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Constellation Energy

June 18, 2004

Hon. James McNutly
Secretary
Pennsylvania Public Utilities Commission
400 North Street
Harrisburg, PA 17120

Re: Provider of Last Resort (POLR) Roundtable, Docket M-00041792

Dear Secretary McNutly:

Attached please find the Reply Comments of Constellation Power Source, Inc. and Constellation NewEnergy, Inc. (collectively, "Constellation") to Comments and Presentations at the POLR Roundtable Issues List. These written comments supplement those submitted by Constellation on June 14, 2004 in the above referenced docket.

Please let us know if you have any questions.

Sincerely,

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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Provider of Last Resort (POLR) Roundtable) Docket No. M-00041792

REPLY COMMENTS OF

CONSTELLATION POWER SOURCE, INC. AND

CONSTELLATION NEWENERGY, INC. TO

COMMENTS AND PRESENTATIONS AT THE

THE POLR ROUNDTABLE ISSUES LIST

Dated: June 18, 2004

I. INTRODUCTION

On June 14, 2004, Constellation Power Source, Inc. ("CPS") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") submitted to the Pennsylvania Public Utilities Commission ("Commission") their responses to the POLR Roundtable Issues List issued by the Commission on March 19, 2004 ("Issues List"). In those comments, Constellation set forth the principles that it believes should guide the Commission's development of POLR Regulations, principles that:

- Provide all customer classes a fairly priced electricity service that is market responsive.
- Support robust wholesale competition as a necessary component for achieving reasonable POLR prices and promoting retail competition.
- Promote retail competition by providing accurate price signals to all customer classes and preserving customer choice.

The principles espoused by Constellation are as follows:

- POLR service should be a basic service offering for customers who cannot or do not elect competitive service. The same level of POLR service should be offered to all customers in a specific rate class and the incumbent utility should not be allowed to offer different levels of service or multiple products to customers within a rate class.
- Customers must be free to choose between POLR service and competitive retail service. Switching restrictions that limit a customer's ability to choose freely between POLR and competitive service should be eliminated in favor of seasonal rates and other customer migration risk mitigation methodologies that do not deter competition.
- POLR service rates should be reasonably reflective of current market rates for electricity, so as not to create unreasonable gaps between POLR prices and competitive market prices. The duration of POLR pricing for each customer class should reflect a balance between the need to minimize these price differentials, and

the need to ensure that customers have the ability to obtain reasonably priced, stable POLR rates if they cannot procure this price stability from the competitive market.

- POLR service rate components should be clearly stated, and should reflect the cost of wholesale full requirements service, transmission service, an amount that reflects the administrative costs associated with serving POLR customers (including a reasonable margin for the POLR provider commensurate with the risk assumed by the POLR provider), and taxes.
- The POLR provider's acquisition of the full requirements supply in the post transition period should result from a competitive wholesale bidding process.
- This competitive procurement process for the wholesale full requirements supply should be fully developed before procurement begins, including the development of a Request for Proposals ("RFP") that (i) articulates the procurement structure, bid process, contract periods, bid block sizes, and bid timetables, (ii) provides for the availability of detailed customer load data, and (iii) includes the wholesale contract to be executed between winning suppliers and the utility containing the terms and conditions of the full service requirements for POLR supply.
- The contract between the winning suppliers and the utility should provide for industry standard, comprehensive, bilateral credit and collateral provisions.
- The contract between the winning suppliers and the utility should be approved by the Commission without delay, i.e., within two days of submission.

While many parties participating in the Roundtable supported the same or similar principles, the purpose of these comments is to highlight specific critical issues on which there were disparate views, provide Constellation's opinion with respect to those issues, and, thus, assist the Commission in determining the best POLR design for the Commonwealth of Pennsylvania. Those critical issues are as follows:

- **<u>Benefits of statewide standardization of POLR service</u>:** Statewide POLR Regulations, established now, will provide market certainty which will result in lower costs for customers.

- **Benefits of a well designed wholesale competitive bid process:** Requiring EDCs, as the POLR Provider, to procure their supplies through a well defined wholesale competitive process will result in lower costs for customers.
- **POLR supply contract length and resource adequacy issues:** Resource adequacy should continue to be managed through PJM markets. The length of POLR contracts, which should be tailored to meet the requirements of different customer classes, need not, and should not, serve as the contractual underpinning for new resources.
- **Benefits of Bilateral Credit and Collateral Provisions:** The Commission should assert a key leadership role in developing bilateral credit provisions for POLR service in order to lower customers' costs.
- **POLR costs must be fully reflected in POLR rates:** For competition to flourish, and for customers to receive the full benefits of competition, POLR prices must reflect all the costs associated with that service.
- **Switching restrictions should be eliminated and avoided:** Switching restrictions will impede the development of competition, and should be replaced with market based customer migration risk mitigation mechanisms, where appropriate.
- **POLR service should be a basic service:** POLR Service should be a basic service available to all EDC customers, allowing customized product offerings to be made available to customers through the competitive markets.

