

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

**Provider of Last Resort
(POLR) Roundtable**

Docket No. M-00041792

COMMENTS OF MIRANT CORPORATION
FOR THE POLR ROUNDTABLES

Introduction

Mirant Corporation and its subsidiary, Mirant Mid-Atlantic, LLC, are pleased to submit comments to the Issues List published by the Pennsylvania Public Utility Commission (“PUC” or the “Commission”) as part of its Provider of Last Resort (“POLR”) Roundtable proceedings. In addition to these comments Mirant will participate in the Roundtable Session scheduled for May 19, 2004.

Mirant Mid-Atlantic owns and operates generating facilities totaling 5256 MW in the Mid-Atlantic region. Our facilities include the Morgantown Generating Plant (1492 MW), the Dickerson Generating Plant (853) and the Chalk Point Generating Plant (2492 MW) in Maryland as well as the Potomac River Generating Plant (482) in Virginia. Mirant is an active participant in both the PJM and the Midwest ISO markets.

Mirant supports the concept of POLR and recognizes the need for such services as the market continues to evolve toward retail choice. Mirant further recognizes that consumers served by POLR are entitled to reliable service at fair, market-based prices. A well-designed POLR process will support the move toward competitive markets and away from regulated solutions and will encourage consumers to choose competitive retail providers. A key component of POLR service should be competitive procurement of commodity supply. Two predominant POLR models have emerged, the New Jersey Basic Generation Service (“BGS”) auction and the Maryland RFP process, that should serve as starting points for the Pennsylvania stakeholder discussions.

Attached to Mirant’s comments is a guidebook prepared for the Electric Power Supply Association (“EPSA”) that delineates the design, implementation and monitoring of competitive power supply solicitations (“EPSA Guidebook”). The EPSA Guidebook, entitled “Getting the Best Deal for Electricity Consumers,” provides an excellent roadmap for the Commission to quickly and efficiently design and implement fair, accurate and transparent wholesale competitive procurement programs that ensure consumers receive competitive full requirement supply of energy and ancillary services. The EPSA Guidebook explains in detail the key elements necessary to ensure a fair and credible solicitation process, describes different solicitation formats and product types and reviews important evaluation measures used in competitive solicitations. The EPSA Guidebook also delineates the important benefits properly designed competitive solicitations can provide to state electricity markets. Competitive solicitations can provide necessary forward price signals for suppliers to make investments in new and needed existing resources to meet future power needs. Competitive solicitations also reduce regulatory uncertainty for utilities by demonstrating the prudence of utility decision-making in procuring long-term supply.

I. Scope of POLR Service: “[T]he commission shall promulgate regulations to define the electric distribution company’s obligation to connect and deliver and acquire electricity.” 66 Pa. C.S. §2807(e)(2) (emphasis added).

For the foreseeable future, the POLR obligation should remain with the electric distribution company (“EDC”). At this juncture, it is too costly and potentially disruptive to consumers for entities other than the EDCs to perform this role.

The basic functions outlined in the Commission’s Issues List should remain with the EDC/POLR provider as long as the Commission requires a competitive solicitation process for supply procurement.

Specifically, the generation acquisition/supply obligation for POLR service should remain with the EDC, but the Commission should set forth rules for a competitive procurement process that applies to all EDCs located within the Commission’s

jurisdiction. If the Commission's goal is to further competition in the state, it is critical that the same POLR rules and requirements apply to all EDCs. Competitive commodity suppliers will be less likely to enter the marketplace if they are forced to participate in a separate process for each EDC.

It is also possible that renewable portfolio requirements and demand side response can be fulfilled via bids from competitive suppliers. Many states are requiring renewable energy as part of the supply portfolio. If this is a requirement, then the competitive suppliers should be expected to price renewable energy into their bids and to actually procure the renewable supply. The utility should not have direct responsibility for renewables, other than to confirm that the renewable requirement is included in the bids from competitive suppliers. When designing a competitive solicitation process these factors should be evaluated by the Commission and by stakeholders. Implementation of new renewable portfolio requirements should be timed to coincide with the start of the supply contracts, with sufficient advance notice so that the POLR suppliers can include those costs in their competitive bids or have passthrough provisions to allow the suppliers to recover their additional costs.

Additionally, the treatment of demand response programs deserves attention from all stakeholders. In other states, such as Maryland, the utility continues to provide this service. Under modified POLR rules this is a service that could be provided by competitive retail suppliers.

A final point with regard to the scope of POLR service is that all POLR providers should be required to submit customer data in a single format so that competitive suppliers can easily evaluate the information and compete for load on a level playing field. The EDCs should provide data in a standard format as part of the bidding process.

Note: for more information on the competitive solicitation process please see responses to item III.

II. Qualifications for POLR: A POLR may be either an “electric distribution company or commission-approved alternative supplier.” 66 Pa. C.S. §2807(e)(3)

As stated in Section I, only the EDCs should serve as the POLR at this time.

