

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Rulemaking Re	:	
Electric Distribution Companies'	:	
Obligation to Serve Retail Customers at the	:	Docket No. L-00040169
Conclusion of the Transition Period	:	
Pursuant To 66 Pa. C.S. §2807(e)(2)	:	

REPLY COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

I. INTRODUCTION

The Retail Energy Supply Association ("RESA")¹ submits these reply comments in this Pennsylvania Public Utility Commission ("Commission") rulemaking to respond to the comments submitted by various parties. RESA urges the Commission to adopt positions that are consistent with several key policies when finalizing the rules governing Post-Transition Default Service. In its initial comments, RESA set forth the statutory basis for these key policies: promoting retail competition; requiring market-responsive pricing which covers the full cost of providing retail default electric service; no switching restrictions, exit fees or minimum stay requirements; and uniform rules across all of Pennsylvania. RESA believes that adhering to these key policies will result in a robust, competitive retail marketplace as envisioned by the Electricity Generation Customer Choice and Competition Act ("Electric Choice Act").

There is widespread agreement among the commentators with the Commission's conclusion that Default Service should be designed to promote retail competition and avoid

¹ RESA was formerly known as the Mid-Atlantic Power Supply Association ("MAPSA"), a trade association composed of a broad range of retail electric providers that support the electric services industry and seek to develop a more competitive power industry. MAPSA recently changed its name to more accurately describe its purpose and scope of interest. The opinions expressed in these comments represent the views of RESA concerning the policy framework of Post-Transition Default Service. The opinions expressed in this filing may not represent the views of all members of RESA. Individual members may express their views on details of the Commission's rulemaking in separate company filings.

market distortions. The notable exceptions are the Office of Small Business Advocate ("OSBA") and the Office of Consumer Advocate ("OCA"), which maintain that lower electric prices are the purpose of the Electric Choice Act.² These arguments ignore the demonstrated benefits of competition in other industries, and the other significant benefits of choice in the retail electric market – new and innovative products and services, renewable energy products, incentives to reduce energy costs, and customer hedging of energy prices in line with the needs of their particular business. Lower prices are one of the many benefits of choice, but not necessarily the only goal of a competitive retail market. It is through the confluence of **all** the benefits that competitive retail markets provide – i.e., lower prices, customer choice and greater congruence between customer need and electric supply product – that long-term energy costs are minimized. But that cannot happen unless a truly competitive market is permitted to develop. This is why the Default Service Provider ("DSP") should be permitted to offer only an hourly product to large customers; the competitive retail market should be permitted the opportunity to provide these customers with the fixed price products they desire, without competition from the monopoly utility's default service.³

The electric distribution companies ("EDCs") take a different approach in advocating Default Service rules that would undermine and hinder the development of the competitive retail market. Most of the EDCs profess the need for additional "flexibility" in every aspect of the

² The OSBA argues that competition is the means to an end – lower electric rates – and not the end in itself – and that the Commission should not require or permit "artificially high" Default-Service rates or make Default Service rates "as ugly as possible" in order to stimulate retail competition. OSBA Comments at 2-4. The OCA argues that lower prices are the primary goal of the Electric Choice Act, and asserts that "default service must be viewed as the primary vehicle for the delivery of the promises of the 1996 Act" to residential customers. OCA Comments at 2.

³ As explained below, the threshold for large customers should be reduced from the proposed 500 kW annual peak demand to 200kW to permit more customers to enjoy the benefits that competitive EGSs and the competitive market can provide.

Commission's proposed regulations.⁴ The EDCs' flexibility to formulate Default Service implementation plans ostensibly "tailored" to meet individual EDC's particular circumstances and customer needs is merely a different way for the EDCs to promote what amounts to re-regulation in an effort to thwart retail competition. The EDCs' "flexibility" would simply substitute one regulated construct (traditional cost-of-service, rate base methodologies overlaid with rate caps and transition costs) for another regulated construct (different Default Service administrative procurement processes and rules, and various switching restrictions, for each major EDC) that will perpetuate transition period barriers to competition and distort the relationship between the wholesale and retail electric markets. This will leave customers with little or no choice of competitive retail providers as proven today in other markets that currently rely on administrative procurement regimes.

One of the most anticompetitive examples of the EDCs' desire for continued regulation under the guise of flexibility is the option for retroactive reconciliation of all Default Service expenses and revenues.⁵ RESA favors a mechanism which permits price adjustments to maintain Default Service pricing in accord with the "prevailing market price" standard on a current basis. Retroactive adjustments or "true-ups" to account for variations in historic costs and revenues clearly distort the relationship between the wholesale and retail markets and current prevailing

⁴ See, e.g., Energy Association of Pennsylvania ("EAPA") Comments at 2-4, 6-7, 9-10; Duquesne Light Company ("DLC") Comments at 4-6, 20-24; Exelon Companies (Exelon) Comments at 2; FirstEnergy Operating Companies ("FE") Comments at 1-2. Contrary to the other major EDCs, PPL comments that the PUC "should develop a structured state-wide bidding process to increase the level of consistency for obtaining default service supply." PPL Comments at 2. PPL also comments that "only a tightly defined and structured state-wide process will ensure the most competitive procurement for default service customers [C]ertain key elements of the process should be identified and applied consistently across all default service providers." *Id.* at 15.

⁵ EAPA Comments at 6-7. PPL argues that reconciliation of the costs of fixed price default service is required. PPL Comments at 7.

market prices. Regulated-style retroactive adjustments will result in little to no competition and the same market structure that existed with regulation – monopoly service of a regulated product.

Another example is the EDCs' desire to recover Default Service retail customer care costs through regulated distribution rates rather than through bypassable charges.⁶ Retail customer care costs related to default service, such as billing, collection, bad debt expense and default service price and service inquiries, should be recovered in the Default Service rate and be bypassable so that shopping customers are not forced to pay twice for these costs. This approach will also place retailers in the position to provide these types of competitive services.

Finally, the EDCs' demand the ability to impose switching restrictions, exit fees and minimum stay requirements on customers.⁷ RESA believes that market based price signals, in the form of hourly-priced default service for large customers and market adjustable prices for small commercial and residential customers, will allow customers to best meet their electricity needs.⁸ Switching restrictions, exit fees and minimum stays are antiquated relics of the past that reflect the constraints placed on default service during the phase-in and transition periods.⁹

⁶ EAPA Comments at 8-9.

⁷ EAPA Comments at 10; DLC Comments at 20-24; PPL Comments at 17; Exelon Comments at 19.

⁸ As the National Energy Marketers Association ("NEM") points out, permitting fixed rate Default Service options for large customers overrides the appropriate price signals of hourly pricing for these customers. NEM Comments at 7. NEM also correctly argues that post-transition Default Service pricing for small commercial and residential customers should be based upon a monthly adjusted, market-based commodity rate, plus the fully allocated, embedded costs of providing retail electric Default Service. *Id.*

⁹ DLC incorrectly asserts that the minimum stay and GRA rules adopted in its POLR II proceeding "have proven" to be effective in facilitating shopping because customer shopping increased in DLC's territory during the POLR II period. DLC Comments at 23. DLC's assertion is unsupported. First, the need for these switching restrictions was not "proven" in DLC's POLR II proceeding; these restrictions were adopted in an abbreviated, non-litigated proceeding that was initiated and settled in about 4 months. Second, DLC did not prove the need to continue these switching restrictions in its fully-litigated POLR III proceeding, and the Commission in fact

All of the EDCs' requests for "flexibility" can easily translate to methods that thwart retail competition by continuing traditional, regulatory terms of service. This flexibility will perpetuate barriers to retail competition and market distortions that have stymied the development of the competitive retail market during the stranded cost/rate cap transition period, and create new barriers. Permitting the EDCs to impose these anticompetitive measures on consumers in the post-transition period will place the same constraints on beneficial competition as the two previous regulatory constructs (traditional regulation and rate cap transition): few if any competitive electric generation suppliers ("EGSs") from which to seek service, no competitive pressures to drive market efficiencies, and no benefits brought about by robust, sustainable retail competition. Thus, customers will once again be left with continued monopoly service that fails to meet their needs.

RESA acknowledges that there may be valid reasons for providing different rules for large and small EDCs, but the obvious anticompetitive effects of the EDC-specific restructuring, phase-in and transition plans outweigh any basis for giving the large EDCs "flexibility" to impose disparate Default Service plans. The Commission should instead adhere to principles and policies that will enable retail competition and choice to meet the goals of the Electric Choice Act. As noted in RESA's initial comments, it is uniform rules across Pennsylvania that will eliminate barriers to entry and allow competitive EGSs to bring the benefits of competition to customers.

rejected DLC's proposals to do so. Third, DLC provides no evidence to prove its counter-intuitive assertion that the increased POLR II shopping was caused by the POLR II switching restrictions. Finally, the fact that shopping in Duquesne's service territory during POLR III – without the POLR II switching restrictions – is "double the level of shopping in 2002" during POLR II (DLC Comments at 4) refutes Duquesne's assertion.

RESA fears that the EDCs' "flexibility" proposals seek to preserve regulation and the EDC's monopoly status. The EDCs' proposals, if adopted, would sound the death knell for retail electric competition in the post-transition period when the stranded costs and rate caps come to their proper conclusion. Stranded costs were paid by customers to bring one era – the regulated, cost-of-service world – to an end and, upon the expiration of the rate caps, to allow another era to begin – a competitive retail electric service market based on “prevailing market prices.” RESA submits that market-responsive pricing for Default Service designed to cover all the reasonable costs of providing Default Service without hindering competition is what the Electric Choice Act requires. Such pricing will, by definition, not be "artificially high"¹⁰ or "as ugly as possible"¹¹ but will, as envisioned by the Electric Choice Act, enable the competitive retail market to deliver the benefits of competition to customers. Default Service should **not** be the primary vehicle to deliver the benefits of competition to customers in the post-transition period – rather, a competitive retail electric market should bring about the benefits of competition to customers. In summary, it will be the policy that the Commission decides to establish in this rulemaking that will ultimately determine whether retail electric competition and all of its benefits will be allowed to flourish for the benefit of Pennsylvania's consumers, or if administratively determined processes remain in place that stifle retail competition and hinder efficiencies that vigorous retail competition can provide.

¹⁰ OSBA Comments at 4.

¹¹ *Id.* at 3.

II. SPECIFIC REPLY COMMENTS

A. Default Service Must Be Designed to Promote and Enhance Direct Access for All Retail Customers.

In its rulemaking order, the Commission correctly recognized that "any POLR service model must be carefully designed to avoid distortions to the market," avoid administrative determinations and give preference to market solutions.¹² The standard for pricing Default Service in the post-transition period is that the electricity is to be acquired at "prevailing market prices" and provide for full recovery of all other reasonable costs.¹³ Therefore, post-transition pricing for Default Service must be market-responsive to comply with the Electric Choice Act and to enable the competitive market to deliver innovative electric products and services responsive to customers' needs and preferences.

In its initial comments, RESA argued against the Commission's proposal to permit EDCs to develop implementation plans with disparate, rigid, administrative-style procurement processes and rules, and emphasized the need for a uniform process and rules to eliminate the barriers to competition created by EDC-specific processes and rules – barriers manifested in the lack of shopping during the transition period. The deficient shopping is primarily due to the lack of market responsive pricing for default service. Any attempt by the EDCs to create disparate rules could seriously jeopardize the ability of EGSs to enter and compete across the various EDC territories. Consistent, clear rules will lift significant barriers to entry and will create efficiencies that will benefit all retail customers.

¹² December 16, 2004 Order at 5.

¹³ 66 Pa. C.S. § 2807(e)(3). The fundamental policy declaration that competitive market forces are more effective than economic regulation in producing efficient prices, 66 Pa. C.S. § 2802(5), is the basis for the pricing standard.

1. Large Business Customer Pricing & Threshold

In its initial comments, RESA argued that Default Service pricing for large business customers should be on an hourly-only product, and that the fixed price option for these customers should be eliminated. Some commentators recommend that the fixed rate option be retained, and that hourly pricing poses a problem for compliance with the AEPS act. Permitting the Default Service Provider (“DSP”) to offer a fixed price option to large business customers will place the DSP not only squarely in competition with EGSs, rather than promoting competition among EGSs and permitting the competitive market to deliver the fixed price options that large business customers desire, but will also substitute regulated products for competitive-driven products.¹⁴ For these reasons, in no event should DSPs be able to offer a menu or choice between an hourly and a fixed price.¹⁵

The notion that hourly pricing cannot accommodate AEPS compliance is a red herring. This argument has been raised, and rejected, in New Jersey (which has both renewable energy standards and Large Customer hourly default service pricing). Moreover, PJM's Generation

¹⁴ The Industrial customer groups argue that Section 2806(h) of the Electric Choice Act provides authority for fixed rate Default Service offerings to large customers, asserting that this section "grants the DSP the flexibility necessary to ensure that the DSP's POLR services are a competitive alternative to the market." Industrial customer groups' Comments at 4. This argument is wrong and should be rejected. Section 2806(h) confirms the *Commission's* authority to approve "flexible pricing and flexible rates", but fixed prices are the *opposite* of flexible pricing, and the Commission has correctly concluded that post-transition Default Service is not to be designed as a competitive alternative to the retail market. December 16, 2004 Order at 4-5.

¹⁵ The argument that failing to provide a fixed rate option to large C&I customers unlawfully discriminates against these customers is wrong and should be rejected. Industrial customer groups' Comments at 22-26. The Public Utility Code prohibits only unreasonable discrimination [Sections 1304 and 2804(7)], and large C&I customers have been treated differently under both traditional monopoly utility regulation and transition period regulation for reasons other than "cost-causation," such as, for example, the existence of competitive alternatives. Also, the argument that providing only an hourly product to large customers could subject these customers to "arbitrary" price increases [Industrial customer groups' Comments at 6] is wrong – unless the market prices are the result of the unlawful exercise of market power. The Commission should not presume this to be the rule without proof.

Attributes Tracking System ("GATS") will provide the necessary renewable energy attribute information to allow AEPS to be achievable through an hourly priced product. Hourly priced products are provided by the competitive marketplace in New Jersey, Maryland and Texas, and each of these states have renewable energy requirements. There is no reason Pennsylvania's post-transition default service products cannot be designed to meet the AEPS standards.

In its initial comments, RESA did not take a position on the threshold between large and small business customers. The Commission proposed a peak annual demand of 500 kW. In response, the EDCs (through the Energy Association) request that this threshold be raised to 1000 kW (or 1 Mw), and that the individual EDCs be given flexibility to propose lower thresholds. The EDCs have it backwards and their requests should be rejected. The Commission should set a lower threshold for the major EDCs. A lower threshold will allow more customers to enjoy the benefits that competitive EGSs provide in view of the substantial level of competition that is evident for customers of this size in competitive retail markets where hourly-only or no price-regulated default price prevails. Furthermore, the 300 kW threshold the Commission set recently in Duquesne's POLR III case, and the vigorous competition that has resulted, provides evidence of the soundness of the Duquesne precedent for lowering the threshold below 500 kW. A lower threshold should be maintained in order to allow competitive retail markets to develop as mandated in the Electric Choice Act.¹⁶ In fact, the Commission's rationale in the Duquesne POLR III case¹⁷ supports a lower threshold for post-transition Default Service. RESA urges the Commission to adopt in this rulemaking an hourly priced Default

¹⁶ Petition of Duquesne Light Company, Docket No. P-00032071, Opinion and Order entered August 23, 2004 ("POLR II Order"), at 39; Order on Reconsideration at 23-24.

¹⁷ The Commission's decision was based upon maximizing customers' freedom to move to the competitive market. POLR II Order at 39.

Service threshold of 200 kW annual peak demand.¹⁸ Advances in metering technology during the remainder of the existing EDC transition periods may require further review and lowering of the hourly-only priced threshold below 200 kW at a later date.

