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 DUQUESNE LIGHT COMPANY

Pursuant to the Commission's December 16, 2004 Proposed Rulemaking Order issued in the above-captioned docket, Duquesne Light Company ("Duquesne") submits the following comments regarding the proposed rules governing the obligation of electric distribution companies ("EDCs") to serve retail customers at the conclusion of their respective transition periods. Duquesne appreciates this opportunity to comment on the proposed regulations governing default service (currently referred to as "provider of last resort" ("POLR") service in the Commonwealth). Duquesne can offer a unique and informed perspective on the proposed regulations because of its extensive experience with post-transition period POLR service. Duquesne completed the transition period for most customers in 2002 and, since that time, has successfully implemented two post-transition period POLR programs.

I. DUQUESNE'S EXPERIENCE WITH POST-TRANSITION PERIOD POLR SERVICE

Duquesne entered its post-transition period earlier than any other major electric utility in Pennsylvania because of a successful generation auction that terminated the competitive transition charge ("CTC") in 2002 for most customers. Duquesne's first post-transition period POLR proposal was to obtain wholesale supply from the purchaser of its generation assets, Orion Power MidWest, L.P., the same entity that had provided wholesale supply during Duquesne's transition period. This program, which was known as "POLR II," evolved through a Commission-sponsored collaborative process and resulted in a settlement joined by both consumer and supplier groups. The POLR II rate plan approved by the Commission in December 2000 included a 14.4 percent increase in generation rates, but nevertheless provided retail customers with an average rate cut of 17 percent from the rates paid at the inception of competition due to the elimination of the CTC. *Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service*, Docket No. R-00974104 at 5-6 (Dec. 20, 2000) ("POLR II Order"). During 2002, approximately 23 percent of the load in the Duquesne service area received energy from electric generation suppliers ("EGSs"). The POLR II arrangement with Orion terminated on December 31, 2004.

With the expiration of the POLR II agreement approaching, Duquesne proposed a "POLR III" rate plan that bifurcated small customers (residential and small commercial and industrial customers) from large customers (commercial and industrial customers with greater than 300 kilowatts of demand). For small customers, Duquesne proposed to obtain wholesale supply through a series of bilateral agreements and the purchase of a generation facility by its affiliate Duquesne Power, L.P. Duquesne proposed to offer small customers fixed rates for a six-year period, which would have brought Duquesne in line with the expiration of the transition periods for other EDCs in the Commonwealth. For large customers, Duquesne proposed two rate options: a fixed rate default service that would be supplied through an annual wholesale competitive procurement process, and an hourly service that would be supplied through markets organized by PJM Interconnection, LLC ("PJM").

After a hearing, the Commission approved, with modifications, the proposed POLR III plan. The Commission agreed to a three-year fixed price term for small customers that locked in rate savings of at least 15% since the commencement of competition. The Commission, however, reserved judgment on the final three years of Duquesne's small customer plan, holding that it "is possible that a second three-year term with a price adjustment as proposed will be adopted." *Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service*, Docket No. P-00032071 at 17 (Aug. 23, 2004) ("POLR III Order"). For large customers, the Commission approved an hourly-priced POLR default service, as well as a short-term fixed price service (17 months) that is being supplied through fixed price contracts procured through an RFP process.[1]

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[1] On reconsideration, the Commission extended the fixed price option for an additional 12-month price application period. *Petition of Duquesne Light Company for Approval of Plan for*

The POLR III Plan has resulted in a significant increase in shopping in Duquesne's territory. As of March 2005, shopping in Duquesne's service territory accounts for 46 percent of the retail load, double the level of shopping in 2002, and more than four times the level of shopping in the Pennsylvania utility with the next highest level of retail choice participation.

II. COMMENTS

A. Overview

Duquesne commends the Commission and the participants in the POLR roundtable on the development of proposed regulations that address important and difficult issues. Duquesne agrees with a large portion of the proposed regulations but is concerned that, in some instances, they may limit experimentation and flexibility in designing future default service plans. The Commonwealth has had only limited experience with post-transition period POLR service, and other jurisdictions are just beginning to implement post-transition default service. It is doubtful that any desired "end state" has been developed, much less implemented anywhere in the country. It is therefore important that the Commission not preclude experimentation and flexibility, particularly in the period prior to 2011 when all EDCs in the Commonwealth will have to implement post-transition period default service. This is of particular concern to Duquesne, whose successful plan for small customers was approved through 2007, with the possibility of an extension through 2010.

Post-Transition Period Provider of Last Resort Service, Docket No. P-00032071 at 23-24 (Oct.

