

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION PROVIDER OF LAST :
RESORT (POLR) ROUNDTABLE : Docket No. M-00041792

TESTIMONY OF
DAVID W. TREGO
VICE PRESIDENT – ELECTRIC DISTRIBUTION
UGI UTILITIES, INC. – ELECTRIC DIVISION

UGI Utilities, Inc. – Electric Division (“UGI”) appreciates this opportunity to participate in the Commission’s provider-of-last-resort (“POLR”) roundtable. UGI is a small Electric Distribution Company (“EDC”) serving approximately 62,000 customers in two northeastern Pennsylvania counties. UGI was a leader in making choice available to its customers – all of the customers of UGI could choose their electric generation supplier as of January 1999. UGI was also among the first to terminate stranded cost recovery and emerge out from under the generation rate cap established by Section 2804(4)(ii) of the Public Utility Code – stranded cost recovery from commercial and industrial customers ended as of July 31, 2002, and from residential customers as of October 31, 2002.

Since UGI has completed its transition period it has successfully provided POLR service pursuant to a Commission-approved POLR tariff. As such, it is among a handful of small EDCs¹, and one larger EDC², that are no longer subject to the statutory generation rate cap. EDCs,

¹ Citizens, Pike County Power and Light, and Wellsboro.

² Duquesne Power and Light Company.

serving the vast majority of the Commonwealth's electric consumers will remain subject to the statutory generation rate cap until 2009 and beyond..

In my testimony, I wish to emphasize the following:

- The Commission should delay the development of POLR service regulations until a date closer to the time when the vast majority of Pennsylvania electric consumers will first begin to receive POLR service that is not subject to statutory generation rate caps. Wholesale electric markets are still developing and are quite volatile. Delaying the development of POLR regulations would enable the Commission to assess and develop POLR rules appropriate to what will hopefully be a more mature wholesale electric market and regulatory conditions at that time, relieve the handful of small EDCs and Duquesne that have already completed their transition periods from having to immediately adjust their POLR programs to new regulations, would help protect the customers of these EDCs from current volatile market conditions and would permit a more uniform statewide implementation of POLR rules.
- Alternatively, should the Commission feel the need to develop POLR regulations now, their effective date should be deferred until at least 2009 to more closely coincide with dates when EDCs serving the vast majority of load in Pennsylvania complete stranded cost recovery and emerge from under the statutory generation rate caps. In the interim, small EDCs and Duquesne should continue to provide POLR service pursuant to Commission-approved POLR tariffs that reflect their unique circumstances and conditions, and any other EDCs emerging out from under the statutory generation rate cap should propose interim POLR tariffs unique to their circumstances.

- EDCs should retain POLR obligations unless they petition the Commission to permit a third party POLR provider.
- POLR regulations should be flexible enough to permit a variety of approaches to POLR service tailored to the circumstances of each EDC and the degree of supply risk it is willing to assume.
- Retail competition is enabled where the POLR service provider and EGSs are able to compete against each other on a level playing field – that is where they purchase power in the same wholesale markets and are able to offer similar products and services. Retail choice should be given a chance to perform, and POLR service rates should be regulated by competition (perhaps under a reasonable cap for some transition period), and not regulation, where an EDC does not purchase power from affiliates and is a member of a FERC-approved RTO.
- Wholesale or retail POLR supply auctions are not the best means of establishing POLR prices since they may impose a potentially unacceptable degree of regulatory and counter-party risk, may limit the pool of potential suppliers and may thwart the development of healthy retail markets. They are particularly inappropriate for small EDCs that do not have sufficient loads to attract a wide range of bidders. Instead, EDCs should be permitted to manage supply and credit risks by constructing an appropriate supply portfolio tailored to their circumstances, and recover the costs of that power through mechanisms appropriate to their circumstances.

In general, UGI believes that the Commission should (1) delay development or implementation of POLR regulations until the vast majority of Pennsylvania customer load emerges out from under statutory rate caps, (2) when adopting POLR cost recovery rules, place POLR service providers on the same footing as EGSs, (3) permit sufficient flexibility in approach among POLR service providers so that market risks can be identified and addressed in ways appropriate to each POLR service provider’s circumstances, (4) minimize economic regulation and regulatory review processes that may create additional uncertainty among customers, investors and potential market participants and (5) permit existing interim POLR arrangements of the small EDCs to remain in effect at least until 2009.

