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Dominion™

April 27, 2005

Via Overnight Mail

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

Re: 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. L-00040169; **COMMENTS OF DOMINION RETAIL INC.**

Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and fifteen (15) copies of Dominion Retail, Inc.'s Comments in the above-captioned matter.

If you have any questions concerning the submittal, please direct them to undersigned counsel.

Very truly yours,

A handwritten signature in black ink that reads "Gary A. Jeffries".

Gary A. Jeffries
Senior Counsel

Enclosures

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. L-00040169

COMMENTS OF DOMINION RETAIL, INC.

Dominion Retail, Inc. ("Dominion Retail") hereby provides its Comments on the Proposed Rulemaking Order entered December 16, 2004, and published in the Pennsylvania Bulletin on February 26, 2005.

Dominion Retail is one of the largest competitive providers of energy, both electricity and natural gas, to retail customers in the Commonwealth. Because of its experiences in these markets, it has a unique perspective on the future of Provider of Last Resort Service ("POLR"). In particular Dominion Retail does not believe that POLR service should be "ugly" as some parties have accused. Rather, Dominion Retail believes that POLR service and, in particular, POLR service providers, have a vital role in ensuring that POLR service is fairly priced, but at the same time, not priced as an alternative to competitive service. POLR service providers have a further obligation not only to ensure that competition is not harmed by their actions, but also to promote a vibrant competitive market. Without a robust market, the whole statutory paradigm under which the POLR provider is permitted to recover the costs of POLR service at market based rates becomes a nullity. In short, Dominion Retail's view is that POLR providers must not

only be prohibited from competing via POLR service, but that those same providers must be required to encourage participation in the competitive market.

Dominion Retail believes that the Commission's Proposed Rulemaking Order provides a substantial framework upon which to base the transition to fully competitive markets. Dominion Retail compliments the Commission for confirming its commitment to relying on the advantages of market forces over regulation as the best means of controlling the price of electric generation. In particular, Dominion Retail agrees with the Commission's statement of guiding principles: 1) that POLR service should be designed to avoid distortion of the retail market; 2) that POLR service should be viewed primarily as a "backstop to the competitive retail market"; and, 3) that demands "a POLR service model that avoids administrative determinations and gives preference to market solutions"(page 5). Moreover, Dominion Retail believes the Commission is wise to recognize that "the market will provide the products and services that meet the needs of consumers," if POLR service is properly designed.

Dominion Retail has a few specific suggestions for strengthening the pro-competition focus of the Proposed Rulemaking Order. These follow immediately:

1. Competitive safeguards are needed to prevent anti-competitive POLR pricing tactics.

Dominion Retail submits that the Commission must unequivocally prohibit pricing tactics that have proven to be antithetical to competitive market sustainability. These include: surcharges to POLR rates, restrictions on customer switching, demand charges that continue even after a customer has switched to a competitive supplier, under-collection riders, migration riders, non-bypassable fixed price premiums, and the collection of RPS costs apart from POLR

rates¹. All of these tactics have at one time or another been employed by POLR suppliers in Pennsylvania or in other states in a clear effort to maintain POLR load. The result of such pricing tactics, whether specifically intended or not, is to cause the appearance that POLR prices are lower than prices offered by competitors, by separating costs from the competitive bogey and in some cases collecting them from customers who shop and do not cause the costs. The principle is simple—all costs properly related to the provision of POLR service must be collected in a way that allows suppliers to comparably price their products. To allow otherwise distorts the price comparison to the detriment of the competitive market.

2. The Commission should approve a price methodology for developing POLR prices.

Dominion Retail agrees with the Commission that a “transparent market mechanism” such as an RFP process or an auction is preferable to administratively determined prices (page 7). However, as Dominion Retail has consistently cautioned, while a price established during the type of regulatory proceeding envisioned by the proposed rulemaking may have reflected the market price at the time of filing, it has almost no potential to be market based by the time the filing is approved. The reason is simple: the market moves over time and the longer the time needed for approval, the greater the chance that the proposed price and the actual market will have diverged. Accordingly, Dominion Retail recommends that the Commission make it clear that approval should be sought for an energy acquisition process and a methodology to translate the results of that process into a retail price—including the full unbundling of all POLR related costs. Dominion Retail submits that POLR providers not simply ask for approval of a price after they have gone through an unapproved process. Rather, after approval is given for the process,

¹ See Dominion Retail’s proposed replacement § 54.187(g) in the redline version of that section of Annex A, attached hereto.

the incumbent EDC or approved default service provider can conduct the approved process and submit the resulting prices for approval to ensure that the methodology was properly executed. Dominion Retail agrees that this latter approval process can proceed very quickly.