To be sure, the proposed rulemaking recognizes the need for flexibility in many respects. The Commission stated that "retail and wholesale energy markets will continue to evolve between now and the expiration of the last of the EDC rate caps." Default Rulemaking at 6. The Commission also acknowledged the importance of ensuring that "regulations promulgated now be flexible enough to accommodate markets as they continue to evolve. . . . Consequently, the Commission seeks to avoid overly prescriptive language that may infringe on both its and all other interested parties' ability to manage the default service obligations." *Id.* Duquesne fully supports these statements, but offers comments on areas in which the proposed regulations appear not to meet this goal.

The need for additional flexibility is apparent in two primary areas. First, the Commission's regulations appear to suggest that the *only* way to procure power for POLR customers is through a wholesale competitive solicitation. Duquesne agrees that a competitive solicitation process is *one* reasonable way to procure power, but that does not mean it is the *most* reasonable method or that it will be reasonable under *all* market conditions. Indeed, in Duquesne's POLR III proceeding, the Commission explicitly recognized that "a competitive procurement process is not the exclusive method to arrive at a prevailing market price." Reconsideration Order at 26.

The second area of concern is the proposed rules regarding supplier gaming. By and large, the proposed rules regarding supplier gaming are drafted to permit creative

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5, 2004) ("Reconsideration Order").

methods of addressing these risks. But in certain circumstances, Duquesne suggests additional modifications that will clarify that EDCs have the flexibility to propose reasonable protections that balance the desire to allow customers to freely switch suppliers with the protections needed to ensure that default service can be provided at a reasonable cost.

Duquesne also provides limited comments on several other aspects of the proposed regulations. First, Duquesne addresses the composition of default service rates, including the elements of hourly service and the nature of the customer charge. Second, Duquesne proposes a number of additional changes to several sections of the proposed regulations that are intended to clarify them. Each of the comments provided by Duquesne are reflected in the attached black-line of the Commission's proposed rules.

B. The Commission Should Ensure that the Regulations Leave it Sufficient Flexibility to Approve Default Service Programs that Reflect Evolving Changes in the Market

1. Competitive Solicitations

The proposed rules provide that "each default service provider should have the option of proposing a default service implementation plan best suited to its service territory." Default Rulemaking at 10. This statement is followed, however, by the statement that an implementation plan <u>must</u> include a competitive procurement process for acquiring generation supply. *Id.* at 12. Duquesne does not oppose the use of competitive procurement processes; indeed, Duquesne proposed such a process for its large customers in its POLR III plan. Duquesne does not believe, however, that it should be the *only* method for *all* circumstances.

Section 2807(E)(3) of the Electricity Generation Customer Choice and Competition Act ("Competition Act") provides that an EDC will "acquire electric energy at prevailing market prices to serve [a default] customer and shall recover fully all reasonable costs." 66 Pa. C.S. § 2807(E)(3). The legislature could have, but did not, specify a single method or test for establishing "prevailing market prices." The proposed regulations needlessly tie the Commission's hands, however, by equating prevailing market prices with prices realized as a result of a competitive solicitation, and in doing so ignore other available methods for discerning the prices that prevail in a given market. As discussed below, prevailing market prices may be established through benchmarking to other prices in the region, through a market price index formula, or through other means. While a competitive solicitation may be one appropriate way to determine prevailing market prices, it is certainly not the only way, and, under certain circumstances, may well be less preferable than other methods. Duquesne describes below the limitations of competitive auctions.

a) Competitive Solicitations Are Not Always Successful In Stimulating Retail Competition

Recent experience in neighboring jurisdictions demonstrates that competitive solicitations may not always "foster[] a robust retail market for electricity." Default Rulemaking at 5. In many cases, electric generation suppliers have been unable to compete in markets where wholesale auctions are used to determine default service rates because the resulting prices fail to fully reflect associated retailing costs. The graph below, compiled from 2005 data, compares residential switching in Duquesne's service area with that of utilities in New Jersey, Maryland, and Massachusetts. As the graph demonstrates, Duquesne's residential switching levels are much higher than any of these other markets with mandatory competitive procurement processes. In fact, Duquesne's switching rate for residential customers exceeds that of the Maryland, New Jersey, and Massachusetts utilities combined.[2]