A. THERE IS NO IMMEDIATE NEED FOR POLR REGULATIONS

UGI submits that it makes no sense to develop POLR service regulations many years in advance of the date when EDCs serving the vast majority of POLR loads in Pennsylvania complete stranded costs recovery and emerge out from under statutory rate caps.

To date, the following companies have completed stranded cost recovery, and are providing POLR service through Commission-approved POLR tariffs:

Company	<u>Approximate No. of Customers</u>
Duquesne	580,000
UGI	62,000
Wellsboro	5,700
Pike County	3,000
Citizens	6,620
	Total: 657,320
	Total excluding Duquesne: 77,320

% of PA electric customers excluding
Duquesne: 1.39%

As the Commission is aware, Duquesne has proposed an interim POLR tariff, currently the subject of a proceeding before the Commission, that would be applicable through 2009, and I believe that it is fair to say that this proceeding will be resolved before POLR regulations could be adopted and implemented through the regulatory review process.

As a result of decisions made in the electric restructuring proceedings, all of the large EDCs in Pennsylvania, with the exception of Duquesne, shall be recovering stranded costs and shall remain under generation rate caps through at least the dates indicated below:

Company	Approximate No. of Customers	Gen. Rate Cap End
Penn Power	138,000	December 31, 2006
West Penn Power	900,000	December 31, 2008
PPL Electric Utilities	1,300,000	December 31, 2009
PECO	1,500,000	December 31, 2010
Met-ED	495,000	December 31, 2010
Penelec	580,000	December 31, 2010
	Total: 4,913,000	

% of PA electric customers
including Duquesne: 98.41%

Given immature and volatile wholesale electric markets currently prevailing, and evolving regulatory policies at the federal level, UGI submits that the most prudent course of action for the Commission would be to delay the development of POLR regulations until a date

closer to January 1, 2009, when EDCs representing the bulk of Pennsylvania's electric customers will begin to emerge out from under statutory generation rate caps. As the above numbers indicate, approximately eighty-six percent (86%) of Pennsylvania electric consumers will still be receiving POLR service subject to statutory generation rate cap through 2008, and approximately seventy percent (70%) will be receiving POLR service subject to a statutory generation rate caps through 2009. The remaining customers through those dates will receive POLR service through Commission-approved POLR tariffs that may also include rate caps.

By delaying the development of POLR regulations, the Commission would have the benefit of both knowing how market conditions in the still changing wholesale electric market have evolved, and how the POLR approaches taken in other jurisdictions have worked. By developing POLR regulations now, the Commission would deprive itself of this important information, without any corresponding benefit. Both Maryland and New Jersey developed and implemented their POLR rules to coincide with the emergence of the bulk of customer loads out from under statutory rate caps.

The benefit of waiting for the further development of wholesale markets is illustrated by the results of Maryland's recent completion of bidding for electric standard offer service for the PEPCO and Conectiv service territories. According to an April 2, 2004 press release issued by the Maryland Public Service Commission, and attached as Appendix A to my testimony, the average annual electric bill for a PEPCO residential customer "will increase by approximately 16 percent as a result of a 26 percent increase in the power supply portion of the bill", and the average annual electric bill for a Conectiv residential customer "will increase approximately 12 percent as a result of a 19 percent increase in the power supply portion of the bill." Attached as

Appendix B to my testimony is a graph of wholesale power prices from May of 1999 to the present, showing the volatility of wholesale prices.

Alternatively, should the Commission feel the need to proceed with the adoption of specific POLR regulations now, UGI submits that the effective date of any such regulations should be deferred until January 1, 2009.

Pennsylvania, unlike New Jersey and Maryland, has four jurisdictional EDCs that serve under 65,000 customers, and each of these four small companies have completed their transition periods. Given the small number of customers that are currently served under existing or proposed POLR tariffs, and, in the case of the small EDC's, the lack of any customer dissatisfaction with existing POLR arrangements, it would make no sense to make POLR regulations immediately effective. Further, given customer satisfaction with current POLR service providers, it would make no sense to force customers to alternate POLR providers.