II. Reply Comments to Critical Issues

a. **Benefits of statewide standardization of POLR service:** During the Roundtable discussion and in the submitted comments, there were disparate views on whether this Commission should promulgate regulations at this time that would apply to EDCs that are still years away from the end of their transition periods. Constellation believes that it is vital that the Commission develop its POLR service regulations to provide the market place with certainty about the structure of the market rules that will govern the development of competitive markets in the Commonwealth. Proponents of having regulations established now understand the importance of the clarity of market rules.

Furthermore, the market certainty that the development of standardization of POLR service will foster, will lower customer costs and promote market efficiency.

Specifically, Constellation agrees with the comments in the written statements of Amerada Hess Corporation ("Amerada Hess"), Mirant Corporation and Mirant Mid-Atlantic, LLC ("Mirant"), Reliant Energy ("Reliant"), First Energy Solutions Corp ("FES"), and First Energy Operating Companies ("FEOC") that uniform, statewide POLR regulations are needed to stream-line the procedural, administrative and implementation process.[1] There are several factors that support the adoption of uniform regulations. First, failure of the Commission to establish reasonable guidelines for POLR service could result in higher regulatory costs to utilities, suppliers, and ultimately consumers. As an example, the regulatory and legal costs in the ongoing Duquesne POLR proceeding, according the last data request was in excess of $7 million as of April 30, 2004 for the utility alone.[2] PECO Energy ("PECO") recommendation that POLR regulation need only prescribe a "workable regulatory filing and approval process"[3] would result in a patchwork of proposals, each of which would presumably require full participation from Roundtable participants leading to increased costs for all participants and increased case complexity, all of which is unnecessary given the progress that has occurred to date in other states that the Commission can utilize to craft a uniform state wide approach to this post transition phase.

Exelon Generation Company, LLC ("Exelon") and FES assert that an auction process would be an effective means of attracting multiple bidders.[4] Constellation agrees that an auction process or RFP process would attract multiple bidders, but the maximum benefit

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[1] Comments of Amerada Hess Corporation, May 19, 2004, Docket M-00041792, p. 6 ("Amerada Hess Comments"); Comments of Mirant Corporation for the POLR Roundtables, May 19, 2004, Docket M-00041792, p. 10 ("Mirant Comments"); Reliant Energy's POLR Framework for the Pennsylvania Market, May 19, 2004, Docket M-00041792, p. 2 ("Reliant Comments"); Comments on behalf of FirstEnergy Solutions Corp., May 3, 2004, Docket M-0041792, p. 9 ("FES Comments"); Comments of The FirstEnergy Operating Companies, April 21, 2004, p.20 ("FEOC Comments").

[2] Duquesne Light Company, Response to Constellation On-The-Record Data Request From May 7, 2004, Docket P-00032071.

[3] Comments of PECO Energy for the POLR Roundtable, April 21, 2004, Docket M-00041792, p. 2 ("PECO Comments").

[4] Comment of Exelon Generation Company, LLC, May 19, 2004, Docket M-00041792, p. 9 ("Exelon Comments"); FES Comments p. 9.

of such a process is achieved when a certain aggregated level of activity is brought about by a coordinated statewide process as in Maryland and New Jersey. The auction process and RFP process in New Jersey and Maryland, with their demonstrated high level of bidder participation, stand as a strong testament to the advantages of statewide bidding. Mirant, an independent generator in Pennsylvania, confirmed this when it commented: "Competitive commodity suppliers will be less likely to enter the marketplace if they are forced to participate in a separate process of each EDC."[5] PSEG Energy Resource and Trade, LLC ("PSEG") confirmed the need to have "comparability" to attract multiple bidders.[6] The comparability can best be achieved through similar product requirements across the state. Multiple, disjointed solicitations by different utilities on different timetables, will not result in the economies of scale that have attracted such significant participation levels in New Jersey and Maryland.