III. POLR Service Models: Please comment upon the form POLR Service should take.

Assuming that the EDC serves as the POLR, it is important to discuss the competitive process they will use to procure supply. Overall, the key objective should be extending fair, market-based prices to customers and allowing the POLR to focus on its core business, including reliability and customer care functions. The ideal competitive process will allow blocks of load to be supplied by competitive wholesale suppliers using a uniform, statewide approach. Contract terms should vary to reflect both short-term market realities and longer-term market forecasts.

As temporary default rates expire, those customers who have not chosen an alternative supplier should have the benefit of receiving market based rates from their POLR, rather than rates that have been achieved through a regulated settlement. Both the New Jersey BGS auction and the Maryland RFP process for POLR allow incumbent utilities to auction large blocks of small commercial/residential and large commercial/industrial load to competitive suppliers, extending market pricing immediately to these customers. These processes have a higher degree of transparency and are truly representative of market forces.

In the New Jersey auction bidders indicate how much load they want to serve at an auction managers suggested price. As long as there is more supply than demand at a given price the auction price will tick down. All suppliers are paid the same price. This approach is fully described in Appendix B of the EPSA Guidebook attached to this filing and is further discussed in our response to Section IV, B.

In the Maryland approach each utility issues a standardized, Commission approved RFP for full requirement service (energy and ancillary services) and also including Active Load Management (“ALM”) and renewable requirements. Suppliers submit bids and winning bids are chosen with oversight by the PUC. Suppliers are paid their bid price.

While both the NJ and MD processes are workable, Mirant prefers the NJ auction approach because of its high degree of transparency and because it serves as a single procurement process for virtually all of the POLR load in the state.

Initially contracts should be wholesale look-alike contracts with the EDC. We make this recommendation because switching at the small commercial/residential level in other markets has proven to be slow. Over time, if marketers are able to provide lower prices and/or more valuable services these smaller customers will gravitate towards choosing competitive product offerings and away from default service. Mirant believes it would be premature, for example, to automatically assign customers to marketers. In fact, there may be some regions where there are no active marketers.

Another benefit of the auction process is that competition for smaller-use customers will increase if blocks of load (i.e. 50 or 100 MW’s of Peak Load Capacity (“PLC”)) are aggregated and made available for bid. Unless and until this occurs, competition for these customers will be severely stifled as most competitive suppliers lack the financial and/or human resources to reach these customers directly. Additionally, until the rules of the road are firmly established in Pennsylvania, those marketing directly to small customers will be unlikely to commit the investment needed to achieve economies of scale.

IV. Terms and Conditions of POLR Service: A POLR shall treat a shopping customer who returns to POLR service “exactly as it would any new applicant for energy service.” 66 Pa. C.S. §2807(e)(4).

A. Length of POLR Service term: Is there a recommended length? Must it be uniform across service territories?

In response to the Commission’s question regarding the length of POLR service terms, Mirant believes a "layering" tactic whereby solicitations are for a variety of terms (anywhere from one to three years) is most appropriate. This approach allows customers to receive a “blended” price that takes into account both short-term market realities and longer-term market forecasts. A mix of short and longer-term wholesale supply contracts will also help provide the necessary forward price signals for continued investment in generating resources. For example, if forward prices are higher, it could signify the need for increased investment in new generation assets. Developers and investors, based on the price signal, can build newer, more efficient generation that will benefit consumers over time. Accurate price signals in both the retail and wholesale markets are needed to ensure long term resource adequacy and reliability.

B. Customer Migration: How should the Commission address issues surrounding customer switching, and what is the effect of the statutory language of Section 2807(4)?

With regard to customer migration, under the proposed methods that we’ve described, there should be no reason for switching restrictions provided the program includes appropriate volumetric mitigation measures. Quantifiable volumetric exposures due to switching are commodity risks that can be borne by the competitive supplier, so as not to place the end use customer at risk for “after the fact” cost recovery.

One factor of POLR service is that competitive suppliers must be able to include a premium in their bids to account for volumetric risk. To place some limits on this risk premium, the Maryland process includes provisions to address increments and decrements at the C&I level.¹

Volumetric mitigation for the wholesale suppliers serving C&I fixed price customers is achieved via an increment/decrement process.

¹ The residential program, due to the tendency for residential customers to migrate at a slower pace, will be examined once significant migration is observed. Current residential customers are exposed to fill volumetric risk premiums that suppliers embed in their wholesale bids.

For example, if a 50 MW contract's obligation increases 5 MW above the base load obligation the supplier is compensated through the increment pricing mechanism for that incremental load on a percentage basis.

The incremental compensation is the real time LMP, plus costs for ancillary services with a \$3.00/MWh adder. When the load drops back below the base +5 MW threshold the energy is again priced at the supplier's fixed price.

- Example: At 60 MW of Peak Load Contribution ("PLC") the supplier is paid $50/60 = 0.83$ or 83% of the load at the fixed price plus 16.6% of the load at the incremental price (real time LMP + costs of ancillary service + \$3/MWh).

The decrement is set at -3 MW per contract. When the base load obligation of the contract drops by 3 MW a new base load obligation level is established. This new base load obligation level continues to be served under the original fixed price of the contract. The decrement process allows wholesale suppliers to re-hedge their positions as customers switch to other suppliers and also allows supply to return to the market place to serve those new suppliers. There is no price adjustment for decrement load.

