COMMONWEALTH OF PENNSYLVANIA

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May 26, 2004

In prior sessions of the POLR Roundtable, numerous presenters implied that the test for determining compliance with the Electricity Generation Customer Choice and Competition Act ("the Act") is whether a large enough percentage of retail customers choose to buy generation from an entity other than the EDC. In order to drive customers into the competitive marketplace, these presenters argued that POLR rates should be "as ugly as possible." Not surprisingly, such a scenario would be good for marketers. However, it is not mandated by the Act.

I. BACKGROUND

A review of the floor debate in the House and Senate will verify that legislative supporters and opponents of the Act started with the same stated goal: to reduce rates. No participant in that debate suggested that the PUC should require or permit artificially high POLR rates in order to stimulate competition.

Pressed by irate constituents, the General Assembly sought in the 1980s to mitigate rate shock caused primarily by the construction of nuclear power plants at a time when the demand for electricity was falling far short of projections. For example, legislators severely limited rate

relief for construction work in progress, authorized the PUC to cancel the construction of unnecessary power plants, and provided for at least a partial denial of rate requests in cases involving excess capacity and construction cost overruns.

Unfortunately, the PUC responded by making only modest excess capacity and cost overrun adjustments, choosing not to halt the construction of Limerick II, and approving rates for PECO and Duquesne which were among the country's highest. Faced with that track record, legislators were more open than they would otherwise have been to the argument that competition would do a better job of restraining electric rates in the future than would traditional regulation. Competition was the means to an end (lower electric rates) and not the end itself. In short, the General Assembly approved the Act to benefit consumers—not to benefit marketers.

II. LANGUAGE OF THE STATUTE

As the Commonwealth Court has held, "The purpose of the Competition Act is clear: to relinquish the local utilities' monopoly control over the generation of electricity and to invite competition in an effort to lower electric generation rates for the citizens of this Commonwealth." (emphasis added) Indianapolis Power & Light Company v. Pennsylvania Public Utility Commission, 711 A.2d 1071, 1077 (Pa. Cmwlth. 1998), appeal denied 556 Pa. 698, 727 A.2d 1124, certiorari denied 119 S. Ct. 1143, 143 L. Ed.2d 210.

The General Assembly approved the Act because "[r]ates for electricity in this Commonwealth are on average higher than the national average, and significant differences exist among the rates of Pennsylvania electric utilities" and because "[t]he cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth." See 66 Pa.C.S. § 2802(4) and (6), respectively.

The legislature opted to allow competition in the belief that "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity." (emphasis added) See 66 Pa.C.S. §2802(5).

Consistent with its goal of restraining the cost of generation, the General Assembly mandated that the POLR supplier "acquire electric energy at prevailing market prices" (emphasis added) in order to serve POLR customers. See 66 Pa.C.S. §2807(e)(3). Therefore, the test for determining compliance with the Act is whether the POLR is acquiring energy at prevailing market prices and not how many customers are shopping.

The Act expressly states that "all customers of electric distribution companies … shall have the opportunity to purchase electricity from their choice of electric generation suppliers." (emphasis added) However, the Act makes clear that "[t]he ultimate choice of the electric generation supplier is to rest with the consumer." See 66 Pa.C.S. §2806(a). Nowhere does the Act explicitly or implicitly empower the PUC to influence that choice by making POLR rates "as ugly as possible." Instead, the Act requires that electric service be "available to all customers on reasonable terms and conditions." (emphasis added) See 66 Pa.C.S. §2802(9).

The Act does not expressly define "prevailing market prices." Therefore, in the absence of language to the contrary, a POLR is in compliance with the Act if the POLR is acquiring the needed quantity of energy from a reliable generator at a price equal to the lowest available offer—even if other marketers or generators are unable to compete with that price.

III. KEY POLR PRINCIPLES

The following are key principles which the POLR regulations should incorporate.

A. EDC = POLR

The General Assembly designated the EDC as the provider of last resort unless the PUC selects some other entity to perform that function. See 66 Pa.C.S. §§ 2802(16) and 2807(e)(3). For numerous reasons, the EDC should be the POLR for the foreseeable future.

First, consumers, the PUC, and elected officials would look to the EDC to keep the lights on if a marketer were designated as the POLR but were then to default.

Second, the bulk of potential savings to consumers because of the Act will result from competition at the wholesale level. Any benefit at the retail level which might come from designating a marketer as the POLR does not outweigh the potential cost to consumers if an EDC must pick up the pieces after a marketer/POLR's default.

