from market prices creates substantial risk for new suppliers wishing to enter the market and will impede new market entry.

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66 *Default Service Final Rulemaking Order* at 25. The Commission relied on a report showing that Duquesne's residential customers would have saved $75 million during the first two years of its "POLR III" plan if they had been on monthly priced service while small commercial customers would have realized savings of over $28 million over the first 23 months of the POLR III plan.

Second, there is no guarantee that long-term fixed price contracts will produce lower costs for customers. Predicting whether any particular procurement design will produce higher or lower rates compared to another is impossible because one cannot predict future market prices and conditions. One can, however, rely on the widely accepted financial theory that the longer the term of the contract the greater the risk premium that will be built into the price to account for future events.[67] In fact, long-term fixed price contracts require suppliers to assume a great deal of risk (such as market price risk, fuel price risk, and regulatory uncertainty) which must be reflected in supplier bid prices. The likelihood of future climate change legislation provides one example of such risk. It is likely that any future climate change legislation could impose additional costs on emissions from carbon-based power plants, and this regulatory uncertainty translates directly into costs that must be factored into bids for long-term contracts. Premiums built into a long-term fixed price contract may overcompensate for this uncertainty and lock customers into higher than necessary prices.

Finally, long-term contracts also require suppliers to factor higher capital costs into their bid prices. A supplier must have sufficient capital available in order to enter into a long-term contract, because the supplier must have sufficient liquidity to post collateral to its counterparties throughout the term of the contract. For example, if market prices rise above the fixed price under the contract the supplier must post collateral to the EDC. If market prices fall below the contract price, the supplier may be required to post collateral to its wholesale counterparties depending on the supplier's hedging arrangements. In either case, with a long-term contract, the potential mark to market exposure is greater and the capital that a supplier must have to support

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67 *Default Service Final Rulemaking Order* at 25.

the transaction is greater. Particularly in light of today's tight credit market, these costs can be substantial.

Unfortunately, there is simply no "magic formula" or percentages that can be offered to address question numbers 6 and 10. Rather, as explained above, the Commission needs to be mindful of the impact of various types of contracts in the default service plan and ensure that all of the procurement contracts for the entire plan as a whole will achieve the objectives of the Choice Act which, as explained in these comments, is to ensure that the default service plan promotes competition. In the transition period between the monopoly state where all the customers are receiving generation service from the EDC to the end state of the Choice Act where all the customers are receiving generation service from the competitive market, the "prudent mix" of supply contracts necessary to achieve the end goal will look differently for each service territory and, as discussed below in section number 3, for each customer class.

2. <u>Restrictions on a DSP's Procurement of the Contracts In Its Default Service Plan</u>

a. Question No. 7: Does a "prudent mix" mean that the contracts are diversified and accumulated over time?

b. Question No. 8: Should there be qualified parameters on the prudent mix? For instance, should the regulations preclude a DSP from entering into all of its long-term contracts in one year?

c. Question No. 9: Should the DSP be restricted to entering into a certain percentage of contracts per year?

RESA supports diversified contracts that are accumulated over time as long as the contracts are short-term. In other words, laddering long-term contracts does not make the resulting default service rate market-reflective. While it causes minor movements in the direction of the market, the laddered contracts will never be reflective of the true market price of electricity. Laddering will cause the default service rate to diverge significantly from the market price of electricity, because laddering averages "stale" prices with more contemporaneous prices.

As an example, if a DSP were to hold an auction for laddered contracts, it would procure all of its power needs for year one and part of its needs for years two and three. Assume the DSP is even able to procure power in increments equal to one-third of its load projections and, as result of the year one auction, the default service rate cleared at 10 cents per kWh. In the next year, if the market price goes up by 50%, competitive suppliers will be charging 15 cents per kWh. On the other hand, the DSP would only be charging 11.67 cents per kWh. Competitive suppliers cannot sustain themselves in this environment. If prices go down by 50%, competitive suppliers could sell for 5 cents and the default service rate would be above 8 cents. Despite all of the potential savings, or headroom, competitive suppliers will not enter the market because of the risk of being non-competitive for long periods of time.

3. Allocation of Supply From The Mix Of Contracts Among Rate Classes

a. Question No. 11: Should there be a requirement that some quantity of each rate class procurement group's load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely on only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP?

b. Question No. 13: Is the "prudent mix" standard a different standard for each different customer class?

In determining the "prudent mix" of contracts for each DSP, the Commission should refrain from trying to create a one size fits all approach as there is no magic definition of what would be a prudent mix for each rate class. In fact there are differences in rate classifications across the various service territories as well as other nuances that make creating upfront principles in this regard difficult, if not impossible.

The better approach, as described in the preceding sections, is to ensure that the default service plan reflects a mix of contracts designed to gradually transition toward a robust "end state" of retail competition. Further, the Commission should not confine itself to looking at each

class individually or, as discussed below in Section D, each specific procurement. Rather, the entire default service plan should be viewed holistically to ensure that all components of the plan, when viewed that way, comply with the requirements of the Choice Act.

C. Contingency Planning

a. Question No. 14: What will be the effects of bankruptcies of wholesale supplier to default service suppliers on the short and long term contracts?

RESA supports the inclusion of contingency provisions in the default service plan that set forth a process to address situations where the contracted wholesale supplier is unable to perform pursuant to the procurement contract. Currently effective contingency plans include procuring the lost supply from the spot market and/or scheduling another bid to provide the supply.

D. Role of Alternative Energy Portfolio Standards Credits

a. Question No. 16: How should the requirement that "this section shall apply" to the purchase of AECs be implemented? Section 2807(e)(3.5) states that " . . . the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc."

The Pennsylvania Alternative Energy Portfolio Standard (AEPS) requires that an annually increasing percentage of electricity sold to retail customers in Pennsylvania is from alternative energy sources and requires that retail energy suppliers to utilize Alternative Energy Credits (AECs) for demonstrating compliance with the standard.[68] Thus, in acquiring supply for the default service load, DSPs are required to ensure that some of the supply is provided by alternative energy sources. Regardless of the source of the supply procured by the EDC for default service, Section 2807(e)(3.5) makes clear that its procurement must be made in accordance with the Choice Act. As such, the contracts used to provide alternative energy must

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[68] 66 Pa. C.S. § 2806.1.

be in viewed as part of the default service plan and, therefore, how these contracts are structured should be taken into account in reviewing whether the entire default service plan is consistent with the Choice Act. In the *Default Service Rulemaking Order* the Commission concluded that "long-term contracts should primarily be used to meet the requirements of AEPS, and the supply needs of residential and small business customers in the early years of the post-transition period."[69] RESA supports this provision. Viewing the default service plan holistically, the use of long-term contracts to secure AEPS requirements may be appropriately viewed as providing the "long-term contracts" piece of the prudent mix requirement of the statute. Limiting long-term contracts to AEPS requirement can mitigate the anticompetitive impact of using non-market responsive, long-term contracts as part of the default service mix. If long-term contracts are utilized for AEPS requirements, RESA also urges the Commission to consider competitively neutral structures to ensure that the procurement of long-term contracts does not adversely impact the development of retail competition. One such structure is to permit the EDC to procure long-term renewable contracts, while assigning the Alternative Energy Credits to all load serving entities on a load ration share basis and recover the costs of the long-term procurements through nonbypassable charges. This approach essentially takes the long-term contract out of the default service price and helps keep EGSs on equal footing with the EDCs. It should be noted that EGSs do not have the same ability to enter into long-term contracts (for AECs or commodity supply) as the EDCs because EGSs do not have the default service customer base nor do EGSs have a statutory guarantee of cost recovery.

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69 *Act 129 Proposed Rulemaking Order* at 25.

IV. COMMENTS ON SPECIFIC CHANGES

A. Changes to the currently effective regulations

Generally, the Commission has proposed changes to its regulations which incorporate the specific language of Act 129.[70] With one clarifying revision and a few suggestions to be clear that the Choice Act requires default service plans that promote competition, RESA supports the substantial majority of the Commission's proposed revisions.

1. Section 54.184 (Default service provider obligations)

The Commission proposes to revise Section 54.184 of its regulations to incorporate the language from Section 2807(e)(1) of the Choice Act. More specifically, the Commission proposes the following:

> § 54.184. Default service provider obligations.
>
> (a) [A DSP]While an EDC collects either a competitive transition charge or an intangible transition charge or until 100% of an EDC's customers have electric choice, whichever is longer, an EDC as a default service provider shall be responsible for the reliable provision of default service to retail customers who are not receiving generation services from an alternative EGS within the certificated territory of the EDC that it serves or whose alternative EGS has failed to deliver electric energy.

RESA does not support this change and suggests that it either be deleted or clarified to acknowledge that other entities may be assigned the DSP role. Since Act 129 did not change or alter Section 2807(e)(1), there is no need to change this regulation in this rulemaking. Further, the Commission already considered and addressed Section 2807(e)(1) in its *Final Rulemaking Order* in response to IRRC's questioning of the decision to adopt Section 54.183 which assigned the role of DSP to the EDC but preserved the Commission's authority pursuant to Section

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[70] Id. at Annex A.