2. Switching Restrictions, Exit Fees and Minimum Stay Requirements

As stated above, the post-transition pricing standard requires Default Service prices to cover the reasonable costs of providing the service. This clearly includes customer migration risks and variations in Default Service customer load. Nonetheless, the EDCs claim the need for flexibility to manage these risks through anti-competitive measures such as switching restrictions, exit fees and minimum stay requirements.¹⁹ Instead, the Default Service price should reflect these risks so that the Default Service Provider is fully compensated through the Default Service revenues. As RESA pointed out in its initial comments, customer migration risks are more effectively managed through market-responsive Default Service pricing than through the various switching restrictions covered by the EDCs; if Default Service prices accurately reflect prevailing market prices and cover the full cost of providing Default Service, including the cost of implementing customer migration risk strategies, then customer switching to exploit seasonal price variations, by definition, will be eliminated.²⁰

It must be remembered that the impetus for such switching restrictions arose during the transition period to address the disconnect between wholesale prices and capped retail rates.

This disconnect should disappear in the post-transition period under a correctly determined

¹⁸ Other commentators have suggested 25 kW to 200 kW. Direct Energy Comments at 13-14 (25 kW); Reliant Energy Comments at 26 (100 kW); Amerada Hess Corporation Comments at 4-6 (200 kW). The Commission's customer information regulations set the threshold at 25 kW. 61 Pa. Code § 54.2 (definition of "Small business customer").

¹⁹ See, e.g., EAPA Comments at 10; DLC Comments at 20-24.

²⁰ Interestingly, only PPL describes the issue as "customer" gaming, while the EAPA, other EDCs, the OCA and other commentators describe it as "supplier" gaming.

Section 2807(e)(3) pricing standard, when competitive market forces replace regulatory controls. As emphasized in RESA's initial comments, restrictions on customer switching are anathema to competitive markets, inherently anticompetitive, inconsistent with customer choice and should not be permitted in the future. In the post-transition period, customers should be able to switch service to or from any EGS without the artificial obstructions of switching restrictions, exit fees and minimum stays because market responsive pricing is the required method to manage the cost of customer migration risks in the post-transition period.

A prime example of the problem with switching restrictions is the Generation Rate Adjustment (“GRA”) recently proposed for MetEd and Penelec as a settlement in a pending proceeding.²¹ The MetEd/Penelec GRA settlement proposal provides four (4) different GRA mechanisms – a standard GRA (Standard Price Adjustment); a Monthly Price Option (MPO) based on forecasted summer prices; an Alternative Monthly Price Option (AMPO) based on historic summer prices; and a Standard Price Adjustment-Market (SPM). The anticompetitive effects of such a complicated and complex system on access to the competitive retail market are obvious.

The EDCs continue to raise the "seasonal gaming" argument, but the Commission has not concluded that such gaming has occurred. However, RESA cannot emphasize enough that if Default Service prices reflect prevailing market prices and all reasonable costs to provide the service – as EGS prices must – then there is no opportunity for gaming by either customers or suppliers.

²¹ Docket Nos. R-00016219, R-00016219C001, R-00016220, R-00016220C001, C-20028926, Amended Joint Petition for Full Settlement filed May 27, 2005.

3. Reconciliation of All Default Service Historic Costs/Revenues

In its initial comments, RESA argued that "Default Service pricing should be adjustable to prevailing market prices in order to minimize potential distortions in the competitive market" in order to ensure that the pricing model chosen is flexible enough to permit Default Service prices to be, to the greatest degree possible, adjustable to changing prevailing market prices and conditions. The EDCs have asserted the need for flexibility to impose a different sort of price adjustment – full reconciliation of all Default Service historic costs and revenues – bootstrapping their version of the automatic adjustment clause cost recovery in the AEPS act.²²

The flexibility sought by the EDCs to adjust prices based upon historic costs/revenues is a far cry from the flexibility proposed by RESA for current price adjustments based upon prevailing market prices and conditions. The Commission's authority to permit the reconciliation of these types of costs and revenues in the manner advocated by the EDCs is questionable after the Commonwealth Court's recent decision invalidating a Distribution System Improvement Charge for wastewater companies.²³ However, even if it is argued that such reconciliation is not explicitly prohibited, a simple reading of the Electric Choice Act effectively contradicts any such regulated process. The absence of specific authority for the recovery of the costs of post-transition Default Service through an automatic adjustment clause with reconciliation of historic costs shows that such cost recovery is not envisioned, much less required, by the Electric Choice Act. In addition, the AEPS automatic adjustment clause cost

²² Indeed, PPL and the FirstEnergy EDCs argue that *not* reconciling costs is inconsistent with the directive in Section 2807(e)(3) that the Default Service Provider fully recover all reasonable costs of providing the service. PPL Comments at 7; FE Comments at 2-3.

²³ *Popowsky v. Pa. P.U.C.*, 869 A.2d 1144 (Pa.Cmwlth. 2005), *petitions for allowance of appeal docketed* No. 215 MAL 2005 (PUC) and No. 316 MAL 2005 (Pennsylvania-American Water Company) (specific authority for PUC to permit automatic adjustment clause/reconciled recovery of base rate type costs for water utilities does not provide authority to do so for wastewater utilities).

recovery provision does not provide authority for the EDCs' request for automatic adjustment clause recovery of *all* Default Service costs, and the EDCs' attempt to use the AEPS automatic adjustment clause cost recovery provision to "bootstrap" automatic adjustment clause recovery of all historic Default Service costs and revenues should be rejected. A mechanism where price adjustments are allowed to maintain Default Service pricing in accord with the "prevailing market price" standard in the Electric Choice Act is what is required.

4. Customer Care Costs In Distribution Rates

The post-transition pricing standard requires Default Service prices to cover the reasonable costs of providing the service. This clearly includes retail customer care costs, yet the EDCs argue that unbundling and allocating customer care costs between distribution and generation is unworkable and too complicated, and unnecessary because these costs should remain in EDC Distribution rates.²⁴ Some commentators also assert that EGSs are not inclined to provide customer care services. None of these positions is correct.

Some EDCs, such as Exelon and PPL, provide credits to suppliers that provide metering and billing services. This demonstrates that there are reasonable ways of addressing the unbundling and allocation issues short of protracted, cost-of-service proceedings, in order to ensure that Default Service is priced as a fully separate service from the EDC's retail wires service so that the EDC's Default Service reflects the total cost of providing the service.²⁵ The notion that EGSs do not want to provide customer care services to their customers is wrong. The reality is that EGSs *do* provide customer care services for their customers. "Branding", along

²⁴ See, e.g., EAPA Comments at 7-9; DLC Comments at 28-30.

²⁵ However, RESA does not oppose the National Energy Marketers Association's ("NEM") position that the EDCs be required to disclose their fully allocated, embedded costs to serve each customer class. NEM Comments at 5-6.

with high quality customer care services, is a vital part of many retail businesses. This is especially true for retail energy providers in Pennsylvania because they must compete against the EDC monopoly brand throughout the Commonwealth.

Retail customer care costs for Default Service customers should be fully reflected in Default Service prices through a bypassable charge and not retained in EDC distribution rates. PPL's argument that these costs would be "stranded" if EGSs provide these services to their customers is not a convincing argument in light of the new competitive realities.

III. CONCLUSION

RESA respectfully requests that the Commission reject the EDCs' requests to implement EDC-specific Default Service plans that contain anticompetitive processes and rules because their requests are contrary to the policy declarations and statutory provisions that govern Default Service in the post-transition period. RESA strongly urges the Commission to develop the final regulations guided by policies that will permit the competitive market to deliver benefits to customers as envisioned by the General Assembly's enactment of the Electric Choice Act.

Specifically, Default Service pricing for large customers should be on an hourly-only product, with no fixed price option, and the threshold for large customers should be reduced below the proposed 500 kW annual peak demand to 200 kW. There should be no switching restrictions of any type, and no reconciliation or retroactive adjustment of historic Default Service costs and revenues. Customer care costs for Default Service customers should be

reflected in Default Service prices, not EDC/DSP distribution rates. Finally, the Default Service rules should be uniform for all major EDCs.

Respectfully submitted,

Daniel Clearfield, Esquire
Kevin J. Moody, Esquire
Wolf, Block, Schorr & Solis-Cohen LLP
212 Locust Street, Suite 300
Harrisburg, PA 17101
(717) 237-7160

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Counsel for the Retail Energy
Supply Association