Making POLR regulations effective as of 2009 would enable the handful of existing EDCs with POLR tariffs in effect to plan in advance to accommodate any changes in regulatory requirements, and to petition the Commission in advance for any necessary exemptions for existing supply arrangements. This would also spare the Commission and the small EDCs from having to address issues that might be associated with the immediate implementation of POLR regulations that are inconsistent with existing POLR tariffs.

In addition, it would be unfair to have the small EDCs bear the costs of addressing any implementation issues pertaining to new POLR regulations given their small revenue base. It obviously would be preferable to have such issues addressed on a more industry-wide basis by delaying the effective date of any new POLR rules.

I also do not foresee any UGI-specific problems in keeping existing POLR tariff rules in effect through at least 2009. Initially, I would note that UGI's customers seem pleased with current POLR arrangements. Those POLR rules permit UGI to make long-term fixed price offers for periods of up to three years, and approximately one-third of our customers and about one-third of our customer load have accepted such offers. Remaining POLR customers have an open shopping period each year and are notified of a POLR price for the following year in advance so that they can comparison shop. If an alternate supplier is not selected, customers remain on POLR service for a one-year period until the next open shopping period, thereby minimizing load risks that would otherwise have to be reflected in our prices to the detriment of our customers.

At the time UGI's POLR settlements were crafted in 2002, UGI was able to agree, based on then prevailing market conditions, to certain POLR rate caps through the end of 2004, and has kept its POLR rates below those caps. Market forces were to regulate POLR prices beginning in 2005. Recently, the Office of Small Business Advocate has filed for a petition for reconsideration seeking a determination of how POLR rates will be calculated beginning in 2005. I firmly believe, however, that rate cap extensions based on current market conditions will be able to be worked out for 2005 and 2006, and further extensions will be able to be negotiated in the future based on then prevailing market conditions.

**B. EDCs SHOULD RETAIN THE POLR FUNCTION
UNLESS THEY REQUEST APPROVAL OF AN
ALTERNATIVE POLR PROVIDER**

In crafting POLR rules, UGI believes that the Commission should minimize regulatory risk by articulating clearly that an EDC shall retain its obligation as POLR service provider

unless it requests approval from the Commission to relinquish this right to an alternative POLR service provider.

EDCs have a significant investment in fixed distribution facilities in the Commonwealth, and have an ongoing need to attract capital for future capital investments on reasonable terms. The value of these significant investments would be jeopardized if POLR service, at reasonable rates, were not available. Thus, EDCs have every incentive to ensure that reliable POLR service is provided at reasonable rates.

I also believe that customer confusion and dissatisfaction could result as a result of the “forced” assignment of customers to alternative POLR providers. In this regard, the withdrawal of New Energy from its role as an alternative POLR provider on the PECO system should provide a cautionary tale.

EDCs are also, of course, ultimately the POLR in the event an alternate POLR provider defaults on its POLR service obligations. Investors might perceive an unacceptable level of regulatory risk if alternative POLR service providers are selected through a process that may not adequately consider counter-party or other risks, or if there is perpetual uncertainty as to whether alternative POLR service providers can petition to serve POLR loads. Thus, UGI would urge the Commission to state clearly that the EDC shall retain POLR service obligations unless it petitions for the appointment of an alternative service provider under terms acceptable to it.

C. THE COMMISSION’S POLR RULES SHOULD

BE FLEXIBLE ENOUGH TO ACCOMMODATE
THE DIFFERING CHARACTERISTICS AND
CIRCUMSTANCES OF COMMONWEALTH EDCs

While the Commission might be tempted to adopt a one-size-fits-all approach to POLR rules, UGI believes that there are such differences in the characteristics and circumstances of Pennsylvania EDCs that it would be wise to permit some degree of flexibility in POLR service approaches and cost recovery mechanisms.

For example, UGI is a small EDC that does not own electric generation or purchase power from affiliates. It operates within the control area of a large RTO with a well-developed wholesale market. It is willing to manage the supply risks associated with providing a non-reconcilable market-based POLR service. Some other differences may be that the EDC is not in the control area of an RTO, or that the EDC has an affiliate that owns significant electric generation assets that the EDC purchases power from. Given these differing circumstances, there may be considerable merit in permitting differing approaches to the provision of POLR service, and the Commission's POLR service regulations should permit such flexibility.