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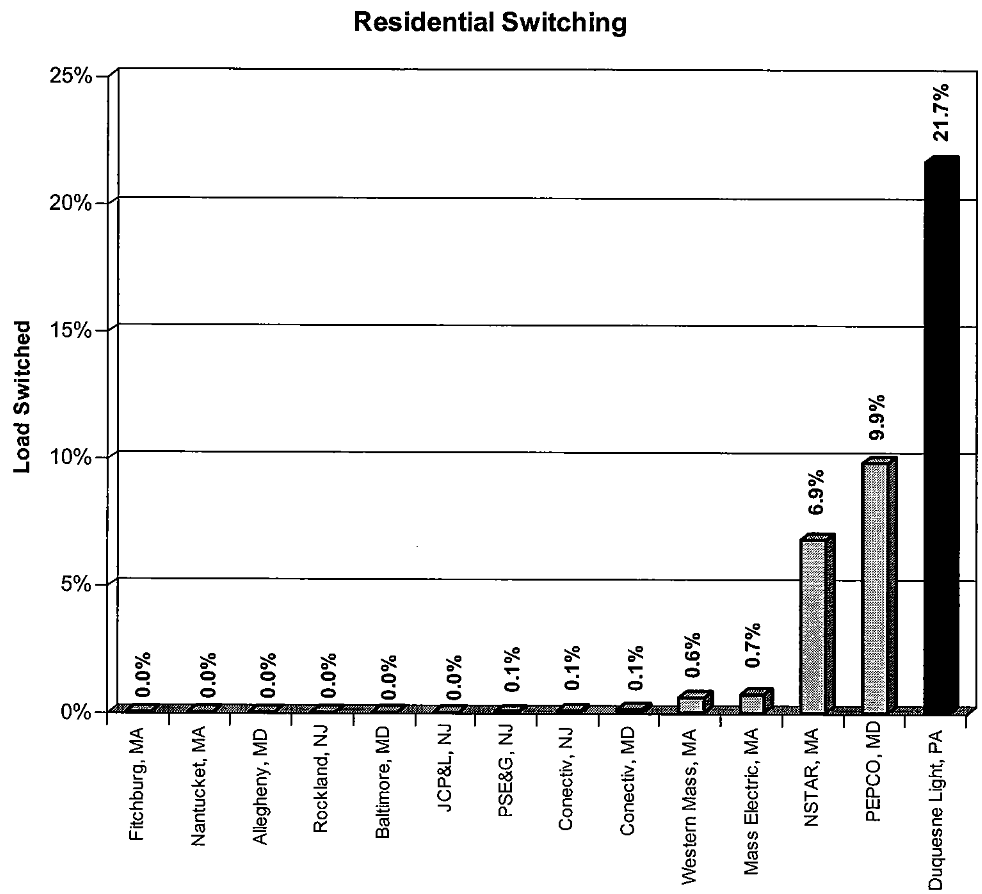
[2] This graph would be even more lopsided if special circumstances in Pepco's and NSTAR's service territories were not present. Two of the alternative retail suppliers in Pepco's region receive discounted wholesale supply from Mirant, the supplier of Pepco's Standard Offer Service. *See* Electric Choice Report 2003, Maryland Office of People's Counsel (July 2003). Switching in the NSTAR region is due to the Cape Light Compact, which serves as an aggregator and collectively purchases electricity for 21 towns. Customers are served by Cape Light rather than NSTAR unless they "opt-out" of the program. *See* http://www.capelightcompact.org.



Sources: 2005 customer switching data from various state utility commissions.

These results have caused electric generation suppliers to oppose wholesale competitive procurement processes in many jurisdictions. In a New York Public Service Commission proceeding, Green Mountain Energy asserted that auctions "eliminate the relationship between [EGSs] and end-use customers and can result in de facto price caps creating a barrier to a competitive supplier."[3] Direct Energy/Centrica

[3] Comments of Green Mountain Energy Company before the New York Public Service Commission at 4, Case 00-M-0504 (Mar. 24, 2004).

North America has taken the position that wholesale auctions foster the continued long-term role of the incumbent utility in the commodity business.[4] Others have argued that because default service rates based on wholesale auctions "do not account for many retail costs that mass marketers incur, there is insufficient headroom to cover acquisition costs and still leave room for savings."[5] The Small Customer Marketer Coalition and Mid-Atlantic Power Supply Association has argued that auctions give the default provider an undue advantage over retail suppliers.[6]

Duquesne does not necessarily endorse all of these views. However, it is important for the Commission to bear in mind that, although competitive auctions may have many virtues, they have, to date, proven less effective in stimulating retail competition than other methods of POLR service and, for that reason, are often opposed by retail suppliers. The Commission should recognize that POLR service inherently

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[4] Comments of Direct Energy/Centrica North America before the New York Public Service Commission at 5-7, Case 00-M-0504 (Mar. 22, 2004).