Constellation also recognizes that certain aspects of any POLR proceeding may need some level of customization. For example, as noted by Amerada Hess, FES and FEOC, not all utilities are members of PJM.[7] Varying EDC rate schedule types, customer group load sizes, interval metering accessibility and other factors might also necessitate minor modifications of what should otherwise be uniform bid and contract documentation. Where possible, common POLR provisions will help keep costs to a minimum, enhance competitive bidding participation, and facilitate state educational efforts that will be required when the long term-administratively set transitional prices expire and the new rules are put in place. Both Maryland and New Jersey have already demonstrated that unique needs of the EDCs can be accommodated in a comprehensive, statewide POLR plan. Moreover, FEOC acknowledged that a phased in approach to POLR policies can be achieved as the respective transition periods end.[8]

Many of the opponents of statewide standards argue that the establishment of common standards now will result in regulations or rules that may be out of step with the better

[5] Mirant Comments, p. 3.
[6] Comments of PSEG Energy Resources & Trade LLC for the POLR Roundtable, May 19, 2004, Docket M-00041792, p.8 ("PSEG Comments").
[7] Amerada Hess Comments, p. 7; FES Comments p. 5; FEOC Comments, p. 6.

practices that may surface in the coming years.[9] As Maryland has demonstrated, a statewide procurement process can easily accommodate staggered timeframes. Moreover, Constellation agrees that POLR rules and regulations should be reviewed and changed over time, as our collective knowledge improves on how best to provide POLR service and promote competitive markets as a means of bringing benefits to consumers. As an example, both New Jersey and Maryland have an annual review process for this purpose of identifying and implementing improvements to the procurement process. The mere fact that it may be desirable to adjust the implementation of standards over time should not, however, serve as an excuse to procrastinate on the statutory obligations to establish post transition POLR service regulations.

Lastly, The Office of Consumer Advocate's ("OCA") recommended that any existing POLR plans should continue to operate to the end of their term.[10] While Constellation does not advocate the abrogation of existing contracts, any contract that has not yet been approved by the Commission should only be approved for a "bridge period", subject to compliance with these pending regulations as soon as practicable. The Commission should not approve any plan that would extend well beyond any reasoned approval period for these regulations.

b. **Benefits of a well designed wholesale competitive bid process:** Nearly all parties at the roundtable supported having the EDCs serve as the POLR Provider. In addition, there was substantial agreement among many participants in the Roundtable that the wholesale energy, capacity, and ancillary services needed by the EDC to meet its POLR obligations should be procured via a competitive process. The Maryland and New Jersey models for competitive wholesale procurement processes were both well supported at the roundtable. Several parties, including PPL Electric Utilities Corporation ("PPL"), PECO, OCA, and Exelon, however, suggested that the EDCs should be allowed significant discretion to develop generation supply plans, and present those plans to the Commission periodically

[8] FEOC Comments p. 6.
[9] Comments of The Energy Association of Pennsylvania ("EAP"), April 21, 2004, Docket M-00041792, p. 3.
[10] Comments of The Office of Consumer Advocate, May 26, 2004, Docket M-0041792, Issues List p. 14 ("OCA Comments").

for approval.[11] Constellation strongly urges the Commission, in considering those proposals, to reject any notion that there can be an effective substitute for a process that allows direct, head to head competition between all qualified suppliers. Furthermore, the Commission should recognize that particularly where affiliates are involved in POLR service transactions, the Federal Energy Regulatory Commission ("FERC") has stringent standards that require affiliates to demonstrate that such contracts have rates that are just and reasonable and do not negatively impacted competitive markets.[12] These standards are subject to ongoing discussion before the FERC.[13] There is good reason for this. Wholesale competitive markets cannot thrive in a scenario where a utility can utilize its own generation or affiliated generation to serve all of its power requirements under contracts that are not competitively priced, where other market participants are precluded from participation.

The best way to ensure that competitive wholesale markets in Pennsylvania continue to thrive is for this Commission to require its regulated utilities to procure their power supply needs directly from the competitive wholesale markets through a transparent bidding process, with affiliated companies competing to serve the utility load on the same playing field with unaffiliated entities. Separate bilateral contract negotiations do not comport to this requirement.

c. POLR supply contract length and resource adequacy issues: There are two important issues that need to be discussed with respect to this important topic.