Third, EDCs are more likely to respond to the PUC's directives than are marketers. Marketers have the option of leaving Pennsylvania or closing their doors entirely. In contrast, even if an EDC were to go bankrupt, it would not be permitted to abandon service without PUC approval. See 66 Pa.C.S. § 1102(a)(2). Furthermore, the return an EDC is authorized to earn on its "wires" business depends upon decisions by the PUC.

B. Wholesale Competition

The POLR should acquire energy through an open competitive auction or RFP. To get the lowest prices for consumers, a generating entity affiliated with one EDC should be permitted to bid to supply energy to any or all EDCs, including its own affiliate. Each winning bidder should deliver energy to the POLR under a load following contract and without reconciliation.

If the PUC commits to the concept of using an auction or RFP process, there are significant questions to be resolved in a subsequent roundtable, such as:

- Should all of the energy be acquired for the entire state at the same time?
- When should the auction/RFP be scheduled in relation to similar solicitations in other states?
- Should each POLR acquire a portfolio of contracts of varying lengths or should all contracts be for the same number of years?
- Should each POLR acquire some specified amount of energy through 10 or 15-year contracts in order to provide incentives for new construction, or must such incentives be provided at the RTO level in order to be effective?
- How should increased reliance on renewable energy and energy generated from waste coal be factored into the competitive acquisition process?
- How should the winning wholesale bids be translated into retail rates?

C. Small Business Rate Structure

1. Process

At the time of restructuring, small business customers generally were paying rates in excess of the cost of supplying energy to them. The restructuring process did not correct that inequity because the Act prohibits interclass shifting of stranded costs during the transition period. See 66 Pa.C.S. § 2808(a). However, perpetuation of this cost misallocation beyond the transition period would be inconsistent with basing POLR rates on market prices. Therefore, at a minimum, the POLR regulations should not permit a wholesale price to be allocated at the retail

level on the basis of either an EDC's last approved cost-of-service study or an across-the-board adjustment to existing class generation rates.

Before it submits a bid to provide POLR energy, each EGS should know exactly how wholesale prices will be translated into retail rates; the size and load profile of each rate class; and whether there will or will not be demand charges, declining rate blocks, and seasonal rate differentials. If those issues are not resolved prior to the wholesale acquisition process, POLR rates are likely to include unnecessarily high risk premiums.

2. Switching Restrictions

Although numerous prior presenters criticized switching restrictions, those restrictions help protect non-shopping customers from having to bear costs caused by shopping customers. For a variety of reasons, the smallest commercial customers are unlikely to shop—and are, therefore, unlikely to create switching costs. However, a relaxation of switching rules would saddle these non-shopping customers with higher POLR rates.

Numerous presenters recommended seasonal rates as an alternative to switching restrictions. However, seasonal usage is only one factor in designing rates. In no event should seasonal rates be implemented in isolation, simply as a substitute for switching rules. Such a trade would benefit marketers and might benefit shopping customers, but those benefits would come at the expense of non-shopping customers.

Seasonal rates can be revenue neutral on a class basis. However, they are unlikely to be revenue neutral on an individual customer basis because many business customers can not shift consumption from one season to another. For example, restaurants and stores could lose customers and offices could lose worker productivity if air conditioning use were curtailed

significantly. Similarly, small manufacturers must meet customer demand, regardless of the season.

3. Fixed Prices

Small businesses need to be able to predict their costs in order to set the prices they charge for their own goods and services. For example, instead of taking their chances with year-to-year market fluctuations, one-third of UGI's customers chose a three-year plan with a known rate increase each year. Accordingly, POLR service should offer prices to small businesses which are fixed for no less than one year.

Numerous prior presenters advocated prices which change twice per year, once per month, or even hourly. Ironically, at the same time they called for adjustable POLR prices, some marketers also trumpeted the fact that they offer multiple-year fixed prices to shopping customers. Marketers make such offerings because they know that is what the vast majority of customers want. Nothing in the Act mandates adjustable POLR rates as an incentive for customers to buy fixed rate service from marketers.

If the marketers believe that frequently adjusted rates are attractive to a significant percentage of small business customers, the solution is simple. Make POLR service a fixed rate for at least one year, thereby enabling marketers to maximize profits by offering prices which fluctuate more often.

IV. CONCLUSION

Because the number of shopping customers is relatively modest statewide (and virtually non-existent in some service territories), it can be argued that the Act has not yet succeeded. However, the proper yardstick for measuring the Act's success, now and after implementation of the POLR regulations, is whether rates are lower than they would have been under rate base/rate of return regulation.