

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**RULEMAKING RE ELECTRIC :
DISTRIBUTION COMPANIES' : DOCKET NO. L-00040169
OBLIGATION TO SERVE RETAIL :
CUSTOMERS AT THE CONCLUSION :
OF THE TRANSITION PERIOD PURSUANT :
TO 66 PA C.S. § 2807(e)(2) :**

**IMPLEMENTATION OF THE ALTERNATE :
ENERGY PORTFOLIO STANDARDS : DOCKET NO. M-00051865
ACT OF 2004 :**

**COMMENTS OF THE INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA,
THE MET-ED INDUSTRIAL USERS GROUP, THE PENELEC INDUSTRIAL
CUSTOMER ALLIANCE, THE PHILADELPHIA AREA INDUSTRIAL ENERGY
USERS GROUP, THE PP&L INDUSTRIAL CUSTOMER ALLIANCE, AND THE WEST
PENN POWER INDUSTRIAL INTERVENORS**

David M. Kleppinger
Derrick Price Williamson
Charis Mincavage
MCNEES WALLACE & NURICK LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
(717) 232-8000
(717) 237-5300 (fax)

Counsel to the Industrial Energy Consumers
of Pennsylvania, the Met-Ed Industrial Users
Group, the Penelec Industrial Customer Alliance,
the Philadelphia Area Industrial Energy Users
Group, the PP&L Industrial Customer Alliance, and
the West Penn Power Industrial Intervenors

Dated: March 8, 2006

I. INTRODUCTION

On November 18, 2005, the Pennsylvania Public Utility Commission ("PUC" or "Commission") entered an Order reopening the comment period for the Commission's proposed Default Service Provider ("DSP") regulations. The Commission took this action as part of its implementation of the Alternative Energy Portfolio Standards Act ("AEPS" or "Act 213"), its consideration of the mandates of the Energy Policy Act of 2005 ("EPACT"), and its intention to examine more fully the issues raised in the comments of the Independent Regulatory Review Commission ("IRRC"). On February 8, 2006, the PUC issued a Secretarial Letter requesting that interested parties provide Comments related to these issues.

The Industrial Energy Consumers of Pennsylvania ("IECPA"), the Met-Ed Industrial Users Group ("MEIUG"), the Penelec Industrial Customer Alliance ("PICA"), the Philadelphia Area Industrial Energy Users Group ("PAIEUG"), the PP&L Industrial Customer Alliance ("PPLICA"), and the West Penn Power Industrial Intervenors ("WPPII") (hereinafter, "IECPA, et al.") submit these Comments in response to the Commission's request in order to address issues of particular importance to large commercial and industrial customers.

IECPA, et al., are ad hoc groups of large commercial and industrial customers receiving service from almost all Electric Distribution Companies ("EDCs") in Pennsylvania. A list of the members for each of these groups is attached hereto as Appendix A. Because IECPA, et al. members use substantial volumes of electricity in their manufacturing and operational processes, these electric costs are significant elements of their respective costs of operation. Because of the importance of these issues, IECPA, et al., submitted Comments and Reply Comments in response to the Commission's December 16, 2004, Proposed Rulemaking Order, which, pursuant to the terms of the Electricity Generation Customer Choice and Competition Act ("Competition

Act"), formally commenced the Commission's process to define the obligations of a DSP to serve retail customers at the conclusion of each EDC's transition period.¹ See PUC Proposed Rulemaking Order; Docket No. L-00040169 (Dec. 16, 2004)(hereinafter, "December 16 Order"). IECPA, et al., has also submitted Comments regarding the Commission's implementation of AEPS, and IECPA, et al., has participated in the Commission's Working Groups regarding both default service and AEPS implementation. In addition, IECPA, et al., filed an Answer to Direct Energy Services, LLC's October 19, 2005, Petition requesting that the comment period in this proceeding be reopened.