[5] Patrick Jeffrey, Direct Energy, Retail Energy Foresight at 3-4 (Feb/Mar/Apr 2005).

[6] "As a general matter, acquisition practices that depart from market based supply procurement, such as a utility sponsored auction, should not be employed. Currently utilities go into the marketplace and acquire supplies to meet the needs of their customers and their regulatory obligations. It is reasonable to assume that they will shop around to various wholesalers, determine what products are available in the market place and then make a reasonable purchasing decision. Given this existing structure, utilities can meet the needs of their customers without resorting to an auction process. The competitive standing of the [EGSs] and the utility should, to the maximum extent possible, be comparable and this can only be accomplished if they are both obligated to go into the market place to acquire supplies for their customers." Comments of The Small Customer Marketer Coalition and Mid-Atlantic Power Supply Association before the New York Public Service Commission at 25, Case 00-M-0504 (Mar. 23, 2004).

involves tradeoffs between several competing objectives – particularly facilitating retail competition and providing POLR power at reasonable prices. Competitive solicitations place a heavy premium on achieving the latter, but do not necessarily give equal weight to the former. The Commission should therefore leave open the possibility that the "prevailing market price" standard in the Act can be satisfied through methods other than competitive auctions.

b) Competitive Solicitations Do Not Always Produce Acceptable Results

In addition to the complaints of suppliers, regulators have often been dissatisfied with the prices that result from competitive solicitations. For example, in Maine, the state commission was authorized to conduct auctions on behalf of EDCs, but was given the authority to reject standard offer bids found not to be in the public interest.[7] In that event, the Legislature authorized the commission to direct utilities to provide standard offer service with power the utilities would purchase in the wholesale market. *Id.* When the initial auctions were conducted in late 1999, in most cases the bids received were either non-conforming or were significantly higher than pre-restructuring rates. *Id.* at 2-5. With the exception of Maine Public Service, a small utility in Northern Maine, the state commission rejected most of the auction outcomes, and the default service obligation was retained by the incumbent EDCs.

[7] Summary of Standard Offer Bids for Central Maine Power Company, Bangor Hydro Electric Company and Maine Public Service Company at 1, Docket No. 99-111 (ME PUC Feb. 1, 2000).

In a subsequent auction attempt in late 2000, Bangor Hydro Energy ("BHE") and Central Maine Power ("CMP") again either received unacceptably high bids (in the range of 8.5 to 10 cents per kWh for BHE residential and small commercial customers and from 8.5 to 9.5 cents per kWh for medium non-residential CMP customers) that were rejected by the PUC or failed to receive bids for all customers.[8] The Maine commission concluded that bids "appeared to be inflated due to recent, substantial run-ups and volatility in natural gas prices as well as the market's response to a December Federal Energy Regulatory Commission (FERC) decision that set a deficiency charge for installed capacity (ICAP) significantly higher than had been expected. Because we believed both of these conditions to be transient, we concluded that accepting standard offer proposals at this particular point in time would not be in the public interest." *Id.* at 3. In September 2001 and January 2002, BHE and CMP finally received bids deemed appropriate given then-current market costs and successfully auctioned their standard offer service for all customer classes.[9]

The Public Utilities Commission of Ohio recently faced a similar situation. In December 2004, that commission rejected the results of FirstEnergy's wholesale auction

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[8] Summary of Standard Offer Bids for Central Maine Power Company, Bangor Hydro Electric Company and Maine Public Service Company at 1-6, Docket No. 2000-808 (ME PUC June 19, 2001).

[9] Order Designating Standard Offer Provider and Directing Utilities to Enter Entitlements Agreements, Docket No. 2001-399 at 1 (ME PUC Sept. 18, 2001).

for its retail electric load, opting to accept the utility's proposed rate stabilization plan.[10] There, the commission found that "it is clear at this time that the [rate stabilization plan ("RSP")] price is more favorable for consumers than the clearing price of the auction, which currently represents the best available market-based price to cover FirstEnergy's retail load. . . . We will analyze the process, procedure and substance of the auction, and will consider another auction next year for the remaining two years of the RSP." *Id.* at 4.

Duquesne is not arguing that auctions represent poor public policy, but these examples are provided to show that, *in certain circumstances,* auctions may not represent the optimum results for customers or regulators. Duquesne faced just such a situation when it prepared the POLR III Plan. The markets were sufficiently undeveloped and unstable that an auction was not appropriate for all customers. Instead, Duquesne successfully developed a fixed rate plan for small customers that nonetheless reflected prevailing market prices and the Commission approved that plan. POLR III Order at 22.

The proposed regulations, however, do not appear to leave the Commission or Duquesne any such flexibility particularly in 2007 when Duquesne's POLR III plan expires. It may be that a competitive solicitation will be appropriate at that time, but it

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[10] In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Approval of a Competitive Bid Process to Bid Out Their Retail Electric Load: Finding and Order, Case 04-1371-EL-ATA (PUCO Dec. 9, 2004).

may also be that other methods of setting POLR rates at prevailing market prices will be appropriate. Duquesne is particularly concerned that any auction conducted for supply beginning in 2008 will not include the remainder of the Commonwealth (because the rate caps of other large utilities do not expire until 2010-2011). As Duquesne experienced with its Large Customer plan in POLR III, a solicitation for Duquesne's area alone may not generate significant participation by wholesale suppliers. As reported to the Commission in confidential exhibits following the initial RFP, Duquesne received bids from only six suppliers, most of which offered to supply only a limited number of tranches. In addition, the bids received included a wide variation in price, with the highest price bid almost 100% above that of the lowest bid.[11] It is certainly possible that similar challenges may face Duquesne if it is forced to perform a competitive solicitation for its entire default service load in the near term. The Commission should therefore not preclude Duquesne from proposing another reasonable method for establishing "prevailing market prices."

c) Creditworthiness Can Undermine the Viability of an Auction

The success of a competitive solicitation also can be compromised when winning bidders' financial health and creditworthiness do not allow them to meet their commitments. The past few years have been unkind to wholesale electric marketers.

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[11] *See* RFP Compliance Filing, *Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service*, Docket No. P-00032071, Confidential Exhs. 4a & 4b (Oct. 2004).

During the fourth quarter of 2000, all but one of the twenty-five largest wholesale marketers had investment-grade credit ratings.[12] Since then, seventeen of those twenty-five marketers have suffered credit downgrades and eleven are now considered "junk rated" credit risks.[13] In some cases, wholesale suppliers that were obligated to supply utility retail load have filed for bankruptcy. For example, as part of its bankruptcy process, NRG Power Marketing Inc. attempted to void its supply contract with Connecticut Light and Power, thereby threatening the price stability of the utility's standard offer supply.[14] Mirant filed for Chapter 11 bankruptcy in July 2003 and indicated that it may have to renege on its default service deal with Potomac Electric Power Company ("Pepco").[15] In October 2003, Pepco agreed to pay Mirant a higher price for the supply and will seek to recoup over $100 million through Mirant's bankruptcy case.[16]

Wholesale suppliers participating in auctions also may seek additional protections that require retail customers to bear additional risks. Similar to the proposed

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[12] *See* Power Markets Week at 5 (Feb. 26, 2001) (marketer power rankings).

[13] *See* Bloomberg (Dec. 9, 2004) (credit ratings of parent corporations).

[14] *NRG Terminates CL&P Standard-offer Contract After Winning Judicial Go-ahead*, Power Markets Week at 12 (June 16, 2003). NRG's decision was overruled by FERC, *see Richard Blumenthal v. NRG Power Marketing, Inc.*, 103 FERC ¶ 61,344 (2003), and the parties recently entered into a settlement.

[15] Mirant Seeks to Renegotiate Some Supply Contracts with PEPCO, or Terminate Them, Electric Utility Week at 2 (Sept. 1, 2003).

[16] Mirant, Pepco Reach Power Purchase Deal, Associated Press (Oct. 27, 2003).

regulations in this docket, the rules in New Jersey and Maryland provide that if a wholesale supplier defaults during the contract period, the utility is allowed to recover incremental replacement costs from retail customers.[17] In Maryland, retail customers bear the costs associated with certain customer switching risks, as well as the risk of a failure to secure bids, the risk associated with auction pricing anomalies, and the risk of wholesale supplier default.[18] Many of these risks would otherwise be borne by the EDC on behalf of its default service customers in the absence of a competitive procurement process.

d) Other Methods of Establishing Prevailing Market Prices Also May be Appropriate

In addition to competitive solicitations, there are several other methods for determining prevailing market prices that may be appropriate under certain circumstances. Duquesne provides a few examples below.

(1) Duquesne's POLR III Plan

Duquesne's POLR III plan proposed a competitive solicitation for its large customers, but for small customers Duquesne did not believe that such an auction was appropriate. At the time, the wholesale market was experiencing volatility and several

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[17] *See, e.g.*, Public Service Elec. & Gas Co., Proposal for Basic Generation Service Requirements to be Procured Effective June 1, 2005 at 8, Docket No. EO04040288 (Nov. 2, 2004). Incremental supply costs are first covered by a defaulting supplier's credit security; customers are responsible for any costs in excess of this credit.

