BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Provider of Last Resort ("POLR") Roundtable

Docket No. M-00041792

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Good afternoon. My name is Doug Krall. I am the Manager of Regulatory Strategy for PPL Electric Utilities Corporation (or "PPL Electric"). On behalf of PPL Electric, I want to commend the Commission for initiating this Roundtable in order to gather information as part of the development of regulations to govern POLR supply in the period after the generation rate caps expire. Even though this Roundtable is being held more than five years prior to the expiration of PPL Electric's cap on generation rates, we believe that this effort is timely. This approach will help to alleviate concerns in the financial community and elsewhere regarding the uncertainties of future POLR obligations. PPL Electric believes that, by conducting this Roundtable and developing rules, the Commission is sending a message that it recognizes the uncertainties that Pennsylvania's distribution companies and their customers could face and that it is committed to providing a regulatory environment in which future POLR obligations are understood. Alleviating these uncertainties will help distribution companies focus on their primary responsibility of providing reliable delivery service, help electricity consumers to anticipate future supply options, and help to establish confidence in wholesale energy markets.

On April 14, PPL Electric filed written responses to each of the issues set forth in the Commission's March 18, 2004 POLR Roundtable Issues List. What I would like to do in these remarks is, rather than trying to address every aspect of

POLR, focus, instead, on what PPL Electric believes are the three principal issues. These are:

1. What entity provides POLR service?
2. How does the POLR obtain supply? and,
3. How should POLR service be priced to customers?

Of course, I'd be happy to respond to questions regarding PPL Electric's view on any aspect of POLR.

With regard to the first of the principal issues, PPL Electric recommends that only the incumbent Electric Distribution Company ("EDC") provide POLR service. PPL Electric offers the following four reasons for our recommendation:

- First, this approach would minimize customer confusion and disruption. The incumbent EDC has been the POLR throughout the transition period and customers know the identity of the POLR and are comfortable dealing with it. Under the Competition Act, customers can choose to purchase supply from an EGS rather than the POLR at any time. However, customers who have elected to remain with their incumbent EDC for POLR service should not be arbitrarily assigned to another entity.
- Second, as a practical matter, the incumbent EDC will remain the "last resort" POLR. If another entity is identified as the POLR and that entity fails to meet its POLR responsibilities, the incumbent EDC will be required to step into the role of POLR to protect the affected customers. In fact, this series of events already has occurred in the context of Competitive Discount Service ("CDS") in the PECO service territory. Given this reality, it makes sense to identify the incumbent EDC as the POLR in the first instance.
- Third, the administrative burdens associated with identifying another entity as the POLR are enormous. A quick review of the issues identified by the Commission in this area reveals the scope of such an undertaking. What requirements must the entity meet? How would the non-EDC POLR be selected? How would competing proposals be evaluated? How would

customers be assigned to the POLR? What happens if the non-EDC POLR defaults? Identification of the incumbent EDC as the POLR eliminates all of these issues and ensures that the regulated entity with decades of experience in this area will provide POLR service to all of the customers in its service area.

- Fourth, and finally, identifying a non-EDC as the POLR risks "stranding" the EDC's investment and personnel in the metering, billing and customer care functions. If the non-EDC POLR assumes these functions, there is no need for the EDC to retain those facilities and personnel. Conversely if, as discussed above, the EDC is likely to become the "last resort" POLR, then it must retain facilities and personnel needed to perform those functions in the future even if they are not being used currently. Identification of the incumbent EDC as the POLR avoids this problem.

With regard to the second of the principal issues, PPL Electric recommends that the POLR obtain supply through a statewide reverse auction process. The reasons behind this recommendation are as follows:

- First, an auction is consistent with the directive of the Competition Act for the POLR to "acquire electric energy at market-based prices". Clearly, supply obtained at auction will reflect the pricing of willing sellers competing against each other in a market environment.
- Second, an auction has understandable and visible mechanics that will maximize price discovery and promote market development. The power of auctions in this regard was clearly demonstrated through the 1990 Clean Air Act Amendments which caused auctions of emission allowances to be conducted years ahead of compliance dates as a way to establish price points that could be used by market participants to measure various compliance options. By most accounts, these auctions were highly successful in promoting the development of economically efficient compliance plans.
- Third, the reverse structure should assure sufficient supply.