As discussed more fully herein, IECPA, et al., provides these Comments to: (1) request that the Commission integrate Act 213 cost recovery with any final default service regulations; (2) note that the Competition Act does not prohibit a DSP from entering into long-term contracts for the procurement of electricity; (3) argue that the Commission should not delay the promulgation of default service regulations, but rather, should maintain flexibility in these regulations in order to allow for modifications as the generation market evolves over time; (4) request that the PUC require DSPs to offer at least one fixed price option to large commercial and industrial customers in order to ensure that EDCs can accurately track the Alternative Energy Credits ("AECs") associated with these customers; (5) suggest that the PUC allow customers creating and registering their own AECs receive an exemption for the flow-through of costs related to the procurement of AECs by an EDC; and (6) submit that the PUC require EDCs "contracting away" AECs to their generation affiliates to file these contracts with the PUC for review and approval.

¹ The December 16 Order contained draft regulations. Because these regulations have not yet been finalized, they are not currently applicable to DSPs. Regardless, these regulations provide some insight into the PUC's initial thoughts on these issues.

II. COMMENTS

- A. *The Promulgation of Final Default Service Regulations Provides the Commission with an Important Opportunity to Account for Act 213 Cost Recovery Issues, While Maintaining the Flexibility Necessary to Address Issues Arising During and After the Cost Recovery Period.*

Under Section 2807(e)(3) of the Competition Act, a DSP has an obligation to provide electric service following the implementation of electric restructuring. See 66 Pa. C.S.

§ 2807(e)(3). As part of this obligation, a DSP may recover all reasonably incurred costs. Id. To that end, the costs associated with meeting the requirements of Act 213 are considered generation supply costs under Section 2807. See 73 Pa. P.S. § 1648.3(a)(3). In light of the interaction between these two provisions, addressing AEPS cost recovery in the Commission's final default service rulemaking is both reasonable and necessary.

In addressing these issues, however, the Commission must be cognizant of the fact that the AEC market is still in its infancy. As a result, the Commission may not be able to consider and regulate all of the issues that may arise in the coming years. Similarly, the AEC market may continually evolve as more alternative generation is built and more EDCs and Electric Generation Suppliers ("EGSs") are subject to AEPS requirements. As a result, the Commission must promulgate regulations that provide direction for EDCs and EGSs to navigate these new waters, while still maintaining a flexibility that will enable the PUC to address new issues as they arise. By creating this balance, the PUC will provide the necessary guidance to EDCs and EGSs, while still protecting the needs of ratepayers.

1. The PUC must integrate AEPS cost recovery issues as part of the final default service regulations.

As the draft regulations in the PUC's December 16 Order suggest, an EDC will need to obtain PUC approval for a default service plan that addresses, among other components, the

charges that will comprise default service rates.² See December 16 Order §54.187. Because Act 213 expenses are a cost of generation supply, an EDC must address these charges as part of its default service plan. By providing guidance on the recovery of these costs, the Commission will ensure the development of a uniform policy with respect to these issues. Conversely, if the Commission does not provide guidance with respect to this cost recovery as part of final default service regulations, this issue will most likely be litigated in various DSP proceedings, which could result in a patchwork of contrary precedent throughout the Commonwealth in the coming years.

For example, in Pennsylvania Power Company's ("Penn Power") recent interim Provider of Last Resort ("POLR") proceeding, questions were raised regarding whether Penn Power had to comply with AEPS requirements for all of its default service customers or whether the wholesale suppliers should factor this cost of compliance into their bids. See Petition of Pennsylvania Power Company for Approval of Interim POLR Supply Plan; Docket No. P-00052188, Recommended Decision, pp. 112-13. Although the Recommended Decision ("R.D.") appropriately determined that the wholesale suppliers should factor this cost of compliance into their bids, the PUC has not yet issued a final order in this proceeding. Id. Accordingly, this issue remains outstanding and will most likely be raised again in other POLR proceedings. Conversely, if the PUC provides guidance with respect to whether the DSP or the wholesale supplier is responsible for these costs, parties will not have to fully debate these issues in future proceedings.

² Under the PUC's December 16 Order, the POLR shall be the incumbent EDC in each service territory, unless the EDC petitions the Commission to be removed from this obligation. See December 16 Order, § 54.183.