3. POLR service should not be a long-term product

The Commission's Order proposes "a term of service be for at least one year," (Page 11, Section E) but nonetheless declines to require "a maximum term length". Dominion Retail submits that the Commission should set a one-year maximum term as well. In Dominion Retail's view, a longer term risks the adoption of a price that will not be market-competitive in the latter years. The Commission recently acknowledged this very real possibility in its decision on Duquesne Light Company's POLR III case (Docket No. P-00032071). Accordingly, Dominion Retail recommends that a pricing term be no longer than one year.

4. The POLR auction processes should be developed in open forum.

Dominion Retail agrees with the Commission's proposed requirement that the default supplier "use a transparent market mechanism, instead of an administrative-determined process," for setting the rates for POLR service. (Page 13, Section F). Such a process is vastly more likely to produce a price that will reflect true market conditions. A market-reflective price is the best way to ensure that alternative suppliers can enter the market and successfully compete. The Commission's intention to monitor the procurement process to ensure that it is "fair, transparent, and non-discriminatory" is a sound idea that should avoid any sort of favoritism toward the default supplier. Dominion Retail is hopeful that the Commission will ensure auction participants that the pricing mechanism will not be determined solely by the default provider, but

rather by the Commission through an open, public process. One example of a pricing model that could be problematic is when prices are “laddered” or “layered in.” Such a process produces a rate that is a blend of several different market prices and could leave consumers confused as to the level of actual market pricing available from the EDC. Instead, utilities must be directed to strive for price transparency. Indeed, price transparency is one of the most critical prerequisites to fair and open competition, such that customers can make informed and meaningful comparisons of prices. In order to avoid the unilateral imposition of non-market sensitive pricing, Dominion Retail believes it is vital that all market participants have a voice in designing the pricing model.

5. The Generation Supply Charge must recover all POLR-related costs.

a. **There should be no reconciliation of charges.** In the Commission’s Order, at Section G, the Commission has clearly identified a key concept in developing a successful default service program—that “all reasonable, identifiable costs associated with providing default service should be fully allocated to default service rates” (page 15). Dominion Retail believes that this view is so important that it cannot be emphasized enough. It is fundamental that no cost deferrals or cost shifting be allowed, since such mechanisms upset the competitive balance by making the price to compare look artificially more attractive than service from marketers, a situation that is similar to that currently existing in the natural gas markets, where reconciled prices that do not collect all default provider related costs, make marketer’s prices look artificially high. The Commission must resist the temptation to allow any type of reconciliation for its proposed “Generation Supply Charge”. Any reconciliation of charges that are subject to competition distorts the ability to compete and confuses customers.

As for the proposed “Customer Charge”, Dominion Retail recommends its elimination entirely.

b. There should be a presumption against fixed charges. While Dominion Retail appreciates the Commission’s initial effort to unbundle the costs correctly, it nonetheless submits that certain specific components of the proposed “Customer Charge”—uncollectible debt charges and a profit component—belong in the “Generation Supply Charge” where they vary with the volume of sales load. Bad debt can be collected by an EGS only through its sales price, and the “reasonable return or risk component” has been previously included in the default service price by the Commission in the Duquesne Light Company POLR III case. To allocate these costs otherwise would artificially depress the “Generation Supply Charge” to the detriment of EGSs in the competitive market. An alternative for handling bad debt is to require those EDCs that collect bad debt expense from all customers as a non-bypassable fixed charge to purchase the accounts receivable of EGSs at the same embedded rate being paid to the EDC via its EDCs distribution rates.

The only charges that should be collected in a fixed charge are those that are discrete, readily identifiable and most importantly, fixed. That is, charges, the cost basis for which increase with increasing volumes, should be volumetric. Risk and hence reward increases with volume, as does bad debt expense. Moreover, metering expense and billing expense vary only with the number of customers, not with the amount of throughput, and thus are appropriately collected as fixed costs.²

² On page 17 the Commission states that it is “aware that EGSs are not currently providing customer care services such as meter reading, etc.” Later, it states that “The default service provider can recover these costs through a modified customer charge that recovers the costs for these specific customer care services being provided to shopping customers.” The Commission should take the opportunity to begin unbundling these costs, traditionally recovered by the EDCs through their distribution rates.

The Commission may wish to consider the inclusion of other volumetrically related items in the "Generation Supply Charge" in order to obtain more accurate rate equalization between the default service price and true retail market prices. For example, the costs of customer services related to electric supply, EDI data exchange, compliance with consumer protection and notifications, database capital investment and management, customer attrition, and other miscellaneous expenses such as supplier licenses. All of these charges should be allocated, at least in part, to the Generation Supply Charge.

c. **AEPS charges must be collected as Generation Supply Charges.** One other potentially significant group of costs that vary with volume and are faced by EDCs and EGSs alike are the costs associated with compliance with the requirements of the Alternative Energy Portfolio Standards Act, signed into law on November 30, 2004. The proposed regulations "provide for the recovery of all reasonable cost associated with this obligation through an automatic adjustment clause". Because of the obvious problem with comparability of rates that is caused by collecting such a charge through either a separate and reconciled charge or through a reconciled portion of the Generation Supply Charge, Dominion believes that the most equitable method to implement the AEPS Act would be for the EDCs to purchase the needed credits for all customers and correspondingly collect payments from all customers. This method is least likely to distort the competitive retail electric market in the way that natural gas markets are currently distorted by the §1307(f) reconciliation process. Alternatively, EDCs could be directed to purchase the credits and allocate the financial responsibility for them among the EGSs on its system according to the load breakdown, provided, of course, that the AEPS charge is reflected as a component of the Generation Supply Charge. Still another alternative is that all AEPS payments be reflected in "Generation Charges" so that the "price-to-compare" between EDCs

and EGSs is placed on a comparable basis. In any event, there should be no deferrals, or separate charges allowed that could undermine the competitive marketplace.

d. The Commission should eliminate the fixed Customer Charge. Finally, Dominion Retail believes that the fixed Customer Charge concept is problematic to the point that the Commission should abandon the idea altogether. Convincing customers to participate in customer choice is hard enough; adding new and different charges that require complicated explanations layers on another level of complexity, particularly for small consumers, that will only keep them out of the competitive market. While such a charge may be acceptable for larger and more industry-sophisticated customers, most small customers want to quickly move to the bottom line and have a strong distaste for complicated pricing. While Dominion Retail appreciates the creativity and logic shown by the Commission in creating the Customer Charge that defines fixed costs in this manner, Dominion Retail submits that the concept should be abandoned for simplicity's sake, and suggests that all POLR-related costs be included in the Generation Supply Charge. Moreover, unless the make-up of the fixed charge is forever frozen, gaming, by moving costs from a volumetric charge to a fixed charge can cause serious harm to competitors. At minimum, there must be a presumption that all charges are volumetric and there must be a significant and compelling justification to move any charge to a fixed charge either at the time filing or otherwise.

6. Customer switching incentives are needed for post transition periods.

Encouraging customers to participate in the retail energy market through specific switching targets and a system of incentives for meeting or not meeting those targets is a necessary component of the market transition. While it may be true that the statutory

requirements for POLR service did not mandate specific requirements in this regard, Dominion Retail believes the overall statutory scheme nonetheless demands it. The purpose of this critical rulemaking is to structure a market that will move customer choice forward after the transition period. Dominion Retail does not believe that such a goal can be left to chance. Rather, Dominion Retail believes that thresholds of market success must be designated, and that incentives must be established toward ensuring that the threshold goals are met.

It has been established by experience that once customers switch to the competitive market, they rarely return to POLR service voluntarily. One can conclude, therefore, that the customers remain with competitive suppliers because the competitive market is satisfying their needs. However, the customers that have switched are not the problem, rather, it is the group that has not switched. One reason that many do not switch is that the EDC has not promoted competition as a way for customers to add electricity service to the list of almost every other product that customers buy in the competitive marketplace. Customers need to hear EDCs say unequivocally that competition is good. In some cases, those customers may even need a nudge. Change is hard – but taking the easy route will never get us to the desired endpoint.

Dominion Retail believes that the Commission should incentivize EDCs to be promoters of customer choice. Accordingly, Dominion Retail submits that the Commission should specifically link the EDC's privileged and incumbent position as the default service provider to the degree of customer switching. As part of this Rulemaking process, the Commission should introduce requirements for the POLR provider to promote competition. That promotion would take the form of a plan to attain and maintain at least 25% small customer shopping over the term of the EDCs default service. Such a plan could include such things as an auction or an allocation. That is, rather than have any retail party or parties petitioning the Commission to be

a “retail” default service provider(s) at the end of the transition period, those competitive retail suppliers will be provided first priority to serve the small customer base as the default service provider, over the EDC, under a Commission approved retail auction, if the switching threshold level is not maintained.

By agreeing to such framework the Commission can insure that intransigent EDCs must promote customer choice at least to some degree and that those EDCs will not create POLR rules and anti-competitive pricing schemes that lead customers to return to default service.

7. Under certain circumstances the Commission should mandate retail auctions.

Dominion Retail notes with more than just a passing interest that the Commission finds that the “competitive retail market is still in transition” and “Therefore, the Commission opts not to propose a retail POLR model in the current market environment.” (Page 9, **Section C “Default Service Provider”**). While Dominion Retail appreciates the Commission’s view on this subject, it may nonetheless be appropriate for the Commission to consider now the conditions under which it may consider pilot retail auctions. By determining in the near term what conditions ought to trigger retail auctions, the Commission can make clear that it intends to forcefully promote competition if and when it becomes clear that the market cannot do it on its own. A pilot auction program could be implemented at the end of the stranded cost collection period, or sooner, and could be applied to those EDCs where small customer shopping is non-existent or sluggish (i.e., less than 10%). A pilot in such territories would allow the Commission to better gauge the advantages and disadvantages of such an approach. While it may seem complicated to initiate, a retail auction could eventually eliminate the need for extensive analysis and consideration related to approving EDC POLR filings.

8. Specific Comments to ANNEX A.

Below are listed some specific comments on selected sections of Annex A of the Order.

Subchapter E. COMPETITIVE SAFEGUARDS, § 54.123. Transfer of customers to default service. This section prohibits the transfer of a retail customer to default service except in certain situations such as revocation or abandonment of an EGS license, nonpayment by a retail customer, to correct an accidental switch, or upon normal expiration of contracts that were not designed to exploit seasonal differences in market prices. This provision is designed to prevent “gaming” of price variations by an EGS. The application of this principle seems fair and equitable to ensure the financial health of the default service provider.

Subchapter G. DEFAULT SERVICE, §54.182. Definitions. The definitions provided herein appear logical and reasonable.

Subchapter G. DEFAULT SERVICE, §54.183. Default service provider. This provision provides for the incumbent EDC in each service territory to be the default service provider except that the EDC may petition the Commission to be relieved of this obligation and a competitive process would determine alternative default service provider. At this stage of development of the retail markets in Pennsylvania, this is a rational approach that provides some degree of certainty as to what entity will provide the service while allowing the potential future transfer of the service provider to other competitive entities as the market evolves.

Subchapter G. DEFAULT SERVICE, §54.185. Default service implementation plans and terms of service. Subsection (c) provides that a default service plan will include a minimum service term of 12 months, or multiple 12-month periods. As noted in the body of the Comments, Dominion Retail submits that the maximum permitted term should also be 12 months.

Subchapter G. DEFAULT SERVICE, §54.187. Default service rates and the recovery of reasonable costs.

§54.187(a)(2). As noted in the Comments and in the attached redline of Annex A, Dominion Retail recommends the elimination in its entirety of the “Customer Charge”.

§54.187(c). The section provides for a fixed rate option for residential customers and a fixed rate option for all non-residential default service customers whose load has a peak demand of 500 or less kilowatts. The fixed price option for residential customers is a good choice and easy for residential consumers to understand. However, it is unclear as to why the Commission picked the non-residential threshold of 500 kW. In view of the type of customer involved the Commission may wish to revise this level down to 50 kW so those customers with higher peaks would default to hourly pricing.

§54.187(g). Please refer to the attached redline for Dominion Retail’s proposed revision of this subsection.

§54.187(h). The default service provider projected and actual costs would not be subject to Commission review and reconciliation except in special circumstances. This provision will prevent any market distortions from occurring due to later cost reconciliation that would

only serve to confuse consumers and EGS' as to the current prices they thought they were receiving.

§54.187(i). Under the requirements of this subsection, the default service provider would be allowed to procure generation at prevailing market prices and recover all reasonable costs in the event a generation supplier failed to delivered generation supply. This provision seems fair and reasonable to the default provider.

Subchapter G. DEFAULT SERVICE. §54.189. Default service customers. This section prohibits any minimum stay requirements or switching fees for customers who may leave default service for an EGS or vice versa. This is a very beneficial provision for consumers in allowing this kind of flexibility and avoids the market distortions that can occur with more restrictive rules. It also encourages the default service provider to incorporate the potential risk of customer migration into its Customer charge as compensation.

CONCLUSION

Dominion Retail believes that the Proposed Rulemaking Order is a commendable first effort at producing a workable framework for the future of electric competition in Pennsylvania. These Comments provide the feedback of a very interested and hopeful continuing participant in

those markets. Modifications to the proposal of the sort proposed herein will only improve that product.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Gary A. Jeffries". The signature is written in a cursive, slightly slanted style.

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Dated: April 27, 2005

ANNEX A

TITLE 52. PUBLIC UTILITIES
PART I. PUBLIC UTILITY COMMISSION
Subpart C. FIXED SERVICE UTILITIES
CHAPTER 54. ELECTRICITY GENERATION
CUSTOMER CHOICE

Subchapter G. DEFAULT SERVICE

* * * * *

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

(a) The costs incurred for providing default service shall be recovered through the following mechanisms or charges:

(1) Generation supply charge – the generation supply charge is a non-reconcilable charge that includes all reasonable costs associated with the acquisition of generation supply, exclusive of the costs of generation supply recovered through §54.187(a)(3), to meet default service demand. The associated costs with this charge include:

- (i) The prevailing market price of energy.
- (ii) The prevailing market price of RTO or ISO capacity or any similar obligation.
- (iii) FERC approved ancillary services and transmission charges.
- (iv) Required RTO or ISO charges.
- (v) Applicable taxes.
- (vi) **Uncollectible debt.**

- (vii) A reasonable return or risk component for the default service provider.
- (viii) Costs associated with acquisition of AEPS credits.
- (ix) Other reasonable, identifiable generation supply acquisition costs, administrative or regulatory expenses.

~~(2) Customer charge. The customer charge is a non-reconcilable, fixed charge, set on a per customer class basis, that includes all identifiable, reasonable costs associated with providing default service to an average member of that class, exclusive of generation supply costs and costs recovered through §54.187(a)(3).~~

~~The associated costs with this charge include:~~

- ~~(i) Default service related costs for customer billing, collections, customer service, meter reading, and uncollectible debt.~~
- ~~(ii) A reasonable return or risk component for the default service provider.~~
- ~~(iii) Applicable taxes.~~
- ~~(iv) Other reasonable and identifiable administrative or regulatory expenses.~~

(2) A default service provider shall acquire the necessary credits under Alternative Energy Portfolio Standards Act, No. 213 of 2004, for all load delivered on its system and may use an automatic energy adjustment clause, consistent with 66 Pa. C.S. §1307 to recover all costs incurred through compliance with the Alternative Energy Portfolio Standards Act, No. 213 of 2004.

(3) The costs recovered through the preceding charges and mechanisms shall not be recovered by an EDC acting as a default service provider through its Commission approved distribution rates.

(b) A default service plan shall include a fixed rate option for all residential customers.

(c) A default service implementation plan shall include a fixed rate option for non-residential default service customers whose load test indicates a registered peak demand of 500 or less kilowatts.

(d) The default service provider shall include an hourly rate in its implementation plan for all default service customers whose load test indicates a registered peak demand of greater than 500 kilowatts. The default service provider may propose a fixed rate for these customers in its default service implementation plan.

(e) The rate for hourly priced service shall include:

(1) The RTO's or ISO's LMP or the equivalent pricing mechanism.

(2) The prevailing market price of RTO or ISO capacity or any similar obligation.

(3) FERC approved ancillary services and transmission charges.

(4) Required RTO or ISO charges.

(5) Applicable taxes.

(6) Other FERC approved or reasonable, identifiable RTO or ISO charges and costs directly related to the hourly priced service.

(7) Other reasonable and identifiable administrative or regulatory expenses.

(f) The default service implementation plan shall include rates that correspond to demand side response and demand side management programs available to retail customers in that EDC service territory.

~~(g) The default service implementation plan may include mechanisms that allow default service providers to adjust their 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.~~

(g) All costs associated with the provision of default service must be collected through the Generation Supply Charge and shall remain in force through

the term of the EDC's default service plan. No surcharges, riders or additional pricing or collection mechanisms shall be utilized for the collection of any default service related charges.

(h) The default service provider's projected and actual incurred costs for providing service may not be subject to Commission review and reconciliation except in extraordinary circumstances, or as provided in §54.187(a)(3).

(i) When a generation supplier fails to deliver generation supply to a default service provider, the default service provider shall be responsible for acquiring replacement generation supply consistent with its Commission approved replacement procurement process. When necessary to procure electric generation supply before the completion of the replacement procurement process, a default service provider shall acquire supply at prevailing market prices and shall fully recover all reasonable costs associated with this activity. In this circumstance, the prevailing market price will be the price of electricity in the RTO or ISO's administered energy markets in whose control area the default service is being provided. The default service provider shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa. C.S. §2807(e)(3), when selecting from the various options available in these energy markets.