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April 27, 2005

VIA FEDERAL EXPRESS


James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Rulemaking RE Electric Distribution Companies' Obligation
to Serve Retail Customers at the Conclusion of the Transition
Period Pursuant to 66 Pa. C.S. §2807(e)(2)**

Dear Secretary McNulty:

Enclosed please find an original and 15 copies of the **Comments of Allegheny Power on Proposed Default Service Regulations** in the above-captioned rulemaking. This filing is made by Federal Express and is deemed filed today, April 27, 2005. Copies have been sent via e-mail to the persons listed below.

Very truly yours,


John L. Munsch
Senior Attorney

Enclosures

cc via email: Cyndi Page – PA Public Utility Commission
Shane Rooney – PA Public Utility Commission

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Rulemaking RE Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa. C.S. §2807(e)(2)	* * *	Docket No. M-00041792
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**COMMENTS OF ALLEGHENY POWER
ON PROPOSED DEFAULT SERVICE REGULATIONS**

Introduction

On December 16, 2004, the Pennsylvania Public Utility Commission (“Commission”) issued a proposed rulemaking order to define the obligation of electric distribution companies (“EDC”) to serve retail customers at the conclusion of their respective transition periods. Prior to issuing the proposed rulemaking the Commission sought comments on this important issue by convening a Provider of Last Resort (“POLR”) Roundtable. Allegheny Power (“AP”) appreciated the opportunity to express its views at the POLR Roundtable, which provided an excellent forum for exchanging ideas concerning this important service. The Commission’s proposed rulemaking presents a balanced, flexible approach to the opinions expressed at the POLR Roundtable. AP would like to offer the following comments on the Commission’s December 16, 2004, proposed rulemaking order.

Comments

AP generally supports the Commission’s proposed rules for default service. The rules

provide a flexible framework to ensure continued electric service to customers who do not receive generation service from an alternative supplier. AP strongly supports the use of a wholesale competitive procurement process to acquire generation supply for default service, and the proposed rulemaking appropriately looks to market forces to regulate the price of default service. However, AP requests the Commission modify and clarify its proposed rules with respect to the full cost recovery the default service provider is ensured under the statute. AP's detailed comments follow and are grouped by proposed rule section.

§54.182. Definitions

- **Competitive Procurement Process** – AP supports the definition and agrees a bid solicitation process should be used to acquire generation supply for default service. The flexibility in the definition recognizes different procurement mechanisms may be appropriate for different service territories and terms of service.
- **Default Service Provider** – AP supports the role of default service provider being reserved to the incumbent EDC within each service territory. With the Commission adopting appropriate protections and with full cost recovery, including a reasonable return or risk component for the default service provider, AP is ready to continue to serve as the default service provider in its service territory after its generation rate caps expire¹. Also, AP supports replacing the term “provider of last resort” with

¹ The Commission recently approved a Joint Settlement of AP and several of its Pennsylvania customer representatives and groups, at Docket Nos. R-00039022 and R-00973981, which extended AP's Pennsylvania generation rate cap from the end of 2008 to the end of 2010.

“default service,” appropriately putting the focus on the service being provided, not the provider.

- **Prevailing Market Price** - AP agrees that the prevailing market price will be realized through a competitive procurement process approved by the Commission. Acquiring electric generation supply in a Regional Transmission Organization ("RTO") or Independent Transmission System Operator ("ISO") administered energy market will also produce the prevailing market price.

Hourly Priced Service – AP supports this proposed definition, which prices the energy component of the generation supply charge according to the RTO or ISO’s Locational Marginal Pricing ("LMP") for energy or other similar mechanism.

However, since the definition only specifically mentions the energy components of the generation supply charge, AP is concerned that potential ambiguity may arise concerning the components that constitute Hourly Priced Service. Therefore, AP suggests the definition be altered to indicate that Hourly Priced Service includes all components listed in Section 54.187(e). AP also supports the provision of proposed Section 54.187(e), providing that the rate for hourly priced service can include reasonable and identifiable administrative or regulatory expenses.

§54.183. Default service provider.

- **EDC as Default Service Provider** - As stated earlier, AP supports the role of default service provider being reserved to the incumbent EDC in each service territory. The public interest is best served by having the EDC act as the default service provider,

and AP agrees with the Commission's decision not to propose a retail POLR model at this time.

§54.184. Default service provider obligations.

- **Universal Service Programs** - AP supports the default service provider being afforded flexibility to modify its existing universal service programs subject to Commission approval.

§54.185. Default service implementation plans and terms of service.