Because AEPS costs are within the ambit of generation supply, the PUC must integrate any proposed cost recovery issues with the consideration of final default service regulations. In doing so, however, the Commission can provide general guidance on these issues, while still reviewing certain concerns via a separate rulemaking proceeding.

2. In formulating final default service and AEPS regulations, the Commission should maintain flexibility to allow for modifications as the generation market evolves.

In providing general guidance on AEPS cost recovery to DSPs, the Commission must also maintain flexibility to allow for the growth of both the AEC and the generation markets. As noted in the Commission's November 18 Order reopening this comment process, both Direct Energy and the IRRC have suggested that the Commission consider delaying the promulgation of POLR regulations closer to the end of the transition period to account for potential changes in the generation market. See 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), Order (Nov. 18, 2005), pp. 2-3 (hereinafter, "November 18 Order"). This proposal, however, would detrimentally affect EDCs whose rate caps expired or expire prior to 2010, leaving them with little direction in developing a default service plan. Moreover, the generation market will continue to evolve even after December 31, 2010, and the Commission may need to account for this evolution on a going-forward basis.

Because AEPS cost recovery is an element of default service regulations, the PUC cannot delay in issuing general regulations to address either DSP or AEPS implementation. In developing these regulations, however, the PUC can provide general guidance while still allowing for continued review of certain issues to account for the ever-changing generation market. As discussed above, Penn Power's interim POLR proceeding raised questions as to

whether Penn Power or the wholesale supplier was responsible for procuring the AECs required under the Act. By offering regulations on this issue, the PUC will enable parties to avoid litigation on this issue.

The Commission may also determine that specific issues can be considered on a different timeframe in order to encourage development of alternative energy resources during the cost recovery period. For example, an EDC may seek to recover costs for an alternative energy source that was not fully contemplated under AEPS. The specific question of recovery for this source may be reviewed on a timeframe separate and apart from general AEPS/DSP regulations to encourage development of this resource, while still ensuring adequate guidance for EDCs with respect to overall cost recovery issues.

Moreover, after Act 213 requirements have been in effect for several years, the Commission may recognize an outgrowth of related issues that were not considered in the initial rulemaking process. By maintaining flexibility with respect to these regulations in order to allow the Commission to revisit these issues as the market continues to evolve, the Commission will provide the guidance necessary at this time, while still ensuring adequate review in the future.

The Commission should encourage development of alternative energy resources during the cost recovery period while still ensuring adequate guidance for EDCs whose cost recovery periods have already expired. By addressing AEPS cost recovery in final default service regulations, EDCs who are in the process of implementing a default service plan will receive the necessary guidance. By recognizing that specific issues may be placed on a separate timetable, developers will be encouraged by the Commission's recognition that flexibility must exist with respect to certain aspects of these regulations.

3. The Commission should integrate costs related to AEPS compliance into the costs identified for default service recovery.

As noted above, Act 213 permits an EDC to account for costs related to AEPS compliance as a cost of generation supply under Section 2807 of the Competition Act. See 73 Pa. P.S. § 1648.3(a)(3). In addition, the EDC may recover these costs pursuant to an automatic adjustment clause under Section 1307 of the Public Utility Code. Id. Because Act 213 requires that AEPS compliance costs be recovered as a cost of default service generation supply, the Commission must consider integrating AEPS costs with other default service costs. In other words, the Commission must provide a means by which to ensure that AEPS cost recovery is included within generation costs, as compared to transmission or distribution costs.

Under the Commission's proposed default service regulations, the costs incurred for providing default service are to be recovered through a generation supply charge and a customer charge. See December 16 Order, § 54.187. The proposed regulations note that both of these charges are non-reconcilable and should include all reasonable costs associated with the acquisition of generation supply. In addition, the regulations provide a general overview of the costs associated with both of these charges. Id. Moreover, the proposed regulations note that a DSP must use an automatic energy adjustment clause, consistent with Section 1307, to recover reasonable costs incurred through compliance with AEPS. Id.

AEPS allows EDCs to recover costs via a Section 1307 mechanism, while the proposed default service regulations allow for DSP cost recovery via a non-reconcilable, fixed charge. Although the means by which to recover these costs differ, AEPS cost recovery is a component of a DSP's generation supply costs. As a result, the Commission must find a means by which to integrate these costs. To do otherwise would increase the possibility of DSPs inappropriately

recovering AEPS costs through distribution or transmission rates, contrary to the requirements of Act 213.