- **Length of POLR Contracts:** The first issue is how the wholesale supply contracts should be structured to serve the various categories of POLR customers to provide stability to the customer classes that require POLR price stability due to the lack of a robust competitive retail market at the present time, without

[11] Comments PPL Electric Utilities Comments, April 21, 2004, Docket M-00041792, p. 9 ("PPL Comments").; PECO Comments pp. 2-3; OCA Comments, p. 10; Exelon Comments, p. 12 *et. seq.*
[12] see *Boston Edison Co. Re. Edgar Electric Energy Co.*, 55 FERC ¶ 61, 382 (1991) and *Southern California Edison Co.,On behalf of Mountainview Power Co., LLC,* 106 FERC ¶ 61, 183 at P 59 (2004).
[13] See *Solicitation Process for Public Utilities,* Notice of Technical Conference, Docket No. PL04-6-000, May 11, 2004.

sacrificing the opportunity for competitive retail market to develop and mature. The Commission received a wide range of comments on how long any fixed priced POLR contract should be, ranging from advocacy that all POLR customers should receive only hourly priced service, to POLR contracts of not more than 6 months in length, to longer term POLR contracts of 3 or more years. This variability in recommendations testifies to the fact that achieving the right balance in this regard is indeed a tricky proposition. It further testifies to the fact that the applicable legislation with respect to this issue - Section 3807(e)(3) - that requires POLR pricing to reflect "prevailing market" provides little guidance on this issue.

Thus, this is a matter that requires significant Commission deliberation. For residential and small commercial customers, who have limited competitive retail alternatives, a portfolio of annual and multiyear contracts – up to three years – best achieves this balance. With a portfolio approach, a portion of the price applicable to the service is regularly reset, ensuring that the overall price does not stray too far from market. This is key for retail suppliers who are unable to develop and implement a viable business strategy when their opportunities to compete depend only on downward market price movements that create headroom against the POLR price. While preserving opportunities for retail competition, such a portfolio approach also provides customers with reasonable levels of price stability and certainty, and provides wholesale suppliers the ability to provide meaningful hedging services in their bids.

If these contracts lengths are longer, not only do retail suppliers find it difficult to stay in business, but the wholesale POLR supply prices will be higher because wholesale prices lose their transparency the further out they go, thus increasing the costs to manage the price risks associated with the longer term, and because the customer attrition risk is likely to be viewed as a greater risk over a longer time period. Finally, a long POLR contract period could preclude the ability to make appropriate course corrections in POLR service design to the extent that improvements in the process would need to be postponed until existing contract expire.

For Large Commercial Customers, who are already familiar with retail service shopping and for whom viable competitive alternatives exist, POLR service is equally necessary, but it is generally only needed as a temporary service, and therefore can and should be tied to spot market prices. It should not be structured to provide market based service options that the competitive market has demonstrated it is able, ready and willing to provide.

- **POLR contracts and resource adequacy:** The second important point in this regard is how and whether the length of the wholesale POLR supply contracts are linked to overall resource adequacy in the market. The Commission questioned several parties, including FERC's Alice Fernandez, on whether and how POLR competitive procurement processes were important in ensuring resource adequacy. In addition, both Calpine Corporation ("Calpine") and PPL suggest that there is a specific link. Calpine states that "longer term competitive procurement is better at promoting the development of new generation and fostering economic development", while PPL, in suggesting that some POLR supply contracts should be as long as ten years, state that "[l]onger terms have the advantage of providing a reasonably assured stream of revenues that would facilitate the construction of new capacity."[14] These comments suggest that requiring the EDCs to enter into longer term contract to meet their POLR obligations would allow those contracts to serve as the underpinning for investment in new or existing infrastructure necessary to maintain resource adequacy. Constellation believes that such comments are misplaced and urges the Commission to reject the notion that POLR service contracts should be the vehicle that underpins capacity resource infrastructure, especially for the Pennsylvania utilities that operate in the PJM markets.

[14] Comments of Calpine Corporation, May 19, 2004, Docket M-00041792, page 2 ("Calpine Comments"); PPL Comments p. 10.

In well functioning organized regional markets, where there is open access to the regulated transmission system, and the operations of the transmission grid are managed by an independent RTO/ISO, like PJM, resource adequacy is addressed through the reliability planning and market design of the RTO. In PJM, there is an annual evaluation of the appropriate reserve margin for the PJM region, and there is a capacity market administered by PJM pursuant to which entities serving load in the PJM region must certify that they have secured resources to meet their share of the capacity reserve margin.

Currently, PJM is conducting a comprehensive review of its capacity market design and PJM staff is expected to submit to its stakeholders on June 30 its strawman proposal for re-design of the PJM administered capacity market. Undoubtedly, vigorous discussion and debate will take place in the PJM stakeholder process on all elements of PJM proposal. It is at the PJM regional level that the discussions and debates about how to ensure resource adequacy should and must take place because resource adequacy is a regional issue, not a state by state issue. This Commission and its Staff have exhibited strong leadership and participation in the PJM stakeholder processes, and the resource adequacy debates and discussion will benefit greatly from that continued involvement.