- **Individual EDC Implementation Plan Filings** - AP supports the Commission's decision not to require a statewide default service procurement process at this time. By allowing for individual default service implementation plan filings, the proposed rules allow a default service provider to propose a procurement mechanism best suited to its service territory. This appropriately recognizes the utilities' differing terms of generation rate caps and POLR plans currently in effect. Alternatively, the proposed rules allow for joint filings should some or all default service providers wish to propose a joint competitive procurement process. AP supports the flexibility afforded by this approach, rather than forcing a "one size fits all" solution on the state.
- **Term of Service** - AP supports a minimum one-year term of service.

- **Reclassification of Customers** - AP supports the rule provision allowing the default service provider to recommend a reclassification of retail customers in its proposed tariff revisions.
- **Replacement Procurement Process** - AP agrees a default service provider's proposed implementation plan should set forth replacement procurement procedures to be followed in the event of a wholesale supplier default. Most importantly, this process should ensure the EDC does not bear the risk of such default. The default service provider must fully recover all reasonable costs associated with the replacement procurement process.

§54.186. Default service supply procurement.

- **Exceptions to Competitive Procurement Process/Replacement Procurement Process** – AP supports the proposed exceptions by which a default service provider will procure generation supply for default service by means other than using a competitive procurement process or replacement procurement process.
 - **Hourly Priced Service** should be made available to large customers with pricing for the energy component of such service based on the RTO's EDC applicable LMP for energy (or other similar mechanism).
 - **Supply procured from RTO/ISO energy markets** by the default service provider under the Commission's proposed circumstances: (1) the approved competitive procurement process yields insufficient supply to meet the load requirements and supply is needed before process can be repeated; (2) the supplier

defaults; and (3) the results of the competitive procurement process are rejected by the Commission due to their non-compliance with the approved procurement process and supply is needed before the process can be repeated.

- **Affiliate Participation** – AP supports the proposed rule allowing a default service provider’s supplier affiliate to participate in the competitive procurement process. All qualified bidders should be eligible to participate in the process.
- **Proposed Competitive Procurement Process** – Section 54.186(b)(2)(i)-(vii) sets forth the information that should be made available to all potential bidders in a default service provider’s proposed competitive procurement process. AP supports this proposed rule and agrees the bid evaluation standards should be clearly specified, including the price and non-price criteria under which bids are evaluated.
- **Commission Review** – AP strongly supports expedited review of the results of the competitive procurement process. AP recommends this review process not take more than 3 business days, as a longer review period will negatively impact and increase rates.

Competitive Procurement Process Yields Insufficient Supply – If the competitive procurement process does not yield sufficient supply, AP agrees it may be appropriate for the default service provider to petition for changes to the process before repeating the process. When necessary to procure supply before the completion of another process, the default service provider will acquire supply at prevailing market prices and fully recover all reasonable costs associated with this activity. AP strongly supports the default service

provider being permitted to fully recover all reasonable costs associated with acquiring supply at prevailing market prices under these circumstances.

§54.187. Default service rates and the recovery of reasonable costs.

▪ **Cost Recovery Mechanisms** – As proposed, costs for default service would be recovered through two charges and one automatic adjustment clause:

- (1) **Generation Supply Charge** – As proposed, this non-reconcilable charge is designed to recover costs for energy, capacity, ancillary and transmission charges, RTO and ISO charges, taxes and other reasonable and identifiable costs. Although the Commission is proposing that this charge be generally non-reconcilable, AP notes default service providers are assured full cost recovery of reasonable costs pursuant to Section 2807(e)(3). As such, AP proposes that this charge instead be subject to a reconciliation and true-up process. A reconciliation and true-up process is necessary to ensure that the default service provider is afforded the full cost recovery provided for by Pennsylvania law. In addition, a reasonable return or risk component for the default service provider should be included in this charge. AP stresses that a reasonable return or risk component is necessary to compensate shareholders of the default service provider for real and perceived risks of managing the default service process and services. Under traditional rate base/rate of return ratemaking, utility shareholders were compensated for investing in the utility through a return on the utility's plant investment in a capital-intensive

industry. However, the provision of default service will require minimal, if any, capital investment by the utility, thereby generating no return under traditional ratemaking. Shareholders and the capital markets cannot be expected to invest in and lend funds to an entity that manages the procurement of hundreds of millions of dollars annually in power supply contracts without adequate compensation for their investment in such a company. In addition, AP would like to note that if the generation charge is structured to be non-reconcilable there would be a negative impact on customers, as suppliers will bear significantly higher risk that will result in increased prices to customers.