In determining the best means by which to integrate AEPS costs into default service recovery, the Commission must reconcile the Section 1307 recovery process for AEPS costs with the rates to be set forth in a DSP's tariff. One potential for integrating these costs would be to allow the DSP to create a price matrix, of which one component would be AEPS costs. The PUC could establish a yearly reconciliation for AEPS costs for each EDC, with this specific component reconciled pursuant to this process. As a result, the DSP's price matrix would be modified on a yearly basis to account for AEPS cost recovery, while still maintaining fixed prices for all other default service costs.

Another option would be for the DSP to calculate AEPS cost recovery under Section 1307 as a surcharge indicated separately in each DSP's Tariff. This charge would then be applied to a customer's DSP rates. By placing AEPS costs in a separate charge, the DSP would be permitted to reconcile these costs pursuant to Section 1307, while generally retaining fixed default service costs. By then adding the AEPS charge to the other default service charges, the Commission would ensure that AEPS cost recovery remains a component of default service generation supply.

Because AEPS cost recovery has been allocated to generation costs, the Commission must determine a means by which to integrate AEPS costs with default service costs. In addition, the Commission must examine the most appropriate means by which to blend these costs into a DSP's tariff. In order to ensure uniformity with respect to this issue among EDCs, the Commission must also provide general guidance on this issue as part of its default service regulations.

4. Because a force majeure claim may affect AEPS cost recovery, the PUC must consider this issue as part of its final default service regulations.

Act 213 provides that an EDC or an EGS can request a determination from the PUC as to whether alternative energy resources are reasonably available in the marketplace in sufficient quantities to meet the necessary reporting period.³ See 73 Pa. P.S. § 1648.2. If the PUC determines that sufficient quantities are not reasonably available, the PUC may modify the obligation of the EDC or EGS under Act 213. Id. Because such a determination may affect a DSP's AEPS cost recovery, resulting in a modification to default service costs, the PUC must integrate the force majeure provisions into any final default service regulations.

If an EDC is unable to obtain the necessary AECs to meet its AEPS requirements due to unavailability and insufficiency in the marketplace, the EDC may petition the Commission requesting modification or absolution of its obligations. If the PUC finds the force majeure provisions to be applicable, the EDC may not need to purchase any AECs for the period in question or purchase a lesser amount than that otherwise required for the period in question. Because of this change in obligation, an EDC may not have to expend as much in purchasing any AECs, resulting in lower default service costs. Accordingly, the Commission must consider how an EDC can implement the force majeure provisions of Act 213 into its default service charges in order to ensure that these charges adequately reflect any reduced AEPS costs.

As explained above, the interrelation between AEPS and default service costs requires the Commission to integrate these costs as part of the final POLR regulations. Because the force majeure provision may impact AEPS costs, and thereby impact default service costs, the Commission must integrate this provision into the default service procurement process.

³ The Commission may also institute such an investigation on its own motion.

The most appropriate means by which to integrate these provisions is by requiring an EDC to file any force majeure claims as part of its default service implementation filing. Because the outcome of a force majeure claim may impact a default service implementation filing, combining these two proceedings would conserve resources. Specifically, the EDC would only be required to make one filing, the parties could review and analyze these issues in one proceeding, and the Commission could review and determine the interrelationship of these issues in a single, final order. By integrating the Act 213 force majeure provisions into a default service implementation process, the PUC can adequately address these issues in an expedited manner.

In examining a force majeure claim, either in a default service implementation filing or via a separate filing, the Commission must examine the criteria set forth in Act 213. AEPS defines a force majeure event as occurring when "alternative energy resources are reasonably available in the marketplace in sufficient quantities for the electric distribution companies and electric generation suppliers to meet their obligations for that reporting period." 73 Pa. P.S. § 1648.2. Thus, in evaluating a force majeure claim, the Commission must consider whether AECs were: (1) reasonably available; (2) in the marketplace; (3) in sufficient quantities for the EDCs.

