

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Provider of Last Resort Roundtable
Docket No. M-00041792

COMMENTS
OF

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These comments are submitted pursuant to procedures set forth by the Pennsylvania Public Utility Commission for its Provider of Last Resort (POLR) Roundtable, and are meant to accompany my presentation of June 2, 2004.

I appreciate the opportunity to make these comments, and I compliment the Commission for establishing this forum to explore ideas and experiences with regard to the POLR concept. As a person long involved in the creation and development of competitive energy markets (and as now, somewhat uniquely, being a large buyer of electricity), I have long appreciated the criticality of getting the POLR concept correct, if indeed competitive energy markets are to replace the over 100 year old public utility, rate of return based industry structure. That structure has served the public well. Nonetheless, our evolving society, let alone the specific acts of the Pennsylvania Legislature, has decreed that it is time to replace the utility structure with competition. To do so, we have confront the realities of the utilities' Public Service Obligation and determine how that obligation will be met, and by whom, in a competitive world.

Competitive markets don't have POLRs because no one entity has or had an obligation, legal or otherwise, to serve anybody and everybody. As critical as food is, there's no food POLR. For those many people who rely on fuel oil to heat their homes, there's no POLR fuel oil supplier. But because the electricity and natural gas utilities do have an obligation to serve (hook up to lines and/or pipes and sell) any and all who apply for service, should

the utilities not be selling their commodities any more, there has to be somebody to take up that public service obligation; at least until there's a confidence that no one will indeed fall through the cracks, or that there won't always be someone out there willing to sell at competitive prices. Hence, there is a need for a POLR if competition exists, and the utility is no longer in the merchant function.

Though mentioned in Pennsylvania's Electricity Competition Act, the POLR concept is more extensively discussed in Pennsylvania's Gas Competition Act (where it is called SOLR), and in the Texas electricity restructuring legislation. There have been extensive POLR rulemaking or collaboration discussions in Texas and New York. More recently, neighboring New Jersey and Maryland engaged in proceedings and ultimately settlements dealing with sister-to-POLR concepts – Basic Generation Service, and Standard Offer Service. Many of the issues discussed in these four states, let alone what are being discussed in this Roundtable, are similar.

Nonetheless, I would argue that the Maryland and New Jersey proceedings, and this proceeding, are different than the New York and Texas proceedings, and the concept of POLR as it has been evolving over the years. As stated above, the POLR was to be the replacement for the utility's Obligation to Serve, allowing the utility to exit the merchant function, without any consumer, or any collection of consumers, not having a merchant. However, in today's context, there's no hint that the utility is going to be able to leave the merchant function in any foreseeable future. Since the utility is going to continue as the merchant, the issue in this proceeding has really become how the EDC is going to pass on to its customers the wholesale prices it experiences in procuring electricity. There is no transition to competition going on at the moment. In short, there's no need at this time to determine an option for the utilities' ongoing supply function, despite the conviction of marketplace advocates that real competitive markets are blocked in their development by the utilities' continued presence in the marketplace.

In essence, the restructured electricity industry (in which the vertically integrated utility is being modified to include independent generation, and potentially independent

transmission) is adopting the model of the gas industry, wherein wholesale market prices predominate the rates charged to utility customers. Before the development of a wholesale market, and before the major increase in gas prices in the 1970's, the gas distribution companies were able to modify the gas cost component of their rates on a monthly basis. The increase in wellhead prices from \$0.17/mcf to \$1.75/mcf during the 70's changed that procedure, and ultimately the Office of Consumer Advocate and the 1307f process were created. Thus, the gas cost component of rates, what the LDCs were paying their pipeline suppliers, was subjected to annual scrutiny and reconciliation. With the growth of the spot market, especially after NYMEX started trading futures contracts at Henry Hub, the increasingly accepted legitimacy of "market prices" changed the focus of the 1307f proceedings to some degree, and more recently quarterly adjustment of gas costs began to be allowed. It will be interesting to see if or how the review of gas costs will change if the new level of gas prices causes our confidence in the wholesale gas market to suffer.