- (2) **Customer Charge** – As proposed this non-reconcilable, fixed charge would be set on per-customer-class basis to include all identifiable, reasonable costs associated with providing default service to an average member of that class, exclusive of generation supply cost. As proposed, this would include costs related to customer billing, collections, customer service, meter reading, and uncollectible debt; reasonable return or risk component; applicable taxes; and other reasonable and identifiable administrative or regulatory expenses. AP does not support this proposed charge, as it is premature to consider which, if any, services traditionally provided by an EDC can or should be provided by an Electric Generation Supplier (“EGS”). Rather, rules for post-transition service should first focus on the development of a competitive electric supply market, for which little progress has been made in AP’s service area during the first six years of transition. However, if the further unbundling of

distribution services proceeds, AP proposes a distribution credit, rather than a customer charge, applicable to shopping customers who receive a customer care service, such as meter reading, from their EGS rather than the EDC. The distribution credit should include only the incremental costs related to the customer care service, as this will more accurately capture the costs the default service provider avoids if a shopping customer receives the service from their EGS.

- (3) **Automatic Energy Adjustment Clause** – This proposed clause is designed to recover costs incurred through compliance with the Alternative Energy Portfolio Standards Act, 73 P.S. §1648.1, which requires an EDC to provide certain percentages of energy supply from alternative energy sources, including renewables and environmentally beneficial resources. AP strongly supports the purpose of this adjustment clause mechanism, which is intended to ensure full cost recovery for the EDC. However, it is not clear to AP how this annually reconciled mechanism will operate in conjunction with the competitive procurement process envisioned by the Commission. AP encourages the Commission to clarify this issue the context of this case as well as in the proceeding devoted to implementation of the Alternative Energy Portfolio Standards Act (Docket No. M-00051865).

Fixed Rate Option As proposed, the fixed rate option would be made available to all residential customers and all non-residential customers with a registered peak demand of 500 kW or less. Based upon its experiences in Maryland, AP believes non-residential

customers of 1,000 kW or less do not necessarily have the level of sophistication or resources available to effectively manage an hourly priced default service. Due to the complexities associated with hourly priced default service, and the potential negative impact for these non-residential customers, AP instead suggests a fixed rate option be made available to all non-residential customers with a demand of 1,000 kW or less. In addition, AP supports the default service provider being given flexibility in defining the parameters that constitute “peak registered demand” in their individual default service plan implementation plan filings.

Hourly Priced Service For the reasons discussed above for the Fixed Rate Option, AP instead supports an hourly priced service being made available to non-residential customers with an EDC defined “peak registered demand” of greater than 1,000 kW, with the option to propose a fixed rate for these customers in the default service provider’s implementation plan.

- **Price Adjustments During Term of Service** – AP strongly supports the proposed rule allowing the default service provider to include mechanisms in its implementation plan to adjust prices during the term of service to recover reasonable, incremental costs of significant changes in the number of default service customers or reasonable, incremental costs of other events that would materially prejudice the reliable provision of default service and the full recovery of reasonable costs.
- **Replacement Procurement Process** - AP emphasizes this process should ensure the EDC does not bear the risk of wholesale supplier default. The default service

provider must fully recover all reasonable costs associated with the replacement procurement process.

- **Extraordinary Circumstances** – The Commission’s proposed rules provide that the default service provider’s projected and actual incurred costs are generally not subject to Commission review and reconciliation except in extraordinary circumstances or as provided for in the automatic energy adjustment clause. To the extent unforeseen, extraordinary circumstances jeopardize the reliable provision of default service a provider may petition the Commission to seek additional cost recovery. This rule importantly provides for the full cost recovery of reasonable costs that default service providers are assured of through Section 2807(e)(3).

§54.188. Commission review of default service implementation plans.

- **Two-Phase Evaluation Process** - AP supports the Commission’s proposed two-phase evaluation process for default service plans and proposed timeline for this process. Default service implementation plans should be filed fifteen months prior to expiration of the generation rate cap or currently effective POLR plan. The Commission will review the proposed plan, including the proposed generation procurement process, and enter a final order within six months of the filing date of the plan. Upon Commission approval of the plan the default service provider will execute its competitive procurement process, with seven months built into the timeline for the provider to implement its process. The Commission will be notified of the process results in writing and have a time period specified in the default service

plan (but not more than 3 business days) to certify the results of the plan. The default service provider will provide customers with the appropriate notice sixty days before the effective date of the default service rates. This timeline allows sufficient time to execute the competitive procurement process and also provides customers with adequate time to compare offers from alternative suppliers.

- **Waiver of Rules** – AP supports the flexibility afforded by the proposed rule allowing a default service provider to petition for a waiver of the Commission’s default service regulations.

§54.189. Default service customers.