Because the Act does not define these terms, the Commission has discretion in determining the reasonableness and sufficiency of AECs in the market place. Thus, the Commission must examine the marketplace applicable to the EDC in question. In reviewing this marketplace, the Commission must look to the quantities of credits in the market to determine if enough AECs were available to meet the EDC's requirements. Finally, the PUC must examine whether these AECs were reasonably available. If, for example, AECs were available, but at an

unreasonable price (e.g., \$1 million per AEC), the Commission may not view this as "reasonably available." Thus, the Commission must examine each claim on an individual basis to determine whether an actual force majeure event occurred, or whether the EDC simply failed to meet its obligation.

A similar review and analysis could be utilized for an EGS claim. Specifically, the EGS could file a petition requesting a finding by the PUC of a force majeure event in the marketplace. The PUC could undertake an investigation to examine the aforementioned criteria in light of the EGS's claims. The PUC could then issue an order, including findings of fact with respect to these events, determining whether a force majeure event occurred. This methodology would provide the EGS with the necessary due process, while also ensuring the PUC adequate review and resolution of these issues.

Because force majeure events may impact an EDC's cost recovery mechanism, which may then impact default service costs, the Commission must integrate Act 213's force majeure provisions into any final default service regulations. By requiring an EDC to make such claims as part of a DSP implementation filing, the Commission ensures adequate ability to review the criteria for these claims, as set forth in the Act. Moreover, creating a similar provision for EGSs also provides the Commission with adequate and appropriate opportunity to address and review these claims. Accordingly, the Commission should address these provisions as part of any final default service regulations.

B. Prevailing Market Conditions Require Long-Term Contracts to Initiate Development of Alternative Energy Resources, and the Competition Act Provides DSPs with the Flexibility to Enter into Such Contracts.

In order to encourage alternative energy resources, prevailing market conditions require provisions for long-term contracts. Developing, building, and implementing alternative energy resources can be expensive, and many developers may be unwilling to undertake such a project unless they are ensured a return on this investment. In addition, the AEC market is still in its infancy, creating questions as to whether the AECs produced by these sources will create enough value to offset investment costs. As a result, long-term contracts may provide developers with the necessary assurances regarding investment capital and cash-flow, as well as guaranteed sales for the AECs resulting from these projects. Thus, DSPs must be able to enter into long-term contracts in order to encourage the development of this, and any other type of, generation.

Fortunately, the Competition Act permits a DSP to enter into long-term contracts. Under the Competition Act, a DSP need only "acquire electric energy at prevailing market prices to serve the customer and shall recover fully all reasonable costs." 66 Pa. C.S. § 2807(e)(3). In fact, the Competition Act places no limitations on the means by which a DSP acquires this energy so long as it is at prevailing market prices.

Several viewpoints have arisen in determining what constitutes "prevailing market prices." In fact, as part of the PUC's November 18 Order, Commissioner Fitzpatrick issued a Dissenting Statement indicating that "it is impossible for a utility to sign a 20 year fixed price supply contract and still comply with the statutory requirement to purchase energy at 'prevailing market prices' for non-shopping customers." November 18 Order, Commission Fitzpatrick Dissenting Statement, p. 1. According to Commission Fitzpatrick, the "price that electric utilities pay for electricity must maintain some reasonable relationship to wholesale prices at any given

time to satisfy the 'prevailing market price' test." Id. In examining this issue, however, the Commission must be open minded with respect to what constitutes "prevailing market prices" in order to ensure full and complete development of both the generation and the AEPS markets.

In order for a DSP to be able to analyze the marketplace and determine the most cost-efficient means by which to procure energy, the DSP must have all of the various market tools at its discretion. Currently, the market provides numerous means by which an entity can purchase electricity, including through locked-in pricing, forward-looking contracts, and hedging options. The Competition Act does not prohibit a DSP from utilizing these tools, and the definition of "prevailing market prices" must not be so stringent as to eliminate these options or to impair the ability to enter into bilateral agreements.