However, it is not the capacity market design alone that incentivizes market participants to maintain existing and build new infrastructure. It is the combination of the market prices signals from the capacity market construct, along with the price signals from the energy and ancillary services markets that will cause buyers and sellers in the market place to respond to those price signals with new capacity resources when and where they are needed. When the capacity market, energy market, and ancillary service market are robustly competitive (liquid and transparent) and rules are stable and well understood by the market participants and provide mechanisms pursuant to which market participants can reasonably predict price trends, buyers and sellers in the market place will enter into contracts to meet their business objectives. When markets are characterized by excessive mitigation of energy prices and lack of energy pricing that reflects short term and long term scarcity, any incentive on the part of energy buyers to manage their capacity requirements is eliminated. Thus, mitigation and pricing policies must carefully balance the need for preventing market power abuse against the need for accurate price signal formation. When that balance is not achieved, and the capacity shortages become apparent, regulators are forced to mandate solutions under cost-based-rate regimes, and the benefits of competition - the reason for moving to deregulated generation markets - is lost. A market that is composed of some rate based resources that have a guarantee of full cost recovery, and resources that do not enjoy such protection is a market whose competitiveness is undermined because assets are not competing on a level playing field. Thus, the first step in preserving the promise of the benefits of competitive markets, is to ensure that the regional market design promotes efficient, transparent and liquid market price signals to all load and to all suppliers, and that buyers and sellers have the confidence that the market design of the wholesale markets will not be undermined by policies that over mitigate and otherwise hamper accurate price formation.

So, if achieving resource adequacy is dependent on a robust competitive regional market, what is the role of competitive POLR service in the context of resource adequacy in Pennsylvania? A comprehensive statewide POLR procurement process, developed in accordance with the principles stated herein, will provide an additional level of market stability that builds on and enhances the stability of the regional wholesale market. The PJM administered market design determines the energy related products that must are necessary to serve load. Those products include energy, capacity, congestion management, ancillary services, and transmission service. The POLR procurement process should require the EDCs to seek bids to supply the full range of required energy products, i.e., the full requirements services. Wholesale suppliers, such as CPS and other entities that have participated in these Roundtable discussions, are very experienced in managing portfolios of generation and contracts, and have an in-depth understanding of the PJM and surrounding market place. They use that experience and understanding of the market place to construct competitive bids to serve those full requirements. Stability in the PJM market place, confidence in the market price signals that PJM helps to foster, and certainty that new regulatory regimes will not undermine that stability and the robustness of the market price signals is the key to enabling wholesale entities to bid effectively to serve POLR-type loads. As market prices begin to rise, signaling to buyers and sellers the need for new infrastructure, wholesale suppliers who compete to serve the load, including the POLR load, will recognize that need and respond to it. They will respond because they will have the assurance that the investment they make will enable them to more effectively avoid costs or competitively serve load. Since their business strategy is founded on serving wholesale requirements, wholesale suppliers should - and will - respond with necessary infrastructure - if the market rules do not undercut the value of those investments. Thus, POLR competitive procurement processes must focus on developing robust mechanisms for the EDCs to secure the PRODUCTS they need to meet their POLR obligations. The wholesale suppliers who compete to provide those products, and who have the most experience in managing and hedging the pricing risks associated with those products will focus on how best to provide the infrastructure required to supply the Products.

d. **The benefits of bilateral wholesale credit and collateral:** Several parties, including Constellation, J. Aron and Company ("J. Aron"), Morgan Stanley Capital Group ("MSCG"), and FES, reiterated the need for industry standard, bilateral credit provisions.[15] In fact, there were no parties at the POLR Roundtables, to Constellation's knowledge, that argued against bilateral credit and collateral provisions. Nevertheless, these bilateral provisions have yet to find their way into any of the prominent POLR

[15] Comments of J. Aron and Company and Morgan Stanley Capital Group, June 7, 2004, Docket M-00041792, p. 3; Calpine Comments, p. 4; FES Comments, pp. 10-11.

models, including Maryland and New Jersey. Constellation urges the Commission to take a leadership position on this issue and correct this flaw as it issues POLR regulations for the Pennsylvania EDCs. There are two compelling reasons for bilateral credit and collateral provisions.

