

COMMONWEALTH OF PENNSYLVANIA



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October 28, 2011

HAND DELIVERED

Rosemary Chaivetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Re: Investigation of Pennsylvania's Retail Electricity Market
Docket No. I-2011-2237952**

Dear Secretary Chaivetta:

In accordance with your Order entered on October 14, 2011, I am delivering for filing the original plus five copies of the Comments on the Tentative Order, on behalf of the Office of Small Business Advocate, in the above-captioned matter.

A copy of the comments has been served on the Office of Competitive Market Oversight via electronic mail. If you have any questions, please contact the OSBA office at (717) 783-2525.

Sincerely,

A handwritten signature in black ink that reads "William R. Lloyd, Jr." with a stylized flourish at the end.

William R. Lloyd, Jr.
Small Business Advocate
Attorney ID No. 16452

Enclosures

cc: Office of Competitive Market Oversight
ra-OCMO@state.pa.us

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Investigation of Pennsylvania's
Retail Electricity Market**

:
: **Docket No. I-2011-2237952**

**COMMENTS OF THE
OFFICE OF SMALL BUSINESS ADVOCATE
ON THE TENTATIVE ORDER**

I. Background

A. Procedural History

In approving the merger of FirstEnergy Corporation and Allegheny Energy Corporation, the Pennsylvania Public Utility Commission (“Commission”) stated its intention to initiate a statewide investigation “with the goal of making recommendations for improvements to ensure that a properly functioning and workable competitive retail electricity market exists in the state.”¹

By Order entered April 29, 2011, the Commission initiated the aforementioned investigation at Docket No. I-2011-2237952. In accordance with Ordering Paragraph No. 3, the Office of Small Business Advocate (“OSBA”) submitted comments on June 3, 2011.

On June 8, 2011, the Commission conducted an *en banc* hearing on the topics raised by the investigation. The OSBA presented testimony at that hearing.

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¹ See *Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company*, Docket Nos. A-2010-2176520 and A-2010-2176732 (Order entered March 8, 2011), at 46.

By Order entered July 28, 2011, the Commission initiated the second phase of its investigation. The OSBA participated in numerous working group sessions conducted by the Commission Staff and in numerous subgroup sessions of interested parties.

By Tentative Order entered October 14, 2011, the Commission issued recommendations regarding the next round of default service plans. In accordance with paragraph 2 of the Tentative Order, the OSBA submits the following comments.

The Commission's recommendations in the Tentative Order include a wide range of retail market modifications. Because of time limitations, the following comments address only some of those recommendations. The OSBA's failure to address a recommendation should not be interpreted as the OSBA's agreement with that recommendation or as a waiver of the OSBA's right to comment on that recommendation at a later stage of this generic proceeding or as part of future proceedings dealing with individual default service plans.

B. No Mandate To Increase Shopping

The Natural Gas Choice and Competition Act ("Gas Competition Act") places an express obligation on the Commission with regard to increased shopping by gas customers. Specifically, the Gas Competition Act provides as follows:

(g) Investigation and report to the General Assembly.—Five years after the effective date of this chapter, the commission shall initiate an investigation or other appropriate proceeding, in which all interested parties are invited to participate, to determine whether effective competition for natural gas supply services exists on the natural gas distribution companies' systems in this Commonwealth. The commission shall report its findings to the General Assembly. Should the commission conclude that effective competition does not exist, the commission shall reconvene the stakeholders in the natural gas industry in this Commonwealth to explore avenues, including legislative, for encouraging increased competition in this Commonwealth.²

² 66 Pa. C.S. §2204(g).

Despite this statutory directive, the Commission has not sought to jump start shopping by imposing aggregation programs on natural gas distribution companies (“NGDCs”). Instead, the Commission has looked to increase gas shopping by promulgating regulations and by approving shopping enhancements at the conclusion of contested, on-the-record proceedings.³

There is no express provision in the Electricity Generation Customer Choice and Competition Act (“Electric Competition Act”) that imposes a comparable obligation on the Commission with regard to electric shopping.⁴ Nevertheless, the Commission’s recommendations in the Tentative Order appear to be “presumptions” in favor of specific retail market modifications designed to increase shopping without an evidentiary record to support those “presumptions.” In addition, several of those “presumptions” conflict with the Electric Competition Act and with the Commission’s recently approved default service regulations and policy statement.

II. Opt-In Auction

A. Summary

Among other things, the Commission’s July 28, 2011, Order provided as follows:⁵

With regard to intermediate steps, OCMA [Office of Competitive Markets Oversight] is directed, without limitation, to examine the following areas:

* * *

5. Annual auction of customers on an opt-in basis;

³ See, e.g., *Natural Gas Distribution Companies and the Promotion of Competitive Retail Markets*, Docket No. L-2008-2069114; and *Petition of PECO Energy Company for Approval of its Natural Gas Supplier Purchase of Receivables Program*, Docket No. P-2009-2143588 (Order entered November 8, 2010).

⁴ See 66 Pa. C.S. Ch. 28.

⁵ See *Investigation of Pennsylvania’s Retail Electricity Market*, Docket No. I-2011-2237952 (Order entered July 28, 2011), at 10-11.