D. TO THE EXTENT POLR RULES ADDRESS
SPECIFIC APPROACHES TO THE PROVISION
OF POLR SERVICE, UGI 'S FIRST CHOICE
WOULD BE TO PERMIT MARKET-BASED POLR
SERVICE OFFERINGS PRIMARILY REGULATED
BY RETAIL COMPETITION

The General Assembly has expressed a clear preference to have market forces, rather than regulation, determine the cost of electric generation service consistent with these federal policies. It has said that “[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity”, that the “Commonwealth must begin the transition from regulation to greater competition in the electric generation market to benefit

all classes of customers”, and that because “of advances in electric generation technology and Federal initiatives to encourage greater competition in the wholesale electric market, it is now in the public interest to permit retail customers to obtain direct access to a competitive generation market. . . .” 66 Pa.C.S. §2802 (3), (5) and (7).

To date, retail competition has, in my opinion, been damaged by the fact that EGS’s must purchase power in wholesale markets where prices will vary over time, but they face competition from POLR service offerings that operate under artificial caps that do not reflect those market conditions. These price caps can be viewed as a form of regulatory risk that has suppressed the development of a fully robust retail generation market. For almost all of the time the statutory generation rate caps have been in effect, market prices for power have exceeded generation rate caps.

Moreover, any form of economic regulation, even one based on some mechanism intended to calculate market prices, could discourage retail competition since it would create regulatory uncertainty. What assurance would an EGS have, for example, in deciding whether to commit resource to enter the retail generation market, that an appropriate “Prevailing Market Price” or an appropriate “mark-up percentage” would be selected in current or future administrative proceedings. Since even a well intentioned, but incorrect decision, could result in a POLR price that does not reflect current market conditions, competition could be discouraged. Similar concerns would apply to a pure pass-through with reconciliation or even an auction approach.

UGI believes that if robust retail competition is to be given a chance to develop, the best POLR service approach would be to permit those EDCs that are in the control area of a FERC-approved RTO, that do not purchase power from affiliates, and that are willing to accept the

risks, to offer below-the-line non-reconcilable POLR service offerings. This would place POLR service providers and EGS on an equal footing since both will be acquiring wholesale supplies in an open wholesale market and repackaging those supplies into retail service offerings. In fact, some EGSs have affiliates that own generation assets that may allow them to acquire supplies without having to provide security or and other costs that an EDC POLR service provider might incur. Competition between the POLR service provider and EGSs should regulate the prices of both. If for some transition period the Commission believed that some cap on POLR prices would be appropriate, a cap could be crafted by reference to an appropriate index with an adder to provide sufficient headroom to reflect the administrative costs and risks associated with the provision of POLR service.

To minimize load risks under this approach, UGI believes the Commission rules should be flexible enough to permit some reasonable limits on customer migration. Just as most EGSs limit load risk by requiring customers to sign up for a term by contract, so should POLR service customers, after being informed in advance of prospective POLR prices and given a reasonable opportunity to shop, be required to remain on POLR service for a specified term, regardless of the POLR provider. While an appropriate balance has to be struck between a customer's right to shop and cost considerations, it was been UGI's experience that load following services can be quite expensive.

It has also been UGI's experience that many customers have a desire for longer-term rate stability. POLR service offerings should be permitted to include longer-term fixed rate service offerings with correspondingly longer customer commitments. UGI has submitted offers it was made to customers for longer-term stable prices to the OCA and OSBA for their review, and has not received any complaints about such offers from customers, marketers or public parties.

E. AUCTIONS ARE
NOT THE BEST MEANS OF PROCURING
POLR SUPPLIES OR OF ESTABLISHING
POLR PRICES

The market-regulated POLR pricing mechanism discussed above provides the best chance of developing a robust retail market. However, should the Commission reject that model, it should not be quick to adopt an auction process. First, an auction process generally requires the adoption of uniform financial security rules in advance. The adoption of such uniform rules, however, fails to permit consideration of the diversity of circumstances among potential suppliers, and leaves no room for the crafting of unique security arrangements through the contracting process. Negotiation of security arrangements can lead to lower costs and a larger pool of potential suppliers. Moreover, many credit arrangements require active on-going supervision that may not be possible in the context of an auction process. EDCs have the skill sets, and expertise to establish and manage counter-party risks, which can frequently change, effectively. They also have a strong incentive to manage such risks appropriately since credit ratings agencies and trading partners can and do evaluate counter-party risks and security levels. If these risks are not managed appropriately, the perceived or actual risks of EDCs will increase, driving up the costs of capital and the financial security requirements of counterparties.

Second, the auction process generally requires the purchase of large blocks of power at a specific point in time. This factor alone may exclude many potential suppliers that may only be able to supply smaller blocks of power, or may only be able to supply blocks of power at different times. A bilateral contracting approach permits opportunistic purchases when opportunities arise, and the circumstances of potential suppliers, including smaller suppliers, can be accommodated better through a bilateral contracting process.

Third, many potential suppliers value confidentiality, and may be unwilling to participate in an auction process where their price may ultimately be revealed.

Fourth, an auction process might increase counter-party risks by lessening supply diversity. It is an unfortunate fact that it is not always possible to tell in advance if a particular supplier will not perform. An individual contracting process permits an EDC to lessen counter-party risk by spreading load among many suppliers in a way that might not be practical in an auction process.

Fifth, any kind of state-wide auction process could be subject to political influences, and increase actual or perceived regulatory risks among investors.

Sixth, it has been UGI's experience that many potential providers are uninterested in participating in auction processes for small blocks of power, since the costs of participating in the auction process and the associated revelation of pricing information is unpalatable.

Finally, potential investors are most comfortable with have the management of the company they have invested in, and who have the best skill set for managing risks and a stake in the outcome of their decisions, in charge of the management of those risks. The public interest is also best advanced by have such an alignment of skills, motivation and responsibility. An auction process potentially severs such links, and will inevitably be viewed as adding another level of risk to EDCs.

APPENDIX A

MD PSC Announces Successful Completion of Bidding For Electric Standard Offer Service

FOR IMMEDIATE RELEASE

April 2, 2004

For More Information, Please Contact:

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MD PSC Announces Successful Completion of Bidding For Electric Standard Offer Service

Baltimore, MD – Today, the Maryland Public Service Commission announced the results of a successful bidding process. That process has secured electric suppliers to provide market priced electric Standard Offer Service for Maryland customers of investor owned electric companies whose fixed price electric service offerings are expiring. The highly competitive bidding process involved 25 wholesale electric suppliers offering electric supply 4-5 times in excess of the load solicited.

Commission Chairman Kenneth D. Schisler stated, "This is another important step in Maryland's transition to a fully competitive retail electric generation market."

Electric customers who do not choose a competitive electric supplier will receive a market priced Standard Offer Service for their electric supply needs. Maryland residential customers of Pepco and Conectiv Power Delivery will receive market priced Standard Offer Service beginning July 1, 2004. For Pepco's residential customers, an average annual bill will increase by approximately 16 percent as a result of a 26 percent increase in the power supply portion of the bill. For an average residential PEPCO customer their annual bill will increase by \$164.28. For residential customers of Conectiv Power Delivery, an average annual electric bill will increase approximately 12 percent as a result of a 19 percent increase in the power supply portion of the bill. For an average residential customer of Conectiv their annual electric bill will increase by \$130.80. Electric supply prices for residential customers of Baltimore Gas and Electric Company continues to be frozen until July 2006. Maryland residential customers of Allegheny Power will continue to have frozen electric supply prices through 2008.

Pepco, BG&E, and Conectiv Power Delivery will post their full Standard Offer Service retail prices by April 30, 2004. Allegheny Power will post their full Standard Offer Service retail prices for commercial and industrial customers by July 1, 2004. These are the prices customers should use to compare offers from licensed retail electric suppliers.

The Electrical Universal Service Program assists low-income electric customers with paying their electric bills. The average grant this year has been \$382. For more information or to obtain an application, contact the Office of Home Energy Programs at 1-800-352-1446.

APPENDIX B

Forward Power Costs Western Hub