2802(16) of the Choice Act to select a non-EDC to fulfill the DSP function.[71] More specifically, the Commission defended its decision to designate each EDC as the *initial* DSP pursuant to 52 Pa. Code § 54.183 while also recognizing that there may be situations when the Commission may make a finding that other parties should be considered for that role.[72] Despite this, the Commission's proposed change Section 54.184 would assign to the EDC the DSP role without regard to the possibility that the Commission may choose to assign that role to another entity through the procedures provided in Section 54.183(b). Additionally, the proposed revision contemplates keeping the EDC in the role of the DSP until 100 percent customer migration is reached. If the Commission wishes to adopt a benchmark level of migration for determining when it may be appropriate to phase out default service or assign the default service obligation to another entity, RESA submits that the 100 percent migration level is unreasonable and not likely attainable. If the Commission is not inclined to delete this proposed change, then RESA suggests that the language be clarified as set forth below:

> § 54.184. Default service provider obligations.
>
> (a) [A DSP]<u>While an EDC collects either a competitive transition charge or an intangible transition charge or until</u> THE COMMISSION DETERMINES THAT IT IS NO LONGER NECESSARY TO HAVE A DEFAULT SERVICE OPTION, OR UNTIL THE COMMISSION DETERMINES THAT IT IS APPROPRIATE TO ASSIGN THE DEFAULT SERVICE OBLIGATION TO ANOTHER ENTITY ~~100% of an EDC's customers have electric choice,~~ <u>whichever is longer, an EDC as a default service provider</u> shall be responsible for the reliable provision of default service to retail customers who are not receiving generation services from an alternative EGS within the certificated territory of the EDC that it serves or whose alternative EGS has failed to deliver electric energy.

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71 *Default Service Final Rulemaking Order* at 11-14.

72 *Id.* at 12-13. The Commission specifically noted that it might make a finding that the EDC should no longer be the DSP if it can no longer provide default service in a safe and efficient manner, and/or in a way that reflects the incurrence of reasonable costs.

2. Section 54.185 (Default service programs and periods of service)

As discussed above, default service plans should be approved only upon finding that the plan: (1) is reasonably likely to promote sustainable retail market development by resulting in a market-reflective and market-responsive default service rate; and, (2) includes all the costs related to the provisioning of default service in the default service rate. If these two elements are present, then the default service plan will necessarily result in providing consumers the least cost over time because competition will develop. Therefore, RESA suggests the following additional language for newly proposed section 541.185(b):

> Section 54.185 (Default service programs and periods of service)
>
> . . .
>
> (b) The Commission shall hold hearings as necessary on the proposed plan TO ENSURE THAT THE PLAN IS REASONABLY LIKELY TO PROMOTE SUSTAINABLE RETAIL MARKET DEVELOPMENT BY RESULTING IN MARKET-REFLECTIVE AND MARKET-RESPONSIVE DEFAULT SERVICE RATES AND INCLUDING ALL THE COSTS OF PROVISIONING DEFAULT SERVICE IN THE DEFAULT SERVICE RATE. If the Commission fails to issue a final order on the plan within 9 months of the date that the plan is filed, the plan shall be deemed to be approved and the default service provider may implement the plan as filed. Costs incurred through an approved competitive procurement plan shall be deemed to be the least cost over time PROVIDED THAT CONSUMERS HAVE COMPETITIVE RETAIL ALTERNATIVES TO DEFAULT SERVICE.

3. Section 54.186 (Default service procurement and implementation plans)

Pursuant to Section 2807(e)(3.4)(iii) and 2807(e)(3.1), a DSP is required to procure electric power through competitive procurement processes which must take the form of an auction, request for proposal or a bilateral agreement. This is the standard that must be applied to all power that is used for default supply,[73] and it clearly requires that electric power used to

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[73] 66 Pa. C.S. § 2807(3.4)("The prudent mix of contracts entered into pursuant to paragraphs (3.2) and (3.3) shall be designed to ensure: (i) Adequate and reliable service. (ii) The least cost to

serve default customers must be procured through competitive procurement processes.[74] While bilateral contracts are permitted, they must still be the result of an open, transparent and competitive solicitation process to be consistent with the Choice Act. Thus, RESA suggests the below capitalized language be added to newly proposed Section 54.186(e) to be consistent with Section 2807(e)(3.1) and (e)(3.4)(iii):

> (e) At the time the Commission evaluates the plan and prior to its approval, in determining if the DSP's plan obtains generation supply at the least cost, the Commission shall consider the DSP's obligation to provide adequate and reliable service to customers and that the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission shall make specific findings which include the following:
>
> 1. The DSP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.
> 2. The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term, and spot market basis.
> 3. Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates federal law.