- **Assignment of Customers** - AP agrees that non-shopping customers should be assigned to default service plans at the conclusion of their currently effective rate caps or POLR plans.

§54.123. Transfer of customers to default service.

- **Transfer of Customers Accounts** – The Commission’s proposed rules do not include provisions for minimum stay or switching fees. To limit potential abuse of default service by the competitive marketplace, the Commission is instead proposing to restrict the transfer of customer accounts to default service by suppliers through an amendment to the competitive safeguards. The transfer of customer accounts to default service may not be initiated without the consent of the default service provider (except for the non-payment by a retail customer for services rendered by an EGS) to

remedy unauthorized or inadvertent transfers of a customer's account away from the default service provider, upon the normal expiration of a contract not designed to exploit seasonal price variations, and when the Commission has approved the abandonment, cancellation or suspension of an EGS license. AP is concerned that this process may create a void for a customer whose supplier wishes to drop them but does not have the "consent" of the default service provider. AP requests that the Commission provide additional specifics and clarify its expectations of how this process will operate, including particulars on how the default service provider will obtain full cost recovery in this situation. AP notes that a default service provider should not be required to assume the receivable associated with a customer returned to default service due to nonpayment to an EGS.

- **Competitive Safeguards** - The Commission notes in its order that it may be appropriate to examine Chapters 54 and 57 to ensure that adequate competitive safeguards are in place, with the question posed whether this rulemaking should be expanded or separate proceeding started to address other issues involving competitive safeguards. AP would support this rulemaking being expanded to the extent that issues are discovered which directly impact default service.

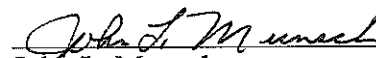
Summary

In summary, AP generally supports the Commission's proposed rules for default service. The rules provide a flexible framework to ensure continued electric service to customers who do not receive generation service from an alternative supplier. AP applauds the

Commission for proposing rules that appropriately look to the market to regulate the price of this important service. AP has experience with procuring market-based default service in Maryland whose procurement process has been recognized by the Federal Energy Regulatory Commission as a model procurement process that is in the public interest, and the Company strongly supports the use of a similar wholesale competitive procurement process to acquire generation supply for default service in Pennsylvania. A copy of the Federal Energy Regulatory Commission order recognizing AP's procurement process is attached as Exhibit 1. AP requests the proposed rules be modified to ensure the default service provider is ensured the full recovery afforded to it under the statute. AP appreciates the opportunity to comment on this proposed rulemaking order and looks forward to continuing to work with the Commission on this important issue.

Respectfully submitted,
Allegheny Power

Date: April 27, 2005


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108 FERC ¶ 61,082
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Allegheny Energy Supply Company, LLC

Docket No. ER04-730-000

ORDER GRANTING AUTHORIZATION TO MAKE AFFILIATE SALES

(Issued July 29, 2004)

1. In this order, we grant an application under section 205 of the Federal Power Act¹ by Allegheny Energy Supply Company, LLC (AE Supply) requesting Commission authorization to make market-based rate sales to its affiliate, The Potomac Edison Company (Potomac). AE Supply will make these sales pursuant to a master Full Requirements Service Agreement (FSA) and three transaction confirmations resulting from a Maryland Public Service Commission (Maryland Commission) supervised request for proposal (RFP) process. This order concludes that this competitive solicitation, as described below, satisfies the Commission's concerns regarding affiliate abuse. This order benefits customers by providing further guidance as to the Commission's standards by which it reviews market-based rate affiliate sales resulting from RFP processes.

Background

2. On April 13, 2004, AE Supply filed the instant application stating that as part of a RFP process supervised by the Maryland Commission, AE Supply had been selected to supply Potomac with full requirements service to fulfill some of Potomac's standard offer service obligations. For this reason, AE Supply seeks Commission authorization to make wholesale power sales to its affiliate, Potomac. AE Supply also requests waiver of the 120-day prior notice of filing requirement to allow an effective date of January 1, 2005.

3. AE Supply and Potomac are both wholly-owned subsidiaries of Allegheny Energy, Inc. AE Supply owns and operates generating facilities and markets energy and energy products at market-based rates. Potomac is a franchised electric utility that has transferred functional control of its transmission system to PJM Interconnection, L.L.C.

¹ 16 U.S.C. § 824d (2000).

Potomac is required to provide standard offer service to any customer that does not choose an alternate supplier under Maryland's retail choice program.

