

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)

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Docket No. L-00040169

REPLY COMMENTS OF ALLEGHENY POWER
ON PROPOSED DEFAULT SERVICE REGULATIONS

Introduction

On December 16, 2004, the Pennsylvania Public Utility Commission ("Commission") issued a proposed rulemaking order to define the obligation of electric distribution companies ("EDCs") to serve retail customers at the conclusion of their respective transition periods. The proposed rulemaking was published in the *Pennsylvania Bulletin* on February 26, 2005 (35 Pa. B. 1421), and parties were given an opportunity to file comments on the proposed rulemaking within 60 days. Allegheny Power ("AP") offers these reply comments in response to the comments filed on or before April 27, 2005 on the Commission's proposed rulemaking.

Default Service Cost Recovery Mechanism Must Be Reconcilable

AP agrees with the comments filed by the Office of Consumer Advocate ("OCA"), the Energy Association of Pennsylvania ("EAPA"), PPL Electric Corporation and PPL EnergyPlus (collectively referred to as "PPL"), Citizens' Electric and Wellsboro Electric ("Citizens & Wellsboro"), Pike County Light & Power Company ("Pike"), and FirstEnergy that the cost recovery mechanism for default service must be reconcilable. A reconciliation and true-up process is necessary to ensure that the default service provider

is afforded full cost recovery provided for by the Pennsylvania statute. AP recommends that the Commission revise its proposed rules to provide for reconciliation of the default service cost recovery mechanism. The methodology and timing for the reconciliation and true-up process should be addressed in each default service provider's implementation plan but should occur at least annually.

Customer Charge Should Remain Bundled in Distribution Rates

AP agrees with the comments filed by the OCA, the EAPA, FirstEnergy, PPL, Duquesne Light Company, Citizens & Wellsboro, and UGI Utilities concerning the proposed customer charge. As proposed this charge improperly assigns distribution costs to default service rates. The customer charge should remain bundled in distribution rates, as these costs are not completely avoided by the default service provider when a customer shops. AP continues to support keeping the customer charge bundled in distribution rates and instead using a distribution credit mechanism applicable to shopping customers who receive a customer care service, such as meter reading, from their EGS rather than the default service provider. The distribution credit should include only the incremental costs related to the customer care service, as this will more accurately capture the costs the default service provider avoids if a shopping customer receives the service from their EGS.

Risk/Return Component

AP agrees with FirstEnergy's recommendation that the risk component should be included in the Generation Supply Charge. AP emphasizes that a reasonable return or risk component is necessary to compensate the default service provider's shareholders for

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Default Service Proposed Rulemaking Order Dated 12/16/04*

the risks of managing the default service process and services. OCA's comments indicate the risk on a default service provider is eliminated if a fully reconcilable charge is implemented. AP does not agree with this assessment. As OCA recognizes on page 13 of its comments, "The EDC will always be required to step in as the 'last resort' when other entities fail, particularly since the EDC will continue to have the obligation to connect all customers and deliver supply through its facilities." This obligation carries with it significant risks which must be recognized and compensated for through a risk/return component in the Generation Supply Charge. Shareholders and the capital markets cannot be expected to invest in and lend funds to an entity that manages the procurement process of hundreds of millions of dollars annually in power supply contracts without adequate compensation for their investment in such a company.

The Office of Small Business Advocate ("OSBA") has suggested that the need for a risk premium for EDCs is eliminated if default service is served by winning bidder under load-following contract without reconciliation. AP does not agree. OSBA's methodology simply reassigns only one component of risk to the wholesale bidders. This will logically result in increased prices from potential wholesale bidders to accommodate the risk premium, which will ripple through to retail customers in the form of increased default service rates. Additionally, this methodology only addresses one component of risk associated with transposing wholesale rates to retail rates, and does not address, mitigate, or eliminate any of the additional risks detailed in AP's initial and reply comments.