4. Section 54.188 (Commission review of default service programs and rates)

Consistent with the comments related to Section 54.186, RESA suggests the following changes to the new language proposed for Section 54.188(d):

> (d) [Upon receiving written notice, the Commission will have 1 business day, to approve or disapprove the results of a competitive bid solicitation process used by a DSP as part of its procurement plan. When the

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customers over time. **(iii) Compliance with the requirements of paragraph (3.1).**") (emphasis added). Subsection 2807(3.5) makes clear that these provisions "**shall apply to any type of energy purchased by a default service provider to provide electric generation supply service.**" 66 Pa. C.S. § 2807(3.5) (emphasis added).

74 This requirement of competitive procurement is echoed throughout other subsections as well. For example, Subsection 2807(3.7) requires the default service provider to take "prudent steps necessary to negotiate favorable generation supply contracts." 66 Pa. C.S. § 2807(3.7)(i).

Commission does not act within 1 business day the results of the process will be deemed approved. The Commission will not certify or otherwise approve or disapprove a DSP's spot market energy purchases made pursuant to a Commission-approved procurement plan. The Commission will monitor the DSP's adherence to the terms of the approved default service program and 66 Pa.C.S. §§ 2801—2812 (relating to the Electricity Generation Customer Choice and Competition Act).] The Commission may initiate an investigation regarding implementation of the DSP's default service program and, at the conclusion of the investigation, order remedies as may be lawful and appropriate. The Commission will not deny the DSP the recovery of its reasonable costs for purchases made pursuant to an approved competitive procurement process unless the DSP concealed or misled the Commission regarding its adherence to the program, or otherwise violated the provisions of this subchapter or the code. Except as provided under the act of November 30, 2004, (P.L. 1672, No. 213), known as the Alternative Energy Portfolio Standards Act, the Commission may not order a DSP to procure power from a specific generation supplier, from a specific generation fuel type or from new generation only. At the time the Commission evaluates the plan and prior to approval, the Commission shall consider the default service provider's obligation to provide adequate and reliable service to customers and that the DSP has obtained a prudent mix of contracts to obtain least cost on a long-term, short-term and spot market basis. The Commission shall make specific findings which include:

(1) The D~~P~~SP's plan includes prudent steps necessary to negotiate favorable generation supply contracts THROUGH A COMPETITIVE PROCUREMENT PROCESS.
(2) The DSP's plan includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis.
(3) Neither the DSP nor its affiliated interest has withheld from the market any generation supply in a manner that violates Federal law.

B. Changes to the Policy Statement

In its *Proposed Policy Statement*, the Commission generally proposes to conform the definitions of "bilateral contract," "default service," and contract terms to the definitions of Act 129.[75] RESA supports these changes. For all the reasons explained in these comments, Act 129 did not change the Commission's prior interpretation of the Choice Act and, therefore, the

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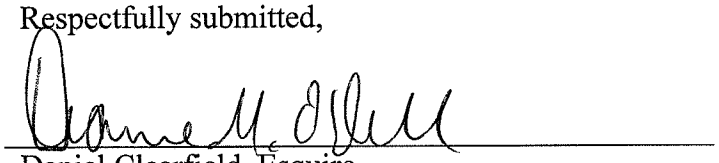
[75] *Act 129 Proposed Policy Statement* at Annex A.

guidance already provided by the currently effective policy statement is consistent with the law and does not need to be revised.

V. CONCLUSION

In conclusion, RESA respectfully suggests that the Commission keep its focus on the goal it is required to achieve – fostering the development of a robust competitive market so that consumers will receive the benefit of innovative products and services at the lowest price possible. By approving default service plans which stimulate competition, the Commission will be fostering this goal. Only default service plans which result in market-reflective and market-responsive default service rates and include all the costs of default service should be approved by the Commission. In determining whether the default service plan will achieve this result, the Commission should review each plan holistically and in consideration of the market in the EDC's service territory. RESA appreciates this opportunity to provide its viewpoint regarding this important proceeding and looks forward to continuing to assist the Commission with this very important process.

Respectfully submitted,



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