* * *

The Tentative Order recommends that each electric distribution company (“EDC”) incorporate a retail “opt-in auction” into its default service plan for the two-year period beginning June 1, 2013. The Tentative Order further recommends that the EDCs use, as a starting point, the opt-in auction proposal developed as part of the retail markets investigation.⁶ Although numerous parties participated in shaping this proposal, the principal advocates are Direct Energy Services (“Direct”) and the Retail Energy Supply Association (“RESA”).⁷

Under the proposal (as it stood when the Commission entered the Tentative Order), a small commercial and industrial (“Small C&I”) customer could voluntarily choose to leave default service and be randomly assigned to an electric generation supplier (“EGS”) as part of an aggregation of Small C&I customers. The customer would receive a pre-established one-time “signing bonus” (if the customer remained with the EGS for at least three months), and would pay a generation rate based on a market clearing price for the opt-in customer group. At the end of the first year, the customer would remain with the EGS to which it had been randomly assigned unless the customer acted affirmatively to switch to a different EGS or to return to default service. If the customer remained with the EGS to which it had been randomly assigned, the future terms and conditions of service would be at the discretion of the EGS.

Because of its impact on default service rates, it would be unlawful for the Commission to approve the opt-in auction proposal for Small C&I customers.⁸

⁶ Tentative Order, at 5-6.

⁷ See, e.g., *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. 1-2011-2237952, Direct Comments (June 3, 2011), at 2-3 and 57-58 and RESA Comments (June 3, 2011), at 19-21.

⁸ In addition to being unlawful, the opt-in auction proposal pending before the Commission is not consistent with the Commission’s July 28, 2011, Order. That Order requires an examination of an *annual* opt-in auction rather than the *one-time* opt-in auction offered by RESA and Direct. The one-time opt-in auction proposal would result in less competition after May 31, 2014, than would the annual opt-in auction contemplated by the Commission’s Order.

B. Impact on Default Service

1. Legal Requirements

As originally enacted, the Electric Competition Act required that the default service provider (“DSP”) acquire electricity for default service customers at “prevailing market prices.”⁹ Act 129 of 2008 repealed that requirement.¹⁰ In place of the “prevailing market prices” requirement, Act 129 specifies that the DSP is to acquire electricity for default service customers through a “prudent mix of contracts . . . designed to ensure . . . [t]he least cost to customers over time.”¹¹

Since the enactment of the Electric Competition Act, EGSs have generally argued that the “end state” intended by the General Assembly is the development of a robust retail market in which most customers shop for electricity from an EGS instead of relying on the DSP to acquire that electricity.¹² To bolster that argument, EGSs traditionally pointed to the “prevailing market prices” requirement and to the legislative declaration that “[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity.”¹³ In fact, EGSs often relied upon the “prevailing market prices” standard to argue for “ugly” default

⁹ See 66 Pa. C.S. §2807(e)(3)(repealed).

¹⁰ See Section 3 of the act of October 15, 2008 (P.L. 1592, No. 129).

¹¹ See, e.g., 66 Pa. C.S. §2807(e)(3.4).

¹² See, e.g., *Implementation of Act 129 of October 15, 2008: Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 34-35 and 36-37. See also *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, Direct Comments (June 3, 2011), at 12-14, 54, and 65 and RESA Comments (June 3, 2011), at 1-2.

¹³ See 66 Pa. C.S. §2802(5). See also, e.g., *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, Direct Comments (June 3, 2011), at 12.

service rates (*i.e.*, rates linked primarily to spot market prices or short-term contracts and, therefore, subject to frequent change as market conditions change).¹⁴

The OSBA never embraced the EGSs' claim about the legislative intent underlying the Electric Competition Act. However, regardless of what might have been intended in 1996, the General Assembly's replacement of the "prevailing market prices" requirement with the "least cost to customers over time" requirement in 2008 evidences a legislative intent to emphasize the achievement of low default service rates over the achievement of a high rate of shopping. Moreover, by expressly requiring the DSP to "offer residential and small business customers a generation supply service rate that shall change no more frequently than on a quarterly basis," the legislature rejected the notion that default service rates should be unstable and should reflect only near-term market conditions.¹⁵

As further evidence of the legislative intent to give low and more stable default service rates priority over shopping, Act 129 expressly authorizes the use of long-term contracts, *i.e.*, contracts of "more than four years and not more than 20 years."¹⁶ Had the General Assembly

¹⁴ See, e.g., *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 41.

¹⁵ See 66 Pa. C.S. §2807(e)(7). See also, the uncodified preamble to Act 129, which provides as follows:

The General Assembly recognizes the following public policy findings and declares that the following objectives of the Commonwealth are served by this act:

(1) The health, safety and prosperity of all citizens of this Commonwealth are inherently dependent upon the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, *taking into account any benefits of price stability*, over time and the impact on the environment.

(2) It is in the public interest to adopt energy efficiency and conservation measures and to *implement energy procurement requirements designed to ensure that electricity obtained reduces the possibility of electric price instability*, promotes economic growth and ensures affordable and available electric service to all residents.

(3) It is in the public interest to expand the use of alternative energy and to explore the feasibility of new sources of alternative energy to provide electric generation in this Commonwealth. (emphasis added)

¹⁶ See 66 Pa. C.S. §2807(e)(3.2)(iii).

intended that most or all customers shop for electricity, it would not have authorized the use of long-term contracts because such contracts would be both unnecessary and imprudent.