[18] Phase II Settlement Agreement, Case No. 8908 (MD PSC July 2, 2003); In the Matter of the Commission's Inquiry into the Competitive Selection of Electricity Suppliers/Standard Offer Service, Case No. 8908, Order No. 78710 (MD PSC Sept. 30, 2003).

wholesale suppliers were either in bankruptcy or had defaulted on supply obligations. Duquesne therefore developed a fixed rate offer for small customers that reflected prevailing market conditions, but did not expose customers to the risks of an auction at that time. During the Commission hearings, extensive review of the proposed prices was performed through a benchmarking process, *i.e.*, the Commission compared the prices proposed by Duquesne with retail prices developed in other jurisdictions. The Commission ultimately concluded that Duquesne provided sufficient market evidence to demonstrate that the proposed default service rates represented prevailing market prices for the first three years. *See* Reconsideration Order at 26 ("we relied on the record evidence to determine that the proposed rates reflected prevailing market prices for energy for a three-year term"). Importantly, the Commission ruled that it "is possible that a second three-year term with a price adjustment as proposed will be adopted." POLR III Order at 17.

The Commission, by adopting a strict competitive-solicitation-only rule, could foreclose the possibility that such a case may be made again in the future. Particularly for the bridge period between 2008 and 2010 when the remainder of the EDCs are completing their transition periods, the Commission should allow itself flexibility to approve a default service implementation plan that is appropriate for the circumstances then present in Duquesne's service territory. Duquesne respectfully requests that the Commission reaffirm the decision it entered in Duquesne's POLR III Order to leave open the possibility of a second three-year small customer rate plan that is based on benchmarked prices.

(2) Market-price index formulae

Another possibility for determining reasonable default service rates that reflect prevailing market prices is linking such rates with a market-price index formula. During the POLR III proceeding, Duquesne (as well as other parties) proposed market-price index formulae to establish prevailing market prices for small customers.[19] And the Commission approved an hourly-priced POLR default service for large customers in that case that was based on *one* form of market price index formula. POLR III Order at 32. Similarly, other longer-term (annual and multi-year) market-price index formulae based on forward prices may be used to establish prevailing market prices and already exist elsewhere in the United States. Various versions of this market index model have been implemented around the country, including for New York State Electric & Gas,[20] Rochester Gas & Electric,[21] the State of Illinois,[22] and the State of Texas. [23]

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[19] *See* Duquesne St. No. 2-R at 11-14, Docket No. P-00032071 (Mar. 17, 2004)

[20] NYSEG offers customers fixed retail rates for a two-year period based on forward electric prices. Joint Proposal, Petition of New York State Electric & Gas Corporation for Approval of its Electric Price Protection Plan at 32-33, Case 01-E-0359 (NYPSC Jan. 2002).

[21] RG&E offers customers fixed retail rates for one year based on forward electric prices. Electric Rate Joint Proposal, Proceeding on Motion of the Commission as the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service at 15-17, Case 03-E-0765 (NYPSC Mar. 9, 2004).

[22] Illinois utilities offer non-residential customers a power purchase option service based on a forward market index. Both residential and non-residential customers that shop receive a market value energy credit based on a forward market price formula. Commonwealth Edison Company Retail Tariff, Rider PPO Power Purchase Option – Market Index, Tariff Sheet at 151.1-15.

For example, default retail customers in Texas were assigned to an unregulated retail affiliate of the EDC in 2002, thereby causing the EDC to exit the commodity business altogether. These retail affiliates continue to charge price-to-beat ("PTB") rates tied to a market price index subject to the Texas commission's approval. In the second phase beginning January 1, 2007, these PTB rates will expire, at which time all retail electric rates, including default rates, will be set by individual retail suppliers without regulatory intervention. The New York Commission recently adopted a similar long-term goal for New York – the elimination of the EDC from the commodity business after a transition period. Although Duquesne does not endorse applying the Texas model in Pennsylvania at this time, Pennsylvania may learn important lessons when PTB rates expire at the end of 2006 about the feasibility of having retail suppliers establish prevailing market prices. If the Texas experiment proves successful by both facilitating retail competition and treating customers fairly, and if such a model is demonstrated to be consistent with the Competition Act, the Commission may wish to consider this type of default service program in the future. Its default service regulations therefore should not prevent the Commission from doing so.

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[23] Senate Bill 7, the Texas electric restructuring law, specified that a retail affiliate of the incumbent utility must provide "Price to Beat" (PTB) service. PTB is comprised of a non-fuel "base rate" plus a fuel factor. While the base rate is frozen, the fuel factor is subject to an adjustment mechanism linked to natural gas prices that allows the PTB provider to raise the fuel factor twice per calendar year. Duquesne has explained in the past that the particular market-price formula developed in Texas suffers several design flaws that have resulted in sizeable rate increases for small customers.

For all the reasons discussed above, Duquesne urges the Commission not to limit itself to the particular default service models identified in the proposed rulemaking. In its order, the Commission stated that it had a choice between a "retail POLR model" (in which the default service obligation is auctioned off) with the model ultimately adopted, implying that these are the only two options. Default Rulemaking at 8. However, there are other possibilities – including Duquesne's POLR III model and the market price index model -- that may prove attractive to the Commission given the passage of time and more experience. The Commission should therefore adopt the modifications to the proposed regulations set forth in Attachment A. These revisions would merely authorize the Commission to approve an alternative procurement process if the default service provider demonstrates that such alternative process will result in electric service supply that reflects prevailing market prices. This approach gives the Commission the flexibility necessary to approve an alternative if circumstances warrant one.

2. Switching Rules

Similar to Duquesne's comments with respect to competitive solicitations, Duquesne respectfully requests that the Commission preserve the flexibility to approve default service implementation plans that include reasonable mechanisms designed to prevent gaming of default service and protect the default service provider from subsidizing competition.

The Commission addressed the issue of gaming in three sections of the proposed regulations. First, the subchapter on competitive safeguards sets forth standards for the return of retail customers to default service. These standards allow an EGS to transfer a customer to default service only if the EGS has abandoned its license, the retail customer has not paid its bill, the retail customer was inadvertently switched to the EGS from default service, or upon the "normal expiration of contracts that are not structured in a way to exploit seasonal variations in market prices." Section 54.123(a). Second, the Commission has proposed in section 54.187(g) that default service implementation plans 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." Finally, the Commission proposed four subsections in section 54.189 that nominally address customer migration. Two of these subsections, relating to the customer's right to depart and return to default service, are applicable only if the customer complies with all Commission regulations. *See* Section 54.189(b) and (d). These provisions thus presumably do not apply if a switch is made for the purpose of exploiting seasonal variations in market prices. Another subsection is identical to a provision in the Competition Act. *See* Section 54.189(c) (requiring a default service provider to treat a customer departing EGS service as it would a new applicant for default service). The final section forbids a default service provider from charging a fee to a retail customer that departs default service. *See* Section 54.189(e).

The Commission's rulemaking order clarifies that the proposed regulations "do not provide for restrictions on the ability of customers to move from default to competitive service, and vice versa." Default Rulemaking at 22. The Commission further noted that it "decline[s] to endorse restrictions such as minimum stay provisions or switching fees at this time. We conclude that these proposed regulations give default service providers the flexibility to effectively manage the risks associated with customer migration without restricting choice." *Id.*

Duquesne interprets the Commission's regulations on switching to encourage the development of customer migration policies that are appropriate to each service territory. Indeed, the Commission stated that it "does not intend to endorse any particular mechanism, and will allow the default service provider to propose reasonable methods of managing this risk [of customer migration]." Default Rulemaking at 19. At the same time, the Commission acknowledged that customer migration mechanisms currently in use elsewhere, such as seasonal rates, may be appropriate. *Id.* Duquesne supports the Commission's decision to welcome these innovations but to withhold judgment until a specific default service implementation plan is before it. This approach is particularly appropriate for switching rules because the need for customer migration mechanisms depends on the nature of default service options proposed as well as the level of switching in a particular service area.

Duquesne is concerned, however, that certain overly prescriptive language in the rulemaking order may leave the Commission insufficient flexibility to adopt mechanisms that are proven to be necessary and appropriate under the circumstances. As the Commission is aware, it has concluded in other cases that minimum stay provisions and generation rate adjustments can be appropriate under certain circumstances. For example, in mid-2000, the Commission issued a final order addressing its "concern over the economic impacts on EDCs of short-term returns of C&I customers to PLR service during high-cost periods." *Guidelines Addressing Return of Customers to Provider of Last Resort Service*, Docket No. M-00960890F0017 (June 22, 2000). There, the Commission "suggested that EDCs who are exposed to that activity might submit proposals for 12-month 'stay provisions'" and further "proposed a generation rate adjustment (GRA) mechanism that should be offered by EDCs to afford C&I customers increased flexibility in gaining access to the competitive supply market following a return to PLR service." *Id.* The Commission soon thereafter approved such a proposal when it adopted a GRA mechanism, as well as a twelve-month minimum stay requirement as an alternative to the GRA, for West Penn Power Company. *Pennsylvania Public Utility Commission v. West Penn Power Company*, Docket No. R-00005538 at 4, 8-9 (February 8, 2001). They also were approved for Duquesne in the context of its POLR II plan. POLR II Order at 10-11.

These protections have proven to be not only effective in precluding gaming, but also in facilitating shopping. Customer shopping *increased* in Duquesne's territory *after* the minimum stay and GRA rules were adopted during POLR II. Furthermore, these types of protections have the advantage of preventing gaming *before* it occurs, rather than relying on after-the-fact detection to remedy abuses. Indeed, the rules in POLR II were adopted only after it became clear that the case-by-case approach adopted in Duquesne's restructuring processing had failed.

Very few changes to the proposed regulations would be necessary to implement Duquesne's recommendation. Nearly all of the proposed regulations preserve the leeway that the Commission stated was important in granting "default service providers the flexibility to effectively manage the risks associated with customer migration." Default Rulemaking at 22. Duquesne suggests that the Commission amend proposed Section 54.189(e) to provide that the Commission may approve an exit fee if the EDC demonstrates that such a fee is consistent with the Competition Act under the circumstances. *See* Attachment A. Duquesne also respectfully requests that the Commission decline in the final rule to rule out a minimum stay or GRA if such mechanism is proven to be necessary or appropriate in the context of a specific default service implementation plan.

Finally, Duquesne notes that the proposed standards in Section 54.123(a) leave a number of questions unanswered. Duquesne recommends that the Commission permit default service providers to provide in their default service implementation plans additional clarifications that will enable the standards to be implemented without unnecessary confusion or litigation. For example, Duquesne expects that default service providers will suggest further details governing how they will determine whether a transfer is upon the "normal expiration" of a contract that isn't structured to exploit seasonal variations in market prices. Such details accordingly would explain the circumstances under which the default service provider will decline an EDI transaction that does not comply with the Commission's rules. A default service plan also may indicate that license revocation is among the penalties that may be applicable to EGSs that violate the Commission's standards. Finally, default service providers may indicate that violations of the standards will prompt expedited procedures and cost recovery mechanisms to ensure that the default service provider is not financially harmed by prolonged litigation regarding gaming disputes. Duquesne requests that the Commission clarify that such additional details may be submitted in default service implementation plans.

C. The Regulations at § 54.187 Governing Default Service Rates Should be Amended

1. The Commission Should Clarify that Hourly Rates Include a Customer Charge and Renewable Charge

Section 54.187(a) of the proposed regulations provides that the costs for providing default service shall be recovered through three charges – the generation supply charge, the customer charge, and an automatic energy adjustment charge that recovers costs of compliance with the Alternative Energy Portfolio Standards Act ("alternative energy charge"). The next two subsections address fixed rate options. *See* §54.187(b) and (c). Subsections (d) and (e) regulate hourly priced service, and identify the "rate" for hourly priced service as including energy, capacity, ancillary services, taxes and other identified costs. These sections do not explicitly state, however, that hourly priced service rates may include the customer charge and the alternative energy charge. Duquesne assumes that this was an oversight in drafting, and that the Commission does not intend to exclude costs recoverable through the customer charge or the alternative energy charge from recovery from customers who opt for hourly service. Duquesne's requested language clarification is set forth in Attachment A.

2. The Nature of the Customer Charge

The proposed rule states that functions such as "billing, meter reading, collections, uncollectible debt, customer service . . . may be more appropriately recovered through default service rates than distribution rates." Default Rulemaking at 16. Therefore, the proposed regulations include the costs of these functions within the customer charge. *See* Section 54.187(a)(2)(i). Because the Commission is aware that EGSs do not currently provide many of these customer care functions, it acknowledged that shopping customers still would need to receive these services from the default service provider. The Commission therefore stated that the default service provider "can recover these costs through a <u>modified customer charge</u> that recovers the costs for those specific customer care services being provided to shopping customers." Default Rulemaking at 17 (emphasis added). The Commission would expect a "near corresponding drop in distribution rates" as a result. *Id.* No further detail was provided regarding the ratemaking process necessary to develop the customer charge or the "modified customer charge."

Neither the intent behind, nor the precise scope of, this proposal is clear. It appears that the "customer charge" is intended to reflect all customer care costs, while the "modified customer charge" would only recover customer care costs provided to shopping customers. In effect, the difference between these two customer charges would represent the dollars that a customer could avoid paying the default service provider if it shopped and took service from an EGS who provided a specific customer care service. In other words, the difference between the two customer charges would