4. On April 29, 2003, the Maryland Commission approved a consensus settlement agreement between twenty parties, including Potomac, setting forth a plan that established the framework for a competitive solicitation process to procure standard offer service supplies in Maryland after utility rate caps expire.²

5. On September 30, 2003, the Maryland Commission approved another settlement agreement that defined the specific requirements and processes necessary to implement the competitive solicitation. The settling parties collaborated to design a uniform, state-wide RFP process whereby Maryland's franchised electric utilities procured supplies to provide standard offer service to their retail customers.³

6. Subsequently, Potomac issued its RFP, soliciting bids for the provision of standard offer service supplies for several different customer classes. AE Supply responded to Potomac's request for proposals in the first, second, and fourth rounds of a four-round process. AE Supply won bids to provide Potomac a total of 187.6 MW for its commercial/small industrial customer class and a total of 227.2 MW for its large commercial/industrial customer class.⁴ AE Supply bid to provide these services beginning January 1, 2005 for a 5-month and a 12-month term respectively. AE Supply lost its bids to provide Potomac with supplies for its small commercial customer class.

² Maryland Commission Order No. 78400 at 5.

³ Maryland Commission Order No. 78710 at 1-3.

⁴ AE Supply won three bids in total. AE Supply will provide 94.6 MW for Potomac's commercial/small industrial class at \$41.90/MWh for summer energy, \$565.00/MW-month for summer demand, \$52.00/Mwh for non-summer energy, and \$550.00/MW-month for non-summer demand. Under its second bid, AE Supply will provide 93 MW for Potomac's commercial/small industrial class at \$42.25/MWh for summer energy, \$565.00/MW-month for summer demand, \$52.80/Mwh for non-summer energy, and \$550.00/MW-month for non-summer demand. Lastly, AE Supply will provide 227.2 MW for Potomac's large commercial/industrial class at \$50.10/MWh for summer energy, \$1025.00/MW-month for summer demand, \$50.85/Mwh for non-summer energy, and \$510.00/MW-month for non-summer demand.

AE Supply states that, as a result of the competitive solicitation, it will serve about half of Potomac's 2005 energy obligation.

7. AE Supply states that the Maryland Commission is deemed to have approved the results of Potomac's RFP because it issued no order to the contrary within two business days of receiving the results, as required by the settlement it had previously approved.

Notice of Filing and Pleadings

8. Notice of AE Supply's filing was published in the *Federal Register*, 69 Fed. Reg. 22,783 (2004), with protests and motions to intervene due on or before May 4, 2004. None was filed.

Discussion

9. As noted, AE Supply asks the Commission to accept a master FSA and three transaction confirmations allowing AE Supply to make sales to its franchised electric utility affiliate, Potomac. In order to meet the Commission's requirements for sales between affiliates, AE Supply offers evidence that these transactions are the result of direct head-to-head competition between itself and competing unaffiliated suppliers. More specifically, AE Supply offers evidence that the Maryland Commission-supervised RFP process satisfies the Commission's concerns regarding sales between affiliates.

10. As discussed above, this RFP was designed through settlement agreements between many diverse and interested parties. As stated in the Maryland Commission's order accepting the second settlement agreement, the settlement "reflects the outcome of extensive and exhaustive negotiations between informed parties of diverse and traditionally adverse interests."⁵

11. Each of Maryland's four electric utilities, including Potomac, issued RFPs through their websites. First-round bids were due more than three months after this posting, giving interested parties sufficient time to respond.

12. To qualify to submit bids, potential suppliers, whether affiliated or not, were required to submit: a signed confidentiality agreement; documentation that the potential

⁵ Maryland Commission Order No. 78710 at 3.

supplier is a member of PJM and a qualified market buyer and market seller in good standing; documentation that the potential seller is authorized at the federal level to make wholesale sales of energy, capacity, and ancillary services at market-based rates; submission of a credit application and associated financial information to the relevant utility; and provision of liquid bid collateral to assure the commitment of the bidder.⁶ By qualifying potential suppliers before they submitted bids, the RFP-issuing utilities guaranteed that all submitted bids met a minimum standard for certain non-price factors. An entity that did not qualify was given an opportunity to correct any problems, resubmit for qualification, and, if then qualified, submit bids.

13. Bids were submitted to each franchised electric utility in standardized spreadsheets. For each bid submitted to Potomac, potential suppliers were allowed to input a volume (in bid blocks of approximately 50 MW each), a price for summer energy (in \$/MWh), a price for non-summer energy (in \$/MWh), a price for summer demand (in \$/MW-month), and a price for non-summer demand (in \$/MW-month). Bidders were only able to choose the volume and price of their bids. For certain customer classes, Potomac solicited bids for different, set contract lengths. Potential suppliers were able to submit bids for any of the set contract lengths and could submit as many different bids as they chose. Bidders were not allowed to submit bids with terms other than those set by Potomac in the RFP.

14. Winning bids were selected on the basis of a single, calculated price for each individual bid. This number, specific to the Maryland RFP process, is called Discounted Average Term Price (DATP). The calculation to determine DATP involved creating a weighted average of different period prices for energy and demand, as well as discounting prices based on contract term and discount factors set by the RFP issuing utility. This calculation was applied using the same weighting method and discount factors for each bid regardless of affiliation. The only changes in this calculation from bid to bid were the values entered by the bidders (*i.e.*, volume and prices). Winning bids were then selected based on DATP alone.

15. Bids submitted in the Maryland RFPs were binding. Winning bidders received the actual price in their offers for each year of the term of their supply contract. Bidders were required to accept the terms of a master FSA. Winning bidders were not permitted to revise prices or any other terms and conditions of their supply contracts.

⁶ *Id.* at 10.

16. Potomac's RFP was monitored by an independent consultant. The Maryland Commission determined the consultant selection qualifications and evaluated potential candidates. The Maryland Commission then directed Potomac as to which candidate to hire and as to the terms and conditions under which the consultant was to be hired. The consultant was selected by, took direction from, and reported to the Maryland Commission. Its duties included monitoring the bid evaluation under the criteria set forth in the settlement agreements approved by the Maryland Commission.

17. In an effort to eliminate the need for bidders to incorporate a risk premium in their bid prices, the Maryland Commission approved a volumetric risk mechanism in the RFPs. To implement this volumetric risk mechanism, Potomac is required to trace standard offer service load served on a daily basis. An increment is triggered when standard offer service load increases more than 5 MW per bid block above the contracted load, while a decrement is triggered when this load decreases more than 3 MW below the contracted amount. In the case of an increment, the wholesale supplier will be paid the PJM spot market price for energy, capacity, and ancillary services plus \$3 per MWh. In the case of a decrement, a new base load is established, and the wholesale supplier is released from its obligation to supply the decrement load at the original contract price. This mechanism allows bidders to make offers without considering the risk of standard-offer service demand shifts.

18. The Commission has stated that, in cases where affiliates are entering into market-based rate sales agreements, it is essential that ratepayers be protected and that transactions be above suspicion in order to ensure that the market is not distorted.⁷ The Commission has approved affiliate sales resulting from competitive bidding processes after the Commission has determined that, based on the evidence, the proposed sale was a result of direct head-to-head competition between affiliated and competing unaffiliated suppliers.⁸ When an entity presents this kind of evidence, the Commission has required assurance that: (1) a competitive solicitation process was designed and implemented

⁷ See *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 FERC ¶ 61,382 at 62,167 (1991) (*Edgar*).

⁸ See *Connecticut Light & Power Company and Western Massachusetts Electric Company*, 90 FERC ¶61,195 at 61,633-34 (2000); *Aquila Energy Marketing Corp.*, 87 FERC ¶61,217 at 61,857-58 (1999); *MEP Pleasant Hill, LLC*, 88 FERC ¶61,027 at 61,059-60 (1999); *Edgar*, 55 FERC ¶61,382 at 62,167-69.

without undue preference for an affiliate; (2) the analysis of bids did not favor affiliates, particularly with respect to nonprice factors; and (3) the affiliate was selected based on some reasonable combination of price and non-price factors.⁹

19. We believe Potomac's RFP meets the *Edgar* standards. Designing Potomac's RFP (and the RFP's of Maryland's other franchised electric utilities) through a Maryland Commission proceeding increased the transparency of this process by keeping the design process public. Further, Potomac's RFP was part of the Maryland Commission's public record before it was issued, which allowed easier access to information such as the details of the bid selection process and potential supplier qualification criteria. Potomac was not allowed to change the terms of its RFP during the implementation phase, meaning that relevant information was available to potential bidders before the issuance of the RFP.

20. We believe the collaboration of parties with diverse interests helped ensure that affiliates of Maryland's franchised electric utilities were not given undue preference in the design phase of this competitive solicitation. Posting the RFPs publicly and providing ample response time helped ensure that affiliates of the franchised electric utility issuing the RFP did not receive undue preference during the bid submission phase of the RFP. Further, by pre-qualifying bidders using publicly available criteria, the franchised electric utilities eliminated the need to evaluate bids on certain non-price factors, thereby allowing bid selection based on price alone. Selecting bids based on only price ensured that affiliates were not given preferential treatment during the selection phase of the process.

21. Accordingly, we conclude that the Maryland Commission competitive bid process described by AE Supply satisfies the Commission's concerns regarding affiliate abuse. Therefore, we will grant AE Supply's request for authorization to make sales to its affiliate Potomac as part of its participation in this Maryland Commission-approved RFP process.