The DSP must have the opportunity to examine and analyze both the short term and long term markets, while maintaining the ability to create a balanced and diverse portfolio. In other words, in order to facilitate market development, the DSP must have the ability to examine all of the prices and tools available in the competitive market in order to predict current and future procurement costs.

Moreover, the Competition Act contemplates DSPs having a panoply of options. Under Section 2806(h) of the Competition Act, the Commission "has the authority to approve flexible pricing and flexible rates, including negotiated, contract-based tariff designed to meet the specific needs of a utility customer and to address competitive alternatives." 66 Pa. C.S. § 2806(h). Under this provision, the Legislature intended EDCs to maintain flexibility in contracting for electricity, which includes entering into long-term contracts. Accordingly, a DSP should be permitted to enter into long-term contracts for any type of electricity, regardless of whether an alternative source is utilized.

The Competition Act only requires that the DSP obtain this electricity at prevailing market prices. Accordingly, for a DSP entering into a long-term contract, the DSP needs to prove that the price for this contract is the prevailing market price for similar long-term contracts at the time of execution. In other words, the electricity price in the contract does not need to maintain a specific relationship to the wholesale prices at any given time during the contract term, but rather, the contract must maintain a reasonable relationship to the wholesale price at the time the contract was entered and for the term of the contract.

Because the Competition Act does not prohibit DSPs from entering into long-term contracts, a DSP should not be prohibited from entering into a long-term contract for energy supplies produced by coal gasification based generation or by any other type of generation. Developing coal gasification based generation may be an expensive and expansive undertaking that may require long-term contracts to ensure a willingness by developers to expand into this area. By recognizing that the Competition Act allows a DSP to enter into long-term contracts for electricity procurement, the Commission will help to encourage alternative resources, such as coal gasification, to develop.

The intent of the Competition Act is to allow DSPs to utilize the tools available in a competitive market for the procurement of electricity for non-shopping customers. In order to facilitate such market development, a DSP must be permitted to enter into long-term contracts, regardless of whether these contracts are based upon alternative generation sources. By adhering to the requirements of the Competition Act, however, and allowing DSPs to enter into such

contracts, the PUC will encourage the development of alternative sources, which may require long-term contracts for such facilitation.⁴

C. The Commission Should Not Delay Promulgation of Final Default Service Regulations, as the Timeframe for Default Service Implementation is Imminent for Many EDCs.

As discussed more fully in Section II.A., supra, the Commission should not delay the promulgation of final default service regulations, as many EDCs will require guidance on these issues in the coming months. Rather, the Commission should implement final default service regulations in order to provide the necessary guidance, while still maintaining flexibility in these regulations in order to enable the Commission to address and modify these provisions as changes in the marketplace arise.

Generation rate caps have already expired for several EDCs, with all generation rate caps expiring by the end of 2010. For example, on October 11, 2005, Penn Power submitted an interim Provider of Last Resort ("POLR") plan with the Commission for implementation on January 1, 2007. See Petition of Pennsylvania Power Company for Approval of an Interim Supply Plan; Docket No. P-00052188. Because of the lack of final default service regulations, the parties litigated this proceeding and are still awaiting a final resolution from the PUC. Some of the issues litigated in this proceeding included the application of AEPS requirements to wholesale supply contracts, the ability of Penn Power to offer fixed price service to large commercial and industrial customers, and the appropriateness of a reconciliation mechanism to Penn Power's price matrix. If final POLR regulations had been issued, the parties may have been able to resolve these issues more easily, rather than resulting to full litigation.

⁴ Because the Competition Act does not prohibit a DSP from entering into long-term contracts, the Commission must ensure that the DSP can utilize such tools regardless of whether the generation at issue comes from an alternative energy source.

Similarly, the Commission has addressed two post-transition period POLR proposals filed by Duquesne Light Company ("Duquesne"), with the Commission most recently considering Duquesne's POLR III plan proposal. See Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service; Docket No. P-00032071, Opinion and Order (Aug. 23, 2004); id., Opinion and Order on Reconsideration (Oct. 5, 2004) (hereinafter, "Duquesne POLR III Reconsideration"). In that proceeding, the PUC determined that large commercial and industrial customers in Duquesne's service territory will have an hