COPY

2005

BEFORE
THE PUBLIC UTILITIES COMMISSION OF PENNSYLVANIA

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

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION

Pursuant to the Public Utilities Commission of Pennsylvania's ("Commission") Proposed Rulemaking Order, dated December 16, 2004, and published in 35 Pa.B. 1421, the National Energy Marketers Association ("NEM")[1] hereby submits comments on the proposed regulations governing the obligation of electric distribution companies ("EDCs") to serve retail customers at the conclusion of each EDC's transition period.

The National Energy Marketers Association and its members are pleased to submit NEM's recommendations for an orderly, reliable, competitive, value-driven and consumer-focused electricity market for the Commonwealth of Pennsylvania. NEM has

[1] NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, electronic trading exchanges and price reporting services, advanced metering, demand side management and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, telecom, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include Multiple Service Organizations (MSOs), inventors, patent holders, systems integrators, and developers of advanced Broadband over Power Line (BPL), Power Line Communications (PLC) technologies, and Hybrid-PLC as well. NEM and its members are committed to helping federal and state lawmakers and regulators to implement a consumer-focused, value-driven transition to a reliable, price and technology competitive retail marketplace for energy, telecom and financial related products, services, information and technologies.

developed these recommendations for their equity, efficiency, competitive neutrality, cost to consumers, and related benefits to the Commonwealth of Pennsylvania. Finally, NEM believes that these recommendations, if implemented, should assist Pennsylvania in achieving a competitive transition and post-transition market, while also serving the public interest.

I. The Proposed Default Service Regulations Should Move Pennsylvania Towards a More Competitive Retail Market.

NEM applauds the Commission's policy decisions that recognize: (i) that competitive markets are superior to utility regulation, protection, compliance and enforcement and estimations in utility rate cases for determining "market based" prices for the cost of electric generation; (ii) that the prevailing market price in a competitive market is analogous to just and reasonable utility rates; and (iii) a preference for customer choice, as evidenced by a decision not to restrict the ability of customers to move from Default Service to competitive service.

NEM recommends, consistent with the Commission's statutory authority, that the Commission set a date certain by which the EDCs must exit the merchant function. Furthermore, NEM recommends that the Commission focus its initial efforts in developing the competitive electric market by requiring the utilities to file fully allocated embedded cost-based rates. Proper rate unbundling is a prerequisite to sending proper price signals to educate consumption decisions and permit suppliers to invest risk capital to make competitive product and service offerings available to Pennsylvania consumers. Subsequent to the utilities implementation of embedded cost-based unbundled rates, a competitively neutral migration process may be appropriate to serve customers that have not yet migrated.

II. The Commission Should Establish A Date Certain for EDCs to No Longer Provide Default Commodity Service.

NEM also recommends that the Commission should establish a date certain by which EDCs no longer provider Default Service. As the Electricity Generation Customer Choice and Competition Act (the "Act") recognizes, the Commission has the express authority to require the EDCs to exit the merchant function and to approve an alternative supplier as the entity to acquire "electric energy at prevailing market prices" and to provide Default Service. (66 Pa. C.S. § 2807(e)). By requiring the EDCs to exit the merchant function by a date certain, the Commission will be implementing one of the Act's key policy declarations, *i.e.*, markets are superior to economic regulation in determining the cost of electric generation, as well as the Commission's goal to develop a regulatory framework for Default Service that will "serve the public interest by fostering a robust retail market for electricity." (Rulemaking at 5). NEM agrees wholeheartedly with the Commission's sentiment and urges the Commission to implement this important policy by unequivocally stating an official end date for each EDC to no longer provide Default Service.

By establishing transitional rules that allow EDCs to continue to provide Default Service for an open-ended duration of time, the Commission imposes a significant regulatory risk of continuing, commercial negotiations and/or regulatory filings with no end in sight. The public interest is not properly served by mandating ratepayers to underwrite the high costs, high risks and potential losses associated with commodity trading, hedging and the related functions of the merchant energy business. This is particularly true when private capital is both willing and able to underwrite these costs and risks and to accept losses that are currently borne by captive ratepayers. True "market solutions" for the formation of a competitive marketplace can be implemented with the Commission approving market participants, not the monopoly EDC, to serve as the Default Service provider.

The Commission already has recognized that regulatory risks can increase the cost of capital significantly when it found that allowing for a longer term of service "may allow a default service provider to attract needed capital investment necessary for the reliable provision of service." (Rulemaking Order at 11). Indeed, some regulatory risks can make a competitive rate of return on invested capital impossible to achieve. Establishing a date certain for EDCs to exit the merchant function is imperative in order to permit market participants an opportunity to manage regulatory risks. The capital and commodity markets need as much regulatory certainty as possible to efficiently price capital. The Commission establishing and sticking to a date certain by which EDCs no longer use their capital and credit to engage in risky commodity purchasing is a very low cost way to lower the cost of capital for both regulated and unregulated investments.

Thus, NEM urges the Commission to permit all stakeholders to rely without concern on the fact that by the end of a clearly defined period for each EDC, Pennsylvania EDCs will no longer be in the commodity supply business. The next step in Pennsylvania's transition to robust retail markets should be the adoption of Default Service regulations that, among other things, encourage, and mandate, if necessary, each EDC to fully exit the merchant function by a date certain.

III. <u>The EDCs' Obligation to Serve Should be an Obligation to Deliver.</u>

NEM encourages the Commission to adopt a long-term vision in which EDC services are defined as those services that only a monopoly can perform and in which

EDCs exit or outsource competitive functions. In particular, reliable EDC delivery services should be separated from competitive commodity supply services. It is no longer in the public interest to continue the EDCs' obligation to serve related to the electricity commodity. However, it is in the critical public interest that the EDCs continue to have an obligation to deliver electricity in a timely, efficient and reliable manner. By removing the obligation to serve a competitive commodity, the EDCs will be able to focus their resources on reliable, cost effective and efficient delivery that the Pennsylvania public both expects and requires.

By separating the obligation to serve into EDC delivery services and competitive supplier commodity services, the Commission potentially will enhance the reliability of electricity supply as well as delivery. NEM submits that the Commission may capture important restructuring dividends for the Commonwealth and its consumers in the form of both competitively-priced electricity and enhanced reliability quality.[2] The public interest would be better served if the EDCs focused on reliability and the competitive suppliers bear the risk of buying and selling volatile commodities. The EDCs should be permitted and encouraged to redeploy capital and credit into reliability-related infrastructure investments, while the competitive marketplace is permitted and encouraged to underwrite the costs and risks of the energy supply/merchant function.

IV. <u>EDCs Must Be Required to Disclose Their Fully Allocated, Embedded Costs to Serve Each Class of Customers.</u>

NEM strongly supports the Commission's decision that "all reasonable, identifiable costs associated with providing default service should be fully allocated to default service rates." (Rulemaking Order at 15). It is imperative that proper embedded

[2] EDC resources historically related to performing competitive functions can be freed up to be reinvested in infrastructure.

cost based unbundled rates be developed to provide consumers proper price signals about default service. In that regard, each EDC must be required to conduct embedded cost of service studies as part of EDC-specific distribution and transmission rate cases.

To assist the Commission in the future "additional on the record" cost of service proceedings (Rulemaking Order at 16)., NEM has attached to these comments a list of electricity functions identified by the New York Public Service Commission in its proceeding on embedded cost based rate unbundling.[3] Functions related to electricity include but are not limited to billing, meter reading, collections, uncollectible debt, customer service, etc. *See* Attachment A. As the Commission has recognized, each EDC must be subject to an embedded cost of service study that determines the "proper allocation of costs to the appropriate rates" for each cost to serve each class of customer in the EDC's service territory. (Rulemaking Order at 16). By properly assigning costs and unbundling competitive services from monopoly services, the Commission will encourage true competition on the basis of pricing, quality of service, and provision of value-added services.

V. Proposed Modifications to the Competitive Procurement Process

Notwithstanding NEM's recommendations to implement embedded cost based rate unbundling at the beginning of the transition, NEM offers the following observations about the proposed default service competitive procurement process.

A. Fixed Price Products are Competitive Offerings that Should be Provided by the Marketplace

NEM is concerned that the proposed rules would permit default service prices to be fixed for extended periods. Even if fixed prices differ seasonally there is a strong

[3] New York Public Service Commission Case 00-M-0504, Order Directing Filing of Embedded Cost Studies, issued November 9, 2001, attachment A.

likelihood that fixed prices will not be reflective of market conditions thereby sending inaccurate pricing signals to consumers. Consumers interested in obtaining fixed price options should be required to obtain such services from the marketplace. Conversely, Default Service should be no-notice, 365 day/7 days a week/24 hours a day commodity service for any customer that is in need of emergency last resort service. Such a service should be a short-term option and priced to reflect all of the risks associated with full, no-notice emergency service. It is anticompetitive to set the Default Service rates at a fixed price for the entire term of the Default Service implementation plan, particularly when the minimum term is one year.

The pricing of commodity to large commercial and industrial customers who can be billed hourly should be based on an hourly, time of use rate. On one hand, the Commission has recognized the importance of accurate pricing for large customers by requiring hourly pricing, but the Commission then overrides the appropriate price signals of hourly pricing by permitting EDCs also to offer fixed priced options for these customers. EDCs should not be permitted to offer fixed pricing for large commercial and industrial consumers. For commodity services to small commercial and residential customers, the commodity component of the Default Service should start with a monthly adjusted, market-based rate to which should be added the fully allocated, embedded costs associated with providing all of the other commodity-related products, services, information and technologies. In addition to the wholesale price of commodity, the costs of providing retail electricity supply includes transmission charges, scheduling and control area services, losses and pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations and laws, and customer care.

B. The Proposed Definition of "Prevailing Market Price" and Default Service Rate Charges Should Be Modified to Represent a Retail Default Service Price

NEM supports the Commission determination that, "in a competitive market the prevailing market price is analogous, though not identical, to the "just and reasonable" standard for utility rates." (Rulemaking at 7). In fact, NEM submits that utility regulation plus the costs associated with estimating via rate cases a "just and reasonable" price are costly proxies for the willingness of privately funded risk capital to compete for customers thereby creating market prices as a by-product.

The source of NEM's concern is the Commission's definition of "prevailing market price" and the charges comprising default service rates that focus on the wholesale market as determinative of default service price without inclusion of the full retail costs of providing this no notice, last resort service. As set forth in proposed Section 54.182 "prevailing market price" is defined as the, "price of electric generation supply for a term of service realized through a default service provider's implementation of and compliance with a Commission approved default service plan." This definition is further explained as the, "price of electric generation supply in the RTO or ISO administered energy markets in whose control area default service is being provided, acquired pursuant to the conditions specified in §§ 54.186(g), 54.187(i) or 54.188(e)." Reading these two parts of the definition together leads to the conclusion that the price of default commodity service will be a function of wholesale markets only and not reflective of the full retail costs of serving 24 hour/7 days last resort service.

Furthermore, proposed Section 54.187 defines the "generation supply charge" as being comprised of: "(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 charge, (v) Applicable taxes, (vi) Other reasonable, identifiable generation supply acquisition costs." Again, the components of the generation supply charge reference only the wholesale market and do not include the fully allocated embedded retail costs associated with providing retail electric default service as discussed above.

C. Default Service Rate Charges Should Be Unbundled on an Embedded Cost Basis

NEM notes that the Commission has proposed a "customer charge" as part of the default service rate that would include: "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." NEM submits that structuring the charge in this fashion will not permit migrating customers to receive accurate price signals and will cause migrating customers to pay twice for these services. If a migrating customer is paying to receive these services (such as billing, customer care, etc.) from a competitive supplier, it should not have to continue to pay the utility for these same services. Accordingly, in order to provide consumers with clear and accurate price signals, NEM recommends that the customer charge should be unbundled, on an embedded cost basis.

VI. Qualified Entities Should be Allowed to Provide Default Service.

As the Commission has recognized by proposing regulations that allow an EDC to voluntarily exit the merchant function as well as regulations that allow the Commission on its own motion to require an EDC to exit the Default Service function, an EDC supplying delivery is not inherently more reliable than a contractual obligation to serve by a qualified supplier, unless there are anti-competitive remnants that remain in law or practice. Many competitive suppliers have the scale, capital and scope necessary to act as Default Service providers. In addition, competitive suppliers have risk management assets that historically have not been part of an EDC's business model since the Commission normally has acted as the EDC's risk manager.

While NEM recognizes that the Commission must adopt regulations governing the competitive Default Service provider, the proposed Default Service regulations do not include sufficient detail regarding the operational and fitness requirements for a competitive Default Service provider, nor do they clearly state which certificate of public convenience requirements will be applied to competitive suppliers providing Default Service.

In order not to create artificial barriers to competition, unreasonable requirements must not be adopted for competitive Default Service providers. For example, companies with certain S&P or Moody ratings should be deemed to meet any creditworthiness standards, with other companies able to satisfy such standards through the posting of a reasonable bond. The regulations governing a competitive Default Service provider should be tailored to address the contractual obligations of a qualified supplier to serve voluntarily, while recognizing that a voluntary contract to serve is a binding obligation to serve.

VII. Conclusion

NEM appreciates this opportunity to offer comments on the Commission's proposed rulemaking for Default Service. NEM suggests that consumers, EDCs and competitive suppliers will be best served by a Default Service regime that is provided by a competitive supplier by a date certain. In the transition prior to that time, utilities should be required to unbundle their rates on an embedded cost basis.

Respectfully submitted,

Craig G. Goodman, Esq.
Stacey Rantala, Esq.
National Energy Marketers Association
3333 K Street, NW, Suite 110
Washington, DC 20007
Tel: (202) 333-3288
Fax: (202) 333-3266
Email: cgoodman@energymarketers.com
Web site: www.energymarketers.com

Dated: April 25, 2005

Attachment A
Electricity Functions

Supply
- Procurement – including risk management

Non-bypassable Supply
(e.g., NUG contracts, other items that may be EDC specific)

Delivery
- Transmission (including Capital, Operation, Maintenance)
- Distribution (including Capital, Operation, Maintenance)
- System Reliability
- Customer Choice including Supplier Care
- Revenue Protection/Theft
- Metering
- Customer Information Systems
- Energy Services

Metering Services
(e.g., installation, maintenance, testing and removal)

Meter Data Services
(e.g., meter reading, meter data translation, customer association, validation, editing and estimation)

Meter Ownership
(e.g., physical meters)

Billing and Payment Processing
(e.g., printing and mailing bills, receiving and recording payments)

Energy Services

Uncollectibles
- Uncollectibles – supply
- Uncollectibles – non-supply

Customer Care
(e.g., call centers, service centers, complaint handling, emergency call handling, customer accounting, non-routine field activities, customer education and outreach, credit and collections, including special needs programs)
- Customer Care – EDC full/default service and T&D related
- Customer Care – EDC Customer Choice, including Supplier care
- Customer Care – Metering, Billing and Payment Processing