22. We also provide here guidance as to the standards the Commission will use in the future to evaluate whether an RFP such as the one in the instant filing meets the *Edgar* criteria. The underlying principle when evaluating an RFP under the *Edgar* criteria is that no affiliate should receive undue preference during any stage of the RFP. The

⁹ *Edgar*, 55 FERC ¶61,382 at 62,168.

following four guidelines will help the Commission determine if an RFP satisfies that underlying principle.¹⁰

- a. Transparency: the competitive solicitation process should be open and fair.
- b. Definition: the product or products sought through the competitive solicitation should be precisely defined.
- c. Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders.
- d. Oversight: an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection.

Transparency principle

23. Transparency is the free flow of information to all parties. No party, particularly the affiliate, should have an informational advantage in any part of the solicitation process. The RFP and all relevant information about it should be released to all potential bidders at the same time. Instead of individually inviting specific bidders, the utility should allow all interested parties to bid on the RFP. All aspects of the competitive solicitation should be widely publicized. For example, the issuer can post the RFP on its website and issue a press release to that effect and/or advertise in the trade press. To compete effectively, bidders should have equal access to data relevant to the RFP. Any communication between RFP issuer and bidder that are not part of the bid should be made available to all other bidders. For example, the answers to clarifying questions should be released to all other bidders, but proprietary bid information should not be released.

24. These principles enhance the fairness and transparency of the entire process. Specific steps in the solicitation process may require more guidance to achieve optimal transparency. Two such examples are when a collaborative design is used or when post-bidding negotiation occurs.

¹⁰ Concurrently, the Commission is issuing an order that sets out the Commission's new guidelines for evaluating affiliate transactions under section 203 of the FPA. *See Ameren Energy Generating Company and Union Electric Company, d/b/a AmerenUE*, 108 FERC ¶ 61,081 (2004).

25. If the RFP is to be designed through a collaborative process, the entire process should be widely publicized and open. An independent third party can ensure meaningful participation by nonaffiliates and eliminate characteristics that improperly give an advantage to the affiliate, *e.g.*, the only acceptable interconnection point for a new nonaffiliate plant is at an affiliate's existing plant.

26. Negotiation may occur after the bidding; for example, when a shortlist has been compiled or a winner has been selected. If the affiliate is on the shortlist or wins, it is important to ensure that the affiliate has no undue advantage resulting from its affiliate relationship. One way to prevent such an advantage from occurring is for the independent third party to be the RFP issuer's agent in the negotiation with the affiliate.

Definition principle

27. The product or products sought through the RFP should be defined in a manner that is clear and nondiscriminatory. The RFP should state all relevant aspects of the product or products sought. At a minimum, these aspects include capacity and term, but other characteristics are usually necessary, among them fuel type, plant technology (*e.g.*, simple cycle gas turbine), and transmission requirements. If there are changes in the product specification, rebids should be allowed.

28. An RFP should not be written to exclude products that can appropriately fill the issuing company's objectives. This is particularly important if such exclusions tend to favor affiliates.

Evaluation principle

29. To fulfill the evaluation principle, RFPs should clearly specify the price and non-price criteria under which the bids are evaluated. Price criteria should specify the relative importance of each item as well as the discount rate to be used in the evaluation. Non-price criteria should also specify the relative importance of items such as firm transmission reservation requirements, including acceptable delivery points; credit evaluation criteria, such as the bond rating; the plant technology if more than one technology is listed in the RFP; plant performance requirements, such as availability; and the anticipated in-service date if the plant needs to be constructed.

30. Naturally, these criteria are not meant to be exhaustive; they are merely illustrative. Keeping in mind that affiliates should have no informational advantage, all

criteria should be specific and detailed so that all bidders can effectively respond to the RFP. Clear evaluation criteria will ensure that the RFP does not give an advantage to the affiliate.

31. RFP issuer and bidders will usually need to divulge commercially sensitive information in the solicitation process. Confidentiality agreements between the issuer and bidders can be signed to address this concern.

Oversight principle

32. Effective oversight of competitive solicitations can be accomplished by using an independent third party in the design, administration, and evaluation stages of the competitive solicitation process. Ensuring that the third party is independent and granting it at the outset the responsibility of ensuring that these guidelines are followed throughout the process will also minimize perceptions of affiliate abuse. Minimum standards for assuring independence and the scope of the third party's role are set forth below.

33. A minimum criterion for independence is that the third party has no financial interest in any of the potential bidders, including the affiliate, or in the outcome of the process.¹¹ Preferably, the independence criterion would be the same as that of an ISO or RTO.¹² In this context, "independence" means that the third party's decision-making process is independent of the affiliate and all bidders.¹³ Without such independence, the third party could be biased towards the affiliate in order to enhance its financial position.