First, customers will pay less for their POLR service. Most of the Pennsylvania EDCs are financially sound and the costs that they will incur to post collateral to the wholesale supplier counterparties will unmistakably be lower that the added premium that suppliers will incorporate into their bids to cover the risk of not having bilateral credit.

Second, bilateral credit provisions will ensure the highest level of participation by qualified wholesale bidders, serving to make the procurement process more competitive, resulting in lower prices to customers. Qualified, experienced wholesale suppliers cannot take on unlimited credit risk exposure, as they are required to do under the existing POLR Models. The lack of counterparty credit support makes those contracts inherently more risky, and that risk must be managed, either by raising the price to provide service under such a contract, or by simply choosing not to participate. Either way, customers lose in the form of higher prices.

e. **The benefit of including all POLR costs in the POLR price:** Nearly all participants in the Roundtable agree that the EDC should be the POLR provider, and many diverse participants in the Roundtable discussions, including retailers, some EDCs, consumer groups and wholesalers, have recognized that it is vital that EDC POLR prices be reflective of all costs to provide POLR service. Others, however, have argued that POLR costs should continue to be embedded in the distribution rates. Failure to adopt a mechanism that ensures that POLR prices reflect the full cost of POLR service will impede, if not halt, the development of competitive retail markets. Without a representation of the full costs of POLR service in the POLR rates, customers will be unable to effectively choose between POLR and non-POLR service. Retail suppliers will be unable to attract customers because any customers that they serve will be paying certain costs to provide generation supply service twice - once to the retail supplier and again to the EDC who collects those same POLR service costs in its distribution rates. Amerada Hess appropriately points out that POLR service should not be subsidized by the distribution rates[16] and recognizes that customer service costs and uncollectible costs, currently embedded in the distribution rates of the Pennsylvania utilities, must be reflected in the POLR rates, and all customers should receive refunds to their distribution rates for shared services provided to both POLR and distribution service customers. Allegheny Power ("Allegheny") elaborates on the "administrative adjustment" crediting mechanism that was used in Maryland to address the issue of the cross subsidization of POLR service by distribution service.[17] This crediting mechanism is fully described in Allegheny's comments as it was in Constellation's comments, and it merits close examination by this Commission.

PPL Energy Plus goes even further by advocating for complete unbundling of metering, billing, customers care and reconciliation processes.[18] Conversely, PSEG argues that retail market support functions and customer care functions should remain the responsibility of the utility, but argues against the any retail adders that would reflect the costs that PSEG incurs in serving POLR customers.[19] FEOC acknowledges that the POLR obligation should include retail market support functions, such as customer lists and demand side response, customer care and chapter 56 functions,[20] and that all such costs should be fully collected from POLR customers.[21] PPL acknowledges that it must maintain certain facilities and personnel to perform certain metering, billing and customer care functions of the POLR service.[22] While Constellation does not recommend that a full unbundling of customer care functions is necessary, when appropriate crediting mechanisms are adopted, it is absolutely vital that (1) the cost of these functions be acknowledged to be part of the POLR service, (2) the costs should not be charged to non-

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[16] Amerada Hess Comments, pp. 4-6.
[17] Comments of West Penn Power Company d/b/a Allegheny Power, April 21, 2004, Docket M-00041792, pp.6-7 ("Allegheny Comments").
[18] Statement of Paul T. Champagne President, PPL EnergyPlus, LLC, May 19, 2004, Docket M-00041792, p. 4 ("PPL EnergyPlus Comments").
[19] PSEG Comments, p. 5.
[20] FEOC Comments, p. 8.
[21] *Id.* at p. 16.
[22] PPL Comments p. 7.

POLR customers, and (3) that the costs of these functions are sufficiently reflected in the POLR retail price where appropriate.

Constellation disagrees with statements by OCA and Office of the Small Business Advocate ("OSBA") that retail rate components that fully reflect the costs of providing service are purposefully intended to make the POLR service unattractive or "ugly" for the sole purpose of promoting competition.[23] Constellation is sympathetic to OCA's position that POLR service should not be in inflated to reflect the **EGS's** costs of acquisition, back-office or margin revenue requirements.[24] However, POLR prices should reflect the **EDC's** full costs for such components, including customer care functions, and not just the incremental costs or "avoidable costs" of POLR service.[25] This is particularly relevant, since OCA acknowledges that the EDC, as POLR provider, must remain responsible for customer care, billing, collection, and Chapter 56 compliance.[26]