PPL Electric recognizes that beyond simply establishing a reverse auction process, other details such as the timing of auctions and the products to be auctioned must be defined. With regard to timing, while it might be convenient to conduct auctions annually so that POLR pricing can be established on an annual cycle, PPL Electric believes that some consideration needs to be given to the sequencing of auctions among EDCs and even among states, and the likelihood that suppliers might bid less aggressively in the first of a series of auctions and more aggressively in the last of the series. This could lead to consumers in one EDC or in one state being disadvantaged relative to others. With regard to products, the simplest approach is probably to seek load following supply for percentages of the forecast POLR load. PPL Electric believes that it is important to further divide supply into tranches that cover time periods of differing lengths (for example, one-year, two-year, three-year, etc.) and that these tranches overlap each other. In addition, PPL Electric believes that a significant portion of supply should be for terms as long as ten years in order to create reasonably assured revenue streams that would facilitate the construction of new generating plants and, thereby, contribute to long-term reliability. PPL Electric believes that this approach of staggered starts, a portfolio of terms, and the inclusion of long term supply will result in pricing that is relatively stable, yet reflective of the market.

PPL Electric also believes that an auction process can accommodate Renewable Portfolio Standards (or "RPS") and Demand Side Response (or "DSR"). With regard to RPS, a bidding requirement could be that all qualifying bids must include an amount of renewable energy that is consistent with the RPS. Alternatively, the POLR could request separate bids for renewable energy in amounts that would allow the POLR to meet the RPS. This latter approach puts the POLR at some risk for having forecasted its needs and for the performance of the renewable sources, but it could have the advantage of providing assured revenue streams that would facilitate investment in renewable generation. With regard to DSR, the POLR could solicit bids in a separate auction for supply to serve DSR programs of specific characteristics; for example, programs that have seasonal or time-of-use pricing that must be forecast in advance.

Finally, with regard to the third principal issue, PPL Electric recommends that POLR rates include an automatic adjustment clause that is reconciled on an annual basis. Conceptually, POLR could be true default service; that is, customer charges would reflect the hourly price for energy used (plus losses) each hour. The POLR would pay the spot market price for that energy and there would be no outstanding cost recovery issue. In this conceptual world, there would be no need for an auction or procurement process, and competitive retail marketers would have all the opportunity they could ever hope to have to bundle and price energy for end-use customers. PPL Electric recognizes, however, that this conceptual view may not be politically achievable because small customers would be exposed to the full volatility of the market with, potentially, no recourse because EGSs do not have an obligation to serve. Nevertheless, this conceptual view illustrates the simplest vision of POLR pricing.

As soon as a POLR is required to bundle and price energy (for example as a flat annual rate), there is a need to forecast prices and usage, the likelihood that actual prices and usage will be different from the forecast, and, as a consequence, the likelihood that there will be over- or under-recovery. The bundling and pricing of energy is fundamental to EGSs' participation in the market and their need to manage risks. EGSs account for forecast risk in their risk management policies and in their pricing. POLR suppliers, on the other hand, participate in generation markets by obligation rather than choice and must be fully compensated for risks associated with that obligation. The best mechanism to do that is a reconciliation of POLR costs to POLR revenues with a true-up if they are not equal. Under a simple supply structure, reconciliation could be, if all goes well, a non-event. Consider the case wherein three suppliers, as a result of a reverse auction, each supply a third of the POLR's load at flat cent per kWh pricing. If that pricing were reflected directly in the pricing to end-use customers, then the transaction would be as simple as the POLR handing the revenues collected from end-use customers to the suppliers and there would be no need for reconciliation. However, if one of the suppliers defaults, then the POLR is left to obtain spot-market supply at potentially higher prices with no assurance of recovery. The reconciliation process would give the POLR the protection it needs consistent with the obligation it carries to serve on demand. In more complex supply structures where pricing may reflect a more complex combination of different quantities over different overlapping time periods, and may include elements of DSR and the need to comply with an RPS, the reconciliation mechanism becomes an essential part of the process by which revenues collected are balanced against the POLR's obligations to suppliers.

Again, on behalf of PPL Electric, I thank you for the opportunity to express its views on this critical issue. I'd be happy to answer any questions you may have.