Provisions such as these allow suppliers to offer their most competitive and efficient bids and protect the consumers from excessive risk premiums that suppliers might otherwise require if no volumetric mitigation measures were included in the POLR's procurement structure.

C. Customer Rate Classes and Design

Both fixed and variable rates should be components of the competitive solicitation process. In the New Jersey auction, the fixed price is largely reserved for small commercial and residential customers, while a variable price is the option for large C&I customers. This structure encourages larger customers, who are better equipped, to evaluate competitive retail offers. Small customer maintain a stable rate but still have the flexibility to choose a competitive supplier.

The first product, Fixed Price (“FP”) service, was used for small to mid-size customers and obligated winning suppliers to provide full requirements service to these customers. The FP service paid suppliers a fixed price (in cents per kilowatt/hour) to cover suppliers’ costs for capacity, energy, ancillary services and transmission costs. The second product, originally called Hourly Electric Price (“HEP”) service and now called Commercial and Industrial Energy Pricing (“CIEP”), for large customers, paid suppliers a capacity payment (in dollars per megawatt/day) and an energy rate based on the PJM zonal real-time hourly market. Suppliers also were paid pre-specified ancillary service rate and transmission rates according to PJM’s Open Access Transmission Tariff.

The primary benefit of the FP auction is that it provides protection for small customers against price volatility while exposing them to market-based rates. The FP auction gives small and mid-sized customers market-based pricing that varies seasonally and, where possible, by time of day. These rates are determined on the basis of the auction price. The customer rate for a given class in a given season is calculated by multiplying a specific seasonal factor times the auction price.

Specifically, the CIEP auction contributes directly to the development of retail markets. Since CIEP customers would be buying energy at hourly market-based prices, competitive suppliers would continue to be able to compete against the BGS offering. Competitive retail suppliers could also provide customers with contracts that protect them against the volatility of hourly pricing. CIEP customers have the sophistication to evaluate the alternatives and to make informed choices of whether to stay on BGS or to contract with a competitive supplier. Under the BGS Auction rules, large customers are not subject to any switching restrictions and would be able to leave BGS service at any time.

In Maryland most utilities retained their existing customer classes and solicited bids for each.

V. Full Recovery of Reasonable Costs: A POLR shall “recover fully all reasonable costs” for its POLR related service. 66 Pa. C.S. §2807(e)(3)

Generally, costs for energy, capacity, ancillary services and transmission are passed through directly to consumers. Other costs should be recoverable, but the details need to be defined. For example, stakeholders need to discuss recovery methodologies for any potential administrative adders, uncollectibles and Universal Service. While all are components of the resulting retail price, none should be included as part of the commodity price component charged by competitive suppliers.

As for any potential impact on the competitive retail market, as long as the POLR price represents a true “last resort” price (vs. the lowest possible price) the competitive retail market should not be disrupted. If the competitive structure allows unrestricted switching, competitive suppliers will need the ability to price migration/volumetric risk into their POLR price. Competitive retail providers, however, can require customers to sign contracts with set terms, affording them the ability to offer a lower price (because they need not price the volumetric risk).

VI. Adjustment and Reconciliation of POLR Rates

A. POLR Rate Adjustment – Please address whether a POLR provider can request adjustment in its rates.

A POLR provider should have the ability to request adjustments in its rates for changes in law, triggering of incremental pricing, etc. on a daily basis. Additionally, PJM charges and changes in renewable requirements, for example, should have pass through provisions on the basis of cost plus a reasonable adder, if possible.

B. Reconciliation of POLR rates- Please address whether the POLR rate should be reconciled at the conclusion of the term of a POLR service plan.

Reconciliations need to occur as frequently as each month or, at most, each quarter. This will allow POLR rates to most accurately reflect the current market as well as the current the customer base (as the customer base shifts, EDCs might face difficulty trying to

recover past costs from a potentially dwindling pool of accounts). Timely POLR pricing is critical for robust and efficient retail competition.

VII. Default of POLR Service Provider

In the event of default, the New Jersey model offers a well thought out solution. If a supplier defaults open tranches may be offered to other winning bidders, bid out or obtained from PJM-administered markets, with additional costs assessed against the defaulting company's BGS security.

VIII. Implementing POLR Rules/ Transition Issues

Timing for a competitive POLR process in Pennsylvania should coincide with the approximate end date for default service of each utility. Once an initial auction is conducted the next auction should coincide with a set of dates for statewide auctions and should coincide with the PJM planning calendar.

Additionally, as competitive processes continue to develop in the PJM and MISO states consideration should be given to the timing of each solicitation on a regional basis. Mirant suggests that, at the appropriate time, regional working groups be formed to address this issue.

Conclusion

Mirant appreciates this opportunity to provide initial comments regarding the development of the POLR process in Pennsylvania. A uniform, statewide competitive solicitation process should form the basis of the POLR program as rate freezes for each EDC come to an end. An approach similar to the New Jersey BGS auction deserves significant attention as it has proven to be a successful solution in that state. Mirant looks forward to continued participation as the Roundtable sessions proceed.