Similarly, PSEG opined that POLR service should not be artificially inflated,[27] a statement with which Constellation agrees. However, it is equally appropriate and necessary that POLR service not be subsidized by distribution service customers only, as advocated by PSEG though the proposal to socialize bad debt expense.[28] Reliant more appropriately disagrees with the subsidy, and correctly advocates for the inclusion of all POLR costs in the POLR rates.[29] Allegheny correctly points to the importance of only charging POLR customers for POLR costs.[30] Constellation concurs with Reliant and Allegheny Power, and recommends that POLR rates should include recovery of energy, capacity, ancillary, and transmission costs, line losses, renewable energy compliance costs, a margin for POLR risks, POLR supply bidding and administration costs, transmission administration costs, legal and regulatory costs associated with POLR

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[23] OCA Comments pp. 2-3; Comments of the Office of Small Business Advocate, May 26, 2004 Docket M-00041792, pp. 1-3 ("OSBA Comments").
[24] OCA Comments p. 21.
[25] *Id.* at List, p. 10.
[26] *Id.* at List, p. 3.
[27] PSEG Comments, p. 4.
[28] *Id.* at pp. 11-12.
[29] Reliant Comments, p. 2.

filings, working capital, POLR regulatory proceeding costs and POLR compliance filings costs, customer education on POLR service, and an allocated share of billing, collection, bad debt and customer care expense, retail and wholesale customer payment processing costs, data management costs, and other general and administrative costs. Constellation further concurs with the crediting mechanism advocated by Amerada Hess and Allegheny, and adopted in the Maryland standard offer service rates, to accommodate the appropriate pricing to achieve this end.

Lastly, The National Energy Marketers Association ("NEMA") provides a thorough review of costs that should be reflected in the POLR rates.[31] The extensive list of costs listed by NEMA underscores some of the real challenges the retail suppliers face when competing against utility transition period prices, whereby many of the customer care and customer service costs are embedded in the distribution rates.

f. **The benefits of elimination of switching restrictions in favor of seasonal rates and other customer migration risk mitigation measures:** One of the more contested issues discussed during the Roundtable is how to achieve the right balance between promoting customer choice (which cannot occur when customers are prohibited from switching away from POLR service) and ensuring a reasonably priced POLR service (recognizing that POLR prices may be higher if customers are able to switch freely). Constellation believes, as did many others at the Roundtable, that the right balance must be grounded firmly on the side of elimination of switching restrictions, along with the adoption of market based mechanisms, especially seasonal pricing, to mitigate the risks associated with customer switching.

OCA expresses concerns that seasonal pricing will elevate certain public policy issues.[32] First and foremost, they assert that seasonal rates may cause summer electricity costs to increase due to A/C use. This is absolutely correct, and customers should be encouraged

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[30] Allegheny Comments, p. 5.

[31] Comments of The National Energy Marketers Association on POLR Roundtable Issues List, May 3, 2003, Docket M-00041792, pp. 9-10 ("NEMA Comments").

[32] OCA Comments, pp. 17-18.

to react to this price signal by reducing peak usage, so that all residential customers benefit from lower prices, including low income consumers. The OCA correctly notes that the EDC will need to continue to be sensitive to medically necessary air conditioning use, and should continue to offer balanced billing services to those consumers that need this service. These issues, however, can be reasonable accommodated.

OSBA argues that seasonal rates are not necessarily revenue neutral for individual customers,[33] and that certain users of A/C may pay more. Once again, this is absolutely right. Currently, certain customers are subsidizing other users. OSBA itself advocates for the need to not continue the cost allocation based on a historical cost-of-service study.[34] Thus, OSBA is inconsistent in its advocacy opposing the status quo, when the status quo is clearly not beneficial to consumers. Whereas some customers may pay more, and be adversely affected to some degree, (1) there will be other businesses that will benefit from a lower cost of electricity based on their off-peak usage patterns, and (2) economic response to these more efficient price signals should result in an overall decrease in electricity costs.

Amerada Hess appropriately points out that POLR service is a back-stop service for those who do not chose a competitive EGS, or whose competitive supplier has defaulted.[35] By definition then, customers should be given ready access to the competitive market without any switching restrictions. Amerada Hess also articulates the balance that must be maintained to ensure that the POLR price minimizes gaming incentives, by advocating for seasonal rates and hourly priced service for large C&I customers, for example. This is consistent with Constellation's POLR position.[36] NEMA advocated that POLR providers should be prohibited from mandating minimum stays as a condition for service.[37]

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[33] OSBA Comments, p. 6.
[34] *Id.* at pp. 5-6.
[35] Amerada Hess Comments, p. 5.
[36] Response of Constellation Power Source, Inc. and Constellation NewEnergy, Inc. to the POLR Roundtable Issues List, June, 14, 2004, Docket M-000041792, p. 4.
[37] NEMA Comments, p. 6.

Calpine, on the other hand, argues that the utility should be able to offer a long term price POLR product whereby consumers would forgo access to retail choice, and further argues that such a product is appropriate, since certain customer classes have not historically migrated to the competitive market.[38] This proposal does not comport with the legislative mandate for pricing at prevailing market prices, is not consistent with the definition of POLR service, and is logically flawed. If certain customer classes have not been participating in retail choice, then the migration risk should be minimal, and the risks can be absorbed by the wholesale supplier as long as there is a seasonal price component to the service and other market based mitigation mechanisms. This also conflicts with the comments of Calpine itself that support the policy that seasonal rates are preferable to switching restrictions or GRA's.[39]

PECO proffers a trio of switching restriction alternatives on the basis that fixed rate POLR pricing will be subject to gaming, whereby customers will leave POLR service in non-summer months, and return in summer months.[40] PECO's proposals however, do not appear to consider the alternative market based solutions to seasonal gaming: mainly seasonal rates for residential and small commercial customers.

PPL proposes multiple POLR options, including a long term pricing option(s) that would prohibit a customer from participating in retail choice for a 2 to 3 year period.[41] Such proposals are extremely problematic for the development of competitive markets in Pennsylvania, non-compliant with the basic statutory definitions of POLR service, and violate basic rights of competitive suppliers to have reasonable access to the distribution system and the customers served by the distribution system of the incumbent utility. Constellation is not aware of any state market in the Northeast with such draconian POLR policies in place.

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[38] Calpine Comments, p. 3.
[39] *Id.* at p. 5.
[40] PECO Comments, pp. 6-7.
[41] PPL Comments, pp. 13-14.

Other generators, including Mirant and Reliant, demonstrated their extensive experience in POLR proceedings by recognizing the need to establish policies that encourage retail choice, by advocating for **no** switching restrictions.[42] Instead, Mirant properly points out that other migration risk measures, such as those used in Maryland, represent a better balance in terms of furthering the competitive policies of the Act.

As to the appropriateness of seasonal rates, PPL EnergyPlus testified that during the transition period, most electricity consumers paid flat rates, and thus had no incentive to change usage patterns. "If customers can see that they actually pay more for electricity during on-peak hours, customers may modify their usage during these on-peak hours if they believe it makes sense to do so."[43] In another vein, PSEG indicated that seasonal rates are an important tool in mitigating the effects of customer switching and potential "gaming" by customers.[44] FES noted that seasonal rates are an important characteristic that should be uniform across the state, while its affiliate, FEOC, acknowledged that the POLR rates should include seasonal differentiation.[45] Taken together, seasonal pricing makes logical sense in the gradual transition to effective competitive markets in Pennsylvania.

g. **POLR Service should be a basic – plain vanilla - service:** As recommended by retailers[46] and wholesalers[47] alike, POLR service should be one, "plain vanilla" service available to each customer group. OCA confirmed this recommendation when noting that POLR service should be a "basic service"[48], and that competitive suppliers should compete by offering a lower price, or by offering better value through, for example, alternative products.[49] Offering a menu of POLR options will frustrate the development of competitive options by the competitive sector, and complicate the wholesale bidding structures advocated by multiple parties in this proceeding.

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[42] Mirant Comments, p.6; Reliant Comments, p. 1.
[43] PPL EnergyPlus Comments, p. 3.
[44] PSEG Comments, p. 11.
[45] FES Comments, p. 5; FEOC Comments, p. 16.
[46] Constellation Comments, p. 4; Amerada Hess Comments, p. 3.
[47] FES Comments, p. 12; PSEG Comments, p. 10.
[48] OCA Comments, p. 8.
[49] *Id.* at p. 6.

III. Conclusions

Establishing comprehensive POLR regulations for the EDC in the Commonwealth is a vitally important task facing this Commission. These regulations will set the tone for competition in the Commonwealth for years to come. As a company committed to bringing the benefits of competitive markets to consumers, Constellation appreciates the Commission's diligence in soliciting the views of all stakeholders. Constellation is eager to continue serving customers in the Commonwealth and strongly urges the Commission to adopt regulations that will foster robustly competitive markets in Pennsylvania. Once again, Constellation appreciates this opportunity to present its views to the Commission as it continues this important work to develop POLR regulations for the Commonwealth.