PUC Review of Procurement Results Should be Expedited

AP agrees with the comments submitted by the OSBA that extending the bid review process beyond three days will result in higher rates for customers. Likewise, AP supports the comments submitted by the EAPA, PPL, PECO Energy Company and Exelon Generating Company (collectively, “Exelon Companies”), Pike, and Constellation recommending an expedited Commission review of the procurement process results. AP recommends the Commission revise its proposed rules to provide that its bid review process will not take more than three business days.

Price As Sole Criteria to Review Bids

AP agrees with the comments submitted by PPL, the Exelon Companies, and Constellation that price should be the only criteria used to evaluate bids. A properly structured implementation plan will address all other bid eligibility criteria upfront, so the only necessary remaining criteria to evaluate the bid is price. In its comments, OCA recommends that the Commission be permitted to reject the procurement results if the Commission finds the process produces non-competitive results. AP believes that introducing this level of Commission discretion after the bidding process has concluded adds a significant level of risk to suppliers and undermines the integrity of the bidding process.

Individual EDC Implementation Plans and Flexibility in Procurement Process

AP continues to support the provision permitting individual EDC implementation plans. AP also supports the comments submitted by OCA, the EAPA, Duquesne Light Company, Citizens & Wellsboro, and UGI supporting additional flexibility in

procurement for default service through a range of procurement methods. Accordingly, AP disagrees with the Morgan Stanley Capital Group recommendation that the EDC competitive procurement plans be based on New Jersey's basic-generation-service auction model. In the proposed rules, the Commission has appropriately recognized that a "one size fits all" approach is not best suited for Pennsylvania. The Commission acknowledges that, given the varying terms of the generation rate caps and existing POLR plans, each default service provider should have the option of proposing an implementation plan best suited to its service territory. AP supports the decision not to mandate a statewide procurement process and instead allow for individual implementation plan filings.

Demand Side Response

AP does not support PJM's proposal to vest legal title to power in retail customers for the purpose of inducing a demand side response. The hourly pricing mechanism proposed for large customers will provide adequate incentives for demand/price response for those large customers that remain on default service. Any additional DSR programs or initiatives should be left to the competitive market to develop and foster.

Seasonal Rates

AP fully supports the Commission's policy that "POLR service should be reliable, available on reasonable terms and conditions, associated with high-quality customer service, and provided consistent with the level of protections currently afforded to low-income customers." AP believes that one component to help ensure that POLR service is "available on reasonable terms and conditions" is to allow seasonal differences in the

fixed rate option. The elimination of seasonal differences, as some parties have proposed, will simply transfer seasonal price risk to the wholesale supplier. One would assume that wholesale suppliers would have to accommodate seasonal price risks by increasing their wholesale bids, which would translate into higher default service prices for the end-use retail customer. On the other hand, incorporation of seasonal differences in the fixed rate option, as proposed by the Commission and supported by AP would: (1) allow a more flexible wholesale product that may attract additional wholesale bidders, thereby allowing market forces to help lower the wholesale bid price; (2) allow wholesale bidders to mitigate seasonal price risk, which would also help lower the wholesale bid price; (3) help educate the end-use retail customer to seasonal price differences that are inherent to the market; and (4) provide additional economic incentive for retail customers to curtail electricity consumption during traditionally high-cost periods. In the neighboring state of Maryland, default service is provided to retail customers during two seasons, summer and non-summer. AP believes the aforementioned benefits of seasonal differences certainly outweigh any apprehension regarding one additional rate change per year, as well as conform to the goal that POLR service should be “available on reasonable terms and conditions.”

Switching Restrictions

There is consternation among some parties about switching restrictions and, specifically, about a minimum-stay period. Since the need for a minimum-stay period, or lack thereof, may be dictated greatly by the terms and conditions of each EDC’s proposed default service implementation plan, the matter is best addressed by a working group to provide

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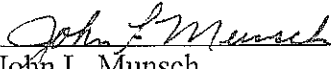
recommendations on the more global issue with respect to “gaming” (e.g., substantial quantities of load swinging back and forth between default service and retail suppliers as market prices rise above and fall below the default service price).

Closing

AP appreciates the opportunity to provide Reply Comments on this proposed rulemaking and looks forward to continuing to work with the Commission on these important issues.

Respectfully submitted,

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