At this point, from the perspective of an electricity buyer who has some understanding of the development of new energy markets, there is reason to not have a whole lot of confidence in the wholesale electricity markets. Despite the apparent successes of the PJM markets, wholesale markets are still rather new (especially considering the increasing – and relatively recent – presence of independent generators and wholesale marketers). There are differences of opinions as to how well ICAP captures the cost of generation capacity. Price caps exist, and generators express dissatisfaction with the mechanics of market design, which have to eventually have an impact on generation investment decisions. I am confident that PJM's inclusive decision-making process will eventually sort all of this out, and that western Pennsylvania will soon be a part of PJM. In the meantime, however, while wholesale electricity prices are the major determinate of retail prices, and until power marketers come up with innovative new products, many somewhat savvy buyers are going to be very wary of wholesale markets. And many such buyers are going to continue buying their electricity from utilities.

Therefore, the EDC is going to remain a merchant, and its Obligation to Serve is going to remain with it. EDC will be buying its electricity requirements in the wholesale market. It does not seem to be appropriate to design a POLR model at a time when there is no hint of the utility's leaving the merchant function. We will know a lot more about competitive markets in a couple of years. We can watch the development of the POLR concept in Texas, and perhaps other jurisdictions as well. On the other hand, the determination of how the EDC prices wholesale power to its customers should not be used as a vehicle for retarding or inhibiting the development of a competitive market. The difficult course the Commission must steer between Charybdis and Scylla (premature determination of a POLR model on one side and a competitive market setback on the other) is perhaps what this POLR Roundtable is meant to determine.

With regard to the Scope of POLR Service, the POLR obligations of connection and delivery (which will always remain with the EDC even if the EDC were to ever leave the merchant function and another party be designated as the POLR), generation acquisitions/supply obligation, reliability, retail market support functions, customer care functions, environmental and conservation requirements, and uniformity – all are utility functions, and should remain so for the foreseeable future.

The Qualifications for POLR, since the POLR is and will be the EDC, are a non-issue. When competition expands to the point that the utility could conceivably leave the merchant function, discussions can commence as to what qualifications a replacement entity must have to replace the utility as POLR.

POLR Service Models should not be determined at this time. The existing state of the market doesn't support any other entity but the EDC being a POLR provider.

With respect to Terms and Conditions of POLR Service, the ongoing provision of EDC sales should be annually evaluated to determine the impact of those EDC sales on the growth and development of competitive markets. Should there be evidence that competitive markets are close on the horizon, and that EDC sales are preventing that

market from getting closer, the Commission should initiate on a utility by utility basis POLR proceedings to determine what might be done to advance the market more expeditiously. Such a proceeding would indeed look at the length of the POLR service term, customer migration, customer rate classes and design, and other issues that have an impact on market developments. It is premature to decide these matters now.

EDCs should be able to achieve the Full Recovery of Reasonable Costs when selling to customers. When there is a competitive market, and they are providing those services as a POLR, they still should receive recovery of all expended costs. Similarly, the Adjustment and Reconciliation of POLR Rates, or the rates being charged by the EDC should be accomplished, as is the case now, under the Section 1307f procedure. The issue that may develop for both of these areas, however, is what the recovery mechanism becomes when the utility assumes the price risk by offering a fixed price contract, and the market moves against that position (and wasn't hedged). Is the EDC entitled to a full recovery of reasonable costs in that circumstance? If the exposure is sufficiently large, will an emergency request for rate relief to be entertained? Indeed, whether there will ever be a Default of the POLR Service Provider, the EDC, will be determined by whether and how frequently such adjustment to rates will be made.

In conclusion, it seems that this POLR Roundtable is really a discussion of how the EDC will pass on its experienced wholesale prices in ways that will not inhibit the growth of a competitive market. Outside of Duquesne Light, it appears that we will be able to learn a lot about wholesale markets, and what is happening in neighboring New Jersey and Maryland, before we have to further design a POLR model. In the meantime, allowing as best we can, the development of the large C&I competitive market seems like a prudent decision. Even that, given the apparent inability of market participants to agree on what it takes to develop competitive markets at this point in the evolution of wholesale and retail markets, will be no easy task.