¹¹ Conference on Solicitation Processes for Electric Utilities, Docket No. PL04-6-000, June 10, 2004 (PL04-6 Conference), Comments of Maine Public Service Commission Chairman Welch, Tr. 78.

¹² PL04-6 Conference, Comments of John Hilke, Federal Trade Commission, Tr. 4.

¹³ Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (2000), FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000 ¶ 31,089 at 31,061 (1999), *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12, 088 (2000), FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000 ¶ 31,092 (2000), *affirmed sub nom.* Public Utility District No. 1 of Snohomish County, Washington, *et al.* v FERC, 272 F. 3d 607 (D.C. Cir. 2001).

Obviously, a similar concern could arise regarding an actual or potential financial interest link between the third party and any potential bidder. Independence can also be satisfied if the state commission has approved the selection of a third party on the basis of established independence criteria. In addition, the third party should not own or operate facilities that participate in the market affected by the RFP.

34. The independent third party should be able to make a determination that the RFP process is transparent and fair and that the RFP issuer's decision is not influenced by any affiliate relationships. For example, if the RFP issuer wishes to use a collaborative RFP design process, the independent third party should be the clearinghouse for comments by potential bidders on a draft RFP and should evaluate those comments as possible revisions to the RFP. The independent third party's role as the sole link for transmitting information between potential bidders and the RFP issuer would also help to ensure that the RFP design will not favor any particular bidder, particularly an affiliate. The independent third party should continue to be a conduit of information between utility and bidders in determining which of the original bid responses are qualified bids or may be included in a short list.

35. At the evaluation stage of the RFP process, the third party should be able to credibly assess all bids based on both price and non-price factors. It should be able to consider both generation asset bids and power purchase agreements. Also, it should be able to independently verify transmission characteristics that may limit the suitability of certain alternatives. The third party should have access to the same information that the RFP issuer uses in its evaluation and should be able to independently verify its correctness. The third party should also be able to evaluate non-price traits of various alternatives.

Potomac's RFP

36. Potomac's RFP process is an example of an RFP process that would meet the foregoing guidelines. We believe that the design, administration, and bid evaluation phases of Potomac's RFP were transparent. Potomac achieved transparency in the design phase through a collaborative process involving informed parties with diverse interests and an on-the-record, public Maryland Commission proceeding. Potomac was not allowed to change the terms of its RFP during its administration, meaning that relevant information was available to potential bidders before its issuance. Further, Potomac's RFP was part of the Maryland Commission's public record before it was issued, which

allowed easier access to information such as the details of the bid selection process and potential supplier qualification criteria.

37. We believe that Potomac's RFP was clearly defined. By including information such as bidder qualification criteria and bid evaluation method in the RFP, Potomac helped ensure that the parameters of the RFP were clearly defined prior to the solicitation of bids. Bidders had knowledge of the process through which they could bid and through which their bids would be evaluated before they were called upon to submit them. We believe that Potomac's RFP was clearly defined.

38. We believe Potomac evaluated bids based on standardized criteria and applied that criteria equally to all bids regardless of affiliation. By setting a minimum standard for non-price factors, Potomac was able to select bids based on price alone. Further, all bidders were required to accept the terms of the master FSA. Selecting bids based only on price ensured that affiliates were not given preferential treatment during the selection phase of the process. Potomac applied the above mentioned DATP calculation to each bid in the same manner and evaluated the bids based on the resulting discounted price. We believe Potomac applied its evaluation criteria to all bids equally.

39. We believe Potomac's RFP had sufficient independent oversight. As described above, Potomac's RFP was monitored by an independent consultant. The fact that this consultant was selected by the Maryland Commission and that the consultant's compensation was determined by the Maryland Commission before the issuance of the RFP helped ensure the consultant's lack of financial interest in the outcome of the RFP. This consultant reported its findings directly to the Maryland Commission. We believe the presence of this independent third party, as well as the involvement of the Maryland Commission, provided sufficient independent third-party oversight of the design, administration, and bid evaluation stages of Potomac's RFP.

40. Finally, we note that AE Supply is in an RTO. Part of the concern about affiliate transactions is that competitors can be foreclosed from the market. In regions with an RTO-operated market, there is less of a risk of foreclosure if all parties have the option of selling into that market. Therefore, we take added comfort here from the fact that this transaction takes place in a region with an RTO-operated market.

The Commission orders:

AE Supply's application for authorization to make sales to its affiliate, Potomac, pursuant to the master Full Requirements Service Agreement included in the instant filing is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.