Without abandoning its commitment to retail competition, the Commission has recognized the shift required by the repeal of the “prevailing market prices” standard. For example, in its recent rulemaking to implement Act 129, the Commission stated as follows:

We note with interest RESA’s extensive comments on this question [‘What is meant by ‘least cost to customers over time?’] We disagree with RESA’s overall recommendations as to the proper interpretation of the ‘least cost’ standard as mandating that default service rates approximate, on a prospective basis, the market price of energy. Such an interpretation would signal retention of the ‘prevailing market price’ standard that has been expressly replaced under Act 129. Moreover, this interpretation conflicts with the Act 129 objective of achieving price stability which dictates consideration of a range of energy products, not just those that necessarily reflect the market price of electricity at a given point in time. Price stability benefits are very important to some customer groups in that exposing them to significant price volatility through general reliance on short term pricing would be inconsistent with Act 129 objectives. We also reject for the same reasons, a recommendation by NEMA [National Energy Marketers Association] for use of a ‘monthly-adjusted, market-based commodity rate for small commercial and residential customers’ as inconsistent with the ‘least cost’ requirement under Act 129.

We also disagree with RESA’s assertion that default service plans are to be structured to promote retail competition to achieve an end-state goal where customers receive no generation service from default suppliers. As PECO noted, this is a misreading of the relevant statutes. The Competition Act, as modified by Act 129, envisioned a continuing role for DSPs to regularly propose procurement plans for Commission review. The requirement to follow a least cost procurement standard does not diminish the Commission’s commitment to retail competition including a continuing role for DSPs, which may be either an EDC or an alternative Commission-approved DSP.

* * *

Finally, we disagree with RESA’s assertion that the ‘least cost’ standard mandates that a default service plan be reasonably likely to result in a ‘market-reflective and market-responsive’ service rate that recovers all costs related to providing default service. We interpret

this standard, not contained in either the Competition Act or Act 129, to mean a preference for short term and spot price supplies which ignore both the Act 129 concerns of price stability and a 'prudent mix' of products. We do not believe that adoption of RESA's suggested standard is consistent with the 'least cost' standard contained in Act 129 and would not adequately protect retail customers from volatility and risks inherent in the energy market. Price stability benefits are very important to some customer groups, so an interpretation of 'least cost' that mandates subjecting all default service customers to significant price volatility through general reliance on short term pricing is inconsistent with Act 129's objectives. This is especially true given that the statute specifically enumerates short-term (up to 4 years) and long-term (over 4 to 20 years) contracts as part of the 'prudent mix' of contracts that should be included in a default service plan. 66 Pa. C.S. §2807(e)(3.2).¹⁷

In view of Act 129 and the Commission's recent default service rulemaking Order, any retail market modifications that would prevent default service rates from being the "least cost to customers over time" or that would make default service rates more volatile than intended under Act 129 would be unlawful.

2. Flaws in Opt-In Auction Proposal

a. Inflated Default Service Rates

Each of the major EDCs has been relying primarily on full-requirements contracts to provide default service to Small C&I customers.¹⁸ The Commission has expressly held that the use of such contracts complies with the Electric Competition Act and is the Commission's

¹⁷ *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 39-41.

¹⁸ *See, e.g., Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 48-51 and 54. *See also Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, RESA Comments (June 3, 2011), at 10.

preferred procurement methodology.¹⁹

To avoid price spikes (such as Pike County Light & Power Company experienced when it purchased all of its default service supply shortly after Hurricane Katrina), the Commission requires the DSP to conduct “a minimum of two competitive bid solicitations a year” for service to Small C&I customers.²⁰

For several reasons, the opt-in auction proposal would create substantial uncertainty about the size and the profile of the Small C&I default service load that wholesale suppliers would be bidding to serve through a full-requirements contract.

First, the aggregation program created by the opt-in auction proposal would deliver electricity for the period of June 1, 2013, through May 31, 2014. That delivery period would coincide with the first year of the new, two-year default service plans. As contemplated by

¹⁹ See, e.g., *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 38, 39, and 54-56; and *Petition of Pennsylvania Power Company for Approval of Interim Default Service Supply Plan: Supply Procurement for Residential Customers*, Docket No. P-00072305 (Order entered March 13, 2008), at 13. As summarized by the Commission, RESA explained the characteristics of full-requirements contracts as follows:

Under the FR [full-requirements] approach, the wholesale supplier bears the risk of customer migration, weather, load variation and economic activity and factors the costs of these risks into a risk premium. If the risk premium is not sufficient to cover ultimate cost, the supplier cannot seek additional cost recovery from the customer or the DSP.

Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 50-51.

The Commission offered a similar explanation, as follows:

The FR process insulates default supply customers from the volatility associated with wholesale market conditions with the supplier bearing the risks of factors such as customer migration, weather, load variation and economic activity. For assuming these risks and performing the portfolio manager function, the supplier charges a risk premium (or profit) that is factored into the winning bids and paid for by default service customers.

Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 54.

²⁰ See 52 Pa. Code §69.1805(1) and (2). See also *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 61-63; and *Petition of the 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-00072342 (Order entered July 25, 2008), at 32-38.

Direct and RESA, customers would not sign up for the opt-in auction until the period of March-May 2013. Therefore, in order to avoid conducting all solicitations for the initial default service delivery period (*i.e.*, the period, regardless of length, that begins on June 1, 2013) during the same potential price spike, the DSP would be required to hold at least one default service procurement prior to the deadline for Small C&I customers to choose to participate in the opt-in auction.

Second, Small C&I customers that participate in the opt-in auction would be permitted to return to default service at any time during the first year of the aggregation (*i.e.*, at any time from June 1, 2013, through May 31, 2014). Significantly, they could do so after three months (*i.e.*, at any time after August 31, 2013) without forfeiting the \$100 signing bonus.

Third, Small C&I customers that participate in the opt-in auction would be permitted to return to default service at the end of the one-year aggregation (*i.e.*, to return effective with the default service delivery period beginning June 1, 2014). Customers' decisions to return to default service could (and probably would) occur *after* the bidding on at least some of the full-requirements contracts for the default service delivery period beginning June 1, 2014.

Because of the uncertainty about the ultimate size and profile of the load, wholesale suppliers would likely include a significant migration risk premium in their bids on full-requirements contracts, both for the year in which the opt-in aggregation would be in effect and for the first year thereafter. This risk premium would inflate default service rates, thereby preventing the DSP from meeting its obligation under Act 129 to "ensure least cost to customers over time."

The DSP could attempt to avoid, or mitigate, this risk premium by relying on spot market purchases, on purchases through shorter-term full-requirements contracts (*e.g.*, three-month

contracts), or both. However, although reliance on a short-term procurement approach might avoid, or mitigate, the migration risk premium, such reliance would make default service rates more volatile and more vulnerable to short-term price spikes than contemplated by Act 129.²¹

b. No Evidentiary Record

By recommending that the DSPs include an opt-in auction proposal in their new default service plans, the Commission has, at a minimum, created a presumption in favor of an opt-in auction and has done so without an evidentiary record.

Direct and RESA have challenged the OSBA's assumption that the opt-in auction would materially increase the migration risk premium in full-requirements contracts.

First, Direct has contended that the risk premium is a function of many factors and that migration risk is not necessarily the dominant one. However, that argument misses the point. The question is not the extent to which each factor influences the risk premium. Rather, the question is whether the migration risk caused by the opt-in auction would make the risk premium higher than it would be, but for the opt-in auction.

Second, RESA has argued that any increase in the risk premium because of the opt-in auction would not be materially different from the increase in the risk premium caused by approval of the other retail market enhancements the Commission is considering. RESA's argument ignores the fundamental differences between the opt-in auction and the other retail market modifications being contemplated. The other modifications are essentially variations on existing policies, which may result in modest and gradual shifts toward increased shopping over time. In contrast, the opt-in auction would provide customers a \$100 signing bonus under a

²¹ The Commission has expressly stated that "subjecting all default service customers to significant price volatility through general reliance on short term pricing is inconsistent with Act 129's objectives." *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. I-2009-2095604 (Order entered October 4, 2011), at 41.

Commission-sponsored program, as of a specific date. As explained above, that date is likely to occur after at least one default service procurement for the delivery period beginning June 1, 2013. Therefore, it is reasonable to infer both that the opt-in auction would be considerably more effective in increasing shopping than the other modifications would be, and that the impact would be much more concentrated. If those inferences are incorrect, then there is no apparent reason for the Commission to consider an opt-in auction.

The challenge by Direct and RESA to the magnitude of the risk premium highlights the problem with establishing a presumption in favor of the opt-in auction without an evidentiary record. Specifically, their challenge underscores the need for an evidentiary proceeding in which experts could testify, and could be cross-examined, on the impact of the proposal on default service rates.

c. Inconsistent with Evidentiary Proceedings

Significantly, the OSBA's assumption about the negative impact of the opt-in auction proposal on default service rates is comparable to the views expressed by several witnesses in evidentiary proceedings before the Commission. For example, in the West Penn merger proceeding (which spawned the current investigation), Constellation witness David Fein testified as follows:

Wholesale suppliers bidding to serve an EDC's Default Service supply requirements under such a DSP [default service plan] understand, accept and account for the fact that the EDC's load will change as customers *at their own election* choose to *leave* Default Service for competitive retail supply from an EGS, and that such individual customers may at some point in time *return* to Default Service.

Municipal Opt-Out Aggregation, however, fundamentally changes the patterns and ways in which customers both leave and return to Default Service. If it seems that

Municipal Opt-Out Aggregation policies are likely to be implemented in the near term, bidders in procurements under DSPs already approved by the Commission will recognize and account for the significant load variability differences that Municipal Opt-Out Aggregation programs present with respect to serving a portion of an EDC's Default Service supply requirements. In order to address such differences, wholesale suppliers may either limit their participation in Default Service procurements or else account for the increased risk of large-scale declining and returning load under Municipal Opt-Out Aggregation through additional premiums in their bids. Reduced participation and/or additional premiums will lead only to *less* competitive Default Service procurements with *less* competitive Default Service bids, to the *detriment* of utilities' Default Service consumers. Higher Default Service prices will be paid by *all* customers who remain on Default Service, even though all municipalities may not have implemented or do not plan to implement Municipal Opt-Out Aggregation programs.

In summary, the implementation of Municipal Opt-Out Aggregation represents a new 'default' product for *certain* municipalities' customers that will *increase* the costs of EDCs' statutorily-mandated Default Service product for *all* customers. Potential wide and growing disparities between customers, *including* between municipalities, that may result from Municipal Opt-Out Aggregation would be harmful to the Commission's [sic] energy future.²²

Similarly, both OSBA witness Robert D. Knecht and Constellation witness Michael Schnitzer testified in West Penn's last default service proceeding that a retail aggregation proposal by Direct witness Frank Lacey would increase migration risk and that this increased switching risk would increase the price of full-requirements contracts and the default service

²² See *Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company*, Docket Nos. A-2010-2176520 and A-2010-2176732 (Order entered March 8, 2011), Constellation Statement No. 1-SR, at 10-11 (emphasis in original).

rates derived from those contracts. Specifically, in responding to the aggregation proposal by Mr. Lacey, Mr. Knecht testified, as follows:

[I]f the Commission were to adopt Mr. Lacey's proposal, or if it were even to suggest that it would consider such a proposal in a future proceeding, wholesale suppliers would recognize that shopping risk had increased. This increase in risk would likely lead to higher risk premiums being built into full requirements contract prices, reduced participation by suppliers in wholesale auctions, or both.²³

In response to Mr. Lacey's aggregation proposal, Mr. Schnitzer testified, as follows:

The problem with introducing aggregation in this fashion is that it materially increases the price for full requirements service for Default Service customers, because it would increase the switching risk to which full requirements suppliers are exposed. This additional switching risk would be factored into the price offered by suppliers. . . . At a minimum, this risk would translate to higher Default Service prices. At the extreme, an opt-out aggregation option could result in a failed Default Service procurement.²⁴

Admittedly, Mr. Fein was analyzing the risk premium in relation to an opt-out auction (*i.e.*, municipal aggregation) rather than in relation to an opt-in auction.²⁵ Similarly, Direct's aggregation proposal analyzed by Mr. Knecht and Mr. Schnitzer (in the West Penn default service proceeding) differed in detail from the opt-in auction advocated by Direct and RESA in this proceeding. However, the \$100 signing bonus is likely to result in a level of participation in the proposed opt-in auction that would be more comparable to the level of participation in an

²³ See *Petition of the 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-00072342 (Order entered July 25, 2008), OSBA Statement No. 2, at 28. See Mr. Lacey's proposal at Direct Energy Statement No. 1, at 19-20.

²⁴ See *Petition of the 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-00072342 (Order entered July 25, 2008), Constellation Statement No. 2R, at 22-23.

²⁵ See also the testimony of the following parties before the House Consumer Affairs Committee regarding the impact on default service rates of migration risk under municipal aggregation: Marjorie R. Philips, PSEG Power LLC and PSEG Energy Resources & Trade LLC, at 2-4; William B. Berg, Exelon Generation Company, at 2-3; and Brian Crowe, PECO, at 2-3.

opt-out auction than to the level of participation in an opt-in auction without a signing bonus. Furthermore, the *uncertainty* associated with the level of participation in the opt-in auction may be even higher than the uncertainty associated with opt-out aggregation plans, leading to an even higher risk to bidders on full-requirements contracts.

d. Inconsistent with Orders and Statutes

The Commission's presumption in favor of an opt-in auction is inconsistent with the Commission's own conclusion that the "robust level of shopping by medium commercial and industrial customers may result in a higher risk premium being priced into default service, which would be passed onto small commercial and industrial customers."²⁶ If migration risk (attributable to customers with maximum peak loads greater than 100 kW) can inflate default service rates for customers with maximum peak loads of 100 kW or lower, then migration risk can inflate default service rates for the customers that do not choose to participate in the opt-in auction.

In addition, the creation of this presumption is inconsistent with the Commission's own statement (in the default service rulemaking) that "[w]e also disagree with RESA's assertion that default service plans are to be structured to promote retail competition to achieve an end-state goal where customers receive no generation service from default suppliers."²⁷

Finally, the creation of a presumption in favor of an opt-in auction as part of new default service plans conflicts with the requirement that the Commission make a specific finding (based

²⁶ Tentative Order, at 8.

²⁷ See *Implementation of Act 129 of October 15, 2008; Default Service and Retail Electric Markets*, Docket No. 1-2009-2095604 (Order entered October 4, 2011), at 40.

on an evidentiary record) that each individual DSP’s plan “includes prudent steps necessary to obtain least cost generation supply contracts.”²⁸

C. Impact on Customer Choice

1. Summary

Rather than stating a goal of achieving the highest possible level of shopping, the Electric Competition Act expressly provides only that “all customers . . . shall have the *opportunity* to purchase electricity from their choice of electric generation suppliers.”²⁹ In addition, the Act expressly provides that customers are entitled to receive default service if they “do not choose an alternative electric generation supplier.”³⁰ In short, a customer is to receive default service if the customer affirmatively chooses not to shop or if the customer simply takes no action whatsoever. Furthermore, once a customer does affirmatively decide to shop, “[t]he ultimate choice of the electric generation supplier is to rest with the consumer.”³¹

Contrary to the Electric Competition Act, the opt-in auction proposal would give one EGS an advantage over other EGSs in winning the competition to serve a Small C&I customer in the second year (*i.e.*, the period from June 1, 2014, through May 31, 2015). Also contrary to the Electric Competition Act, the proposal would deprive a Small C&I customer of the ability to receive default service in the second year by “doing nothing.”

2. Deprived of Real Choice

Each Small C&I customer participating in the opt-in auction would be randomly assigned to an EGS for the first year (*i.e.*, the period from June 1, 2013, through May 31, 2014). The

²⁸ See 66 Pa. C.S. §2807(e)(3.7)(ii).

²⁹ See 66 Pa. C.S. §2806(a) (emphasis added).

³⁰ See the definition of “Default service provider” in 66 Pa. C.S. §2803.

³¹ See 66 Pa. C.S. §2806(a).

impact of random assignment would be mitigated in the first year by the fact that all participating EGSs would charge the same rate to all participating Small C&I customers (in the same EDC service territory) and would pay those customers the same “signing bonus.” However, beginning with the second year (*i.e.*, the period from June 1, 2014, through May 31, 2015), each EGS would be free to set its own terms and conditions of service. As a result, similar Small C&I customers could be charged significantly different rates, depending on the business plans of the EGSs to which they had been randomly assigned for the first year. A Small C&I customer would have to “opt out” of continued service from the EGS to which it was randomly assigned for the first year, *i.e.*, the customer would have to take affirmative action to receive service from a different EGS or to return to default service.

In theory, each Small C&I customer (including one with an unattractive load profile, *e.g.*, a customer with a low load factor or with a “peakier” consumption pattern than the average customer in the same procurement group) would receive offers from other EGSs to help the customer evaluate whether to remain with the randomly-assigned EGS, move to a different EGS, or return to default service. However, there is no evidentiary record to support a Commission finding that such a Small C&I customer would actually have competitive alternatives for the second year. For example, one purported “justification” for the opt-in auction proposal is that it is too costly for EGSs to attract Small C&I customers through mass marketing or through individual customer contacts.³² If such marketing actually is too costly, there is no basis for concluding that an EGS would market to a Small C&I customer of another EGS for service in the second year or subsequent years.

³² See, *e.g.*, *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, Direct Comments (June 3, 2011), at 23 and RESA Comments (June 3, 2011), at 12.

In addition to marketing costs, EGSs frequently argue that “status quo bias” favors continuing on default service and makes it difficult for an EGS to convince Small C&I customers to shop, even when the EGS offers a lower rate than available on default service.³³ Ironically, under the opt-in auction proposal, the EGS to which a Small C&I customer had been randomly assigned for the first year would benefit from “status quo bias” in the second year (and subsequent years) even if another EGS were to offer a better deal.³⁴

The opt-in auction proposal advocated by Direct and RESA in this proceeding is a *one-time* auction rather than the *annual* auction contemplated in the Commission’s July 28, 2011, Order.³⁵ Although the OSBA opposes an *annual* auction because it would probably end the use of full-requirements contracts for default service, the OSBA acknowledges that an *annual* auction would avoid “status quo bias” on and after June 1, 2014, by providing customers with a competitively-procured option each year.³⁶

In effect, an *annual* opt-in auction would be the retail equivalent of the wholesale procurement régime embodied in the current default service plans. Under the existing default service plans, wholesale suppliers enter into contracts of limited durations to provide full-requirements service. To retain their share of the default service load at the end of the term of

³³ See Docket No. I-2011-2237952 (Order entered July 28, 2011), at 6.

³⁴ Michael Schnitzer, testifying for FirstEnergy in the West Penn merger proceeding, made that point in responding to Direct’s opt-out auction proposal. See *Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company and Trans-Allegheny Interstate Line Company*, Docket Nos. A-2010-2176520 and A-2010-2176732 (Order entered March 8, 2011), Joint Applicants Statement No. 9-R, at 31-32. See also *Investigation of Pennsylvania’s Retail Electricity Market*, Docket No. I-2011-2237952, RESA Comments (June 3, 2011), at 8-10.

³⁵ See Docket No. I-2011-2237952 (Order entered July 28, 2011), at 10-11.

³⁶ The Commission presumably specified that the parties were to examine an *annual* opt-in auction because the Commission was aware that customer inertia might not result in robust competition after the year for which a *one-time* auction was conducted. In contrast, an *annual* auction would subject the incumbent EGSs to competition at the end of each one-year period.

their contracts, the wholesale suppliers must compete on price in the procurements for subsequent delivery periods. Even if a customer does not shop, that customer benefits from the wholesale competition. Similarly, under an *annual* opt-in auction, customers would benefit from regular competition among EGSs. In contrast, under the *one-time* auction advocated by Direct and RESA, an EGS would be able to retain customers through inertia. In fact, a *one-time* auction could become a mechanism by which EGSs divide up the shopping customers among themselves, thereby reducing competition rather than increasing it.

Furthermore, an *annual* opt-in auction would better meet the Commission's goal of "instill[ing] peace of mind for customers through potential standard offer requirements" than would the proposal advocated by Direct and RESA.³⁷

3. Deprived of "Least Cost" Default Service

If a Small C&I customer had no competitive alternative in the second year to continued service from the EGS to which it had been randomly assigned for the first year, the opt-in auction proposal would not automatically return that customer to default service for the second year. Rather, the customer would need to take affirmative action in order to receive the default service Act 129 entitles the customer to receive by doing nothing.

Furthermore, because of the negative impact the proposal would have on default service rates, returning to default service in the second year would likely be unattractive. Specifically, just as they would not know the size and shape of the load that they were bidding to serve under a full-requirements contract for the first year, wholesale suppliers would not know the size and shape of the load that would be returning to default service for the second year. Therefore, wholesale suppliers would once again include a significant migration risk premium in their bids on a full-requirements contract. If the DSP sought to protect default service customers from that

³⁷ See Tentative Order, at 5.

risk premium by relying on the spot market and short-term contracts, the result would be more volatile default service rates than intended by Act 129.

D. Procedural Flaws

1. No Regulatory Review

The Commission's failure to subject the opt-in auction proposal to the regulatory process has deprived the parties of the opportunity for review by the Independent Regulatory Review Commission and the legislative standing committees. That failure is especially significant because there is *at least* a "good faith" question whether the proposal is consistent with Act 129 and with the Commission's own default service regulations and policy statement.

2. No Evidentiary Record

The OSBA, Direct, and RESA disagree about the impact the opt-in auction proposal would have on default service rates. However, the Commission has created a presumption in favor of the proposal without providing an opportunity for the parties to develop an evidentiary record on that issue. As a result, there is no basis for a Commission finding that DSPs would be able to comply with Act 129 by offering default service at "the least cost to customers over time" if the opt-in auction proposal were implemented.³⁸

Similarly, there is no evidentiary record to support a Commission finding that there would be competitive alternatives to the rates charged to Small C&I customers in the second year (*i.e.*, from June 1, 2014, through May 31, 2015) by the EGSs to which they were randomly assigned for the first year (*i.e.*, from June 1, 2013, through May 31, 2014). Without competitive

³⁸ *The creation of this presumption is even more problematic because, on the day the Tentative Order was entered, the Commission was not certain of the details of the opt-in auction on which it was basing its presumption. See Tentative Order, at 5-6, which states that "the Commission recommends that EDCs use, as a starting point for prospective opt-in auctions, the format being discussed by a stakeholder sub-group in this Investigation when it is finalized."*

alternatives and without reasonably-priced default service, their EGSs could impose excessive rates on Small C&I customers in the second year and thereafter.

In the absence of evidence supporting these necessary findings, approval of the opt-in auction proposal would be unlawful.

3. No Need for the Opt-In Auction

a. Conclusion Based on Residential Shopping

The creation of a presumption in favor of an opt-in auction is particularly unwarranted for Small C&I customers. In its July 28, 2011, Order at this docket number, the Commission concluded as follows:

Based on shopping statistics alone, consumers are not moving into the retail market place at a rate that we would expect in a well functioning market. The current shopping rate in Pennsylvania is approximately 22% as shown on the Commission's Power Switch website on July 20, 2011. This is despite the fact that in several service territories, competitive offers with substantial savings over default service are available.³⁹

The shopping statistics on which the Commission relied were for residential customers and not for Small C&I customers. Therefore, the Commission's conclusion that shopping is inadequate and needs to be "jump-started" overlooks the fact that about 56% of the Small C&I load is already being served by EGSs. That is about 2½ times the percentage of the residential load being served by EGSs.⁴⁰

³⁹ Docket No. I-2011-2237952 (Order entered July 28, 2011), at 6.

⁴⁰ See the Commission's PA PowerSwitch Update. For default service procurement purposes, small business customers are usually grouped into one or more procurement groups. Depending upon the DSP, small business customers are labeled as "Commercial" customers, Small C&I customers, or Medium C&I customers. It appears that PA PowerSwitch includes all "Commercial," "Small C&I," and "Medium C&I" customers in the "Commercial" shopping statistics and includes none of them in the "Industrial" shopping statistics.

In view of the foregoing, even if the Commission decides that some version of the opt-in auction proposal is necessary and appropriate for residential customers, there is no basis for concluding that the proposal is necessary and appropriate for Small C&I customers.

b. Existing Small C&I Shopping

The implicit assumptions underlying the opt-in auction proposal are that it is too costly for EGSs to attract smaller customers through mass marketing and through one-to-one selling and that these smaller customers require an extra incentive to shop (e.g., a \$100 signing bonus). Those assumptions are inconsistent with shopping statistics provided to the opt-in auction subgroup by PECO and PPL.

Specifically, PECO reported that 37% of its smallest Small C&I customers, *i.e.*, those with maximum peak loads of 0-25 kW, are shopping. Similarly, PPL reported that 33% of its Small C&I customers with maximum peak loads of 0-25 kW and 67% of its Small C&I customers with maximum peak loads of 25-300 kW are shopping.

The PECO and PPL statistics show that the business plans of some EGSs are already succeeding. EGSs which are not successfully marketing to the smallest Small C&I customers should adopt the marketing approaches that are working, instead of jeopardizing default service through an opt-in auction with a \$100 signing bonus.

III. Referral Program

The Tentative Order appears to provide DSPs with substantial latitude in designing customer referral programs in their new default service plans.⁴¹ Conceptually, the OSBA does

⁴¹ Tentative Order, at 7.

not object to customer referral programs. However, the OSBA is opposed to a referral program similar to the one proposed by the Commission Staff.⁴²

The Commission Staff's proposal would require those EGSs participating in the referral program to offer all customers referred to them a discount of 7% for an introductory period of two months. After the introductory period, each EGS would be permitted to set its own rates. Nothing in the Staff proposal would prohibit an EGS from setting rates that are higher than the default service rate. Furthermore, if customers were initially referred to EGSs on a random basis, some customers would receive a better post-introductory rate than other customers simply because of the EGSs to which they had been arbitrarily referred.

Inertia will often keep a customer from shopping for a better deal unless the EGS's rates spike, thereby causing the customer to inquire into those rates. As evidence of that point, the OSBA received numerous complaints about excessive prices from Small C&I customers that were assigned to EGSs under PECO's Market Share Threshold ("MST") program during the rate cap period. Although these customers initially saved money, they were not aware of, or did not understand, the parameters within which their EGSs could set prices after the guaranteed rate reduction transition period. At the time they complained to the OSBA, these customers were still shopping, even though they would have paid significantly lower rates under PECO's capped rates than they were paying to their EGSs.

The customer referral program proposed by the Commission Staff would invite the same type of problems Small C&I customers had under the PECO MST program. By allowing an EGS to offer a discount for only two months and then to set a rate which could be above the default service rate, the Commission would essentially be inviting the EGS to use "bait and

⁴² See *Retail Markets Working Group*, Docket No. M-00072009, Proposed Guidelines for EGS Referral Programs (circulated by Commission Staff e-mail on January 5, 2010).

switch” tactics. Customers would not benefit from such tactics. Therefore, the Commission should not permit an EGS to offer a discount for only the first two months and to retain the customer on an opt-out basis unless the EGS agrees to charge the customer no more than the default service rate after the introductory period.

IV. Time of Use Rates

The Tentative Order recommends that each DSP consider contracting to have an EGS provide time of use (“TOU”) rates for the DSP. According to the Tentative Order, such an approach could help avoid the problems experienced with PPL’s TOU rates.⁴³

Rather than focusing solely on the recommendation that DSPs contract with EGSs, the OSBA suggests that the DSPs also consider complying with their statutory obligation by offering Small C&I customers hourly pricing on an *optional* basis.

V. Hourly-Priced Default Service for Medium Commercial and Industrial Customers

The Tentative Order creates a presumption that mandatory hourly pricing should be extended to all non-residential customers that have maximum peak loads greater than 100 kW but are not already subject to hourly-priced default service. According to the Commission, this extension of mandatory hourly pricing is necessary to protect smaller non-residential customers (*i.e.*, those with maximum peak loads of 100 kW or lower) from inflated default service rates. Such inflated default service rates could occur because of the migration risk that wholesale

⁴³ Tentative Order, at 7. As noted by the Commission, Act 129 requires that each DSP establish and provide TOU rates to customers with smart meters. *See* 66 Pa. C.S. §2807(f)(5). With respect to the problems with PPL’s TOU rates, these problems appear to have been caused, at least in part, by PPL’s reconciliation methodology. Therefore, the problems with PPL’s TOU rates cannot be fixed simply by altering the procurement method for default service TOU supplies.

suppliers price into bids on a full-requirements contract for a procurement group that includes all non-residential customers not defined as Large C&I customers.⁴⁴

The Tentative Order has identified a potential problem involving the shifting of migration risk within a procurement class. However, the presumptive fix suggested by the Commission is misguided.

First, hourly pricing requires a meter capable of measuring consumption on an hourly basis (*e.g.*, an interval meter or a smart meter). It is very unlikely that such meters will be available to all non-residential customers with maximum peak loads above 100 kW during the next default service period (*i.e.*, from June 1, 2013, through May 31, 2015). Therefore, extending mandatory hourly pricing in the way recommended by the Commission would require reconfiguration of the smart meter deployment schedules of the EDCs and would likely cause an increase in smart meter costs.

Second, there is an easier way to remedy the potential problem of risk shifting identified by the Commission. Specifically, instead of extending mandatory hourly pricing, the Commission could require each DSP to establish a separate procurement group for Small C&I customers with maximum peak loads of 100 kW or lower. In that regard, PECO and West Penn already separate the 0-100 kW non-residential customers from the 100-500 kW non-residential customers for purposes of default service procurement. Duquesne separates the 0-25 kW non-residential customers from the 25-300 kW non-residential customers. Requiring the other DSPs to set up a separate procurement group for non-residential customers with maximum peak loads of 100 kW or lower would eliminate the potential for risk shifting without having to wait for the deployment of the necessary meters.

⁴⁴ Tentative Order, at 8.

Third, as the Commission acknowledged, there already is “robust” shopping by non-residential customers that have maximum peak loads greater than 100 kW but are not defined as Large C&I customers. Therefore, it is reasonable to infer that if a customer of that size is not shopping, the customer has intentionally decided not to shop or has not gotten sufficiently attractive offers from EGSs. Imposing mandatory hourly pricing on such customers would be punitive and would be inconsistent with the replacement of the “prevailing market prices” standard by the “least cost to customers over time” standard.

Fourth, the Electric Competition Act states that “[t]he default service provider shall offer residential and small business customers a generation supply service rate that shall change no more frequently than on a quarterly basis.”⁴⁵ Therefore, imposing rates on small business customers that change hourly would be unlawful.⁴⁶

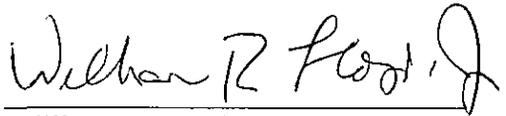
⁴⁵ See 66 Pa. C.S. §2807(e)(7).

⁴⁶ Although 66 Pa. C.S. §2807(e)(7) does not define “small business customers,” the Commission is apparently assuming that the General Assembly intended to adopt the definition of “small business customer” in 52 Pa. Code §54.2. However, it is at least arguable that the legislature had a broader definition in mind. For example, the default service policy statement, at 52 Pa. Code §69.1811(a), refers to “small business customers of up to 25 kW in maximum registered peak load.” (emphasis added) This reference implies that “small business customers” may have a peak load of greater than 25 kW. Consistent with that implication, PPL’s default service plan defines “small commercial and industrial customers” as non-residential customers with maximum load of up to 500 kW. Furthermore, Section 2 of the Small Business Advocate Act, 73 P.S. §399.42, defines “small business consumer” to include businesses with as many as 249 employees and to include customers in small *industrial* rate classes. It is unlikely that many small industrial customers have a maximum peak load of less than 25 kW. It is also unlikely that many small businesses with a maximum peak load of less than 25 kW have 249 employees.

VI. Conclusion

In view of the foregoing, the OSBA respectfully requests that the Commission revise the Tentative Order to delete the recommendations that the next round of default service plans include an opt-in auction proposal and expanded mandatory hourly pricing. The deletion of these two recommendations would not prevent any party from proposing an opt-in auction, expanded mandatory hourly pricing, or both, in individual default service proceedings. However, such a deletion would avoid prejudicing opponents of these two recommendations by forcing them to overcome a Commission "presumption" in favor of each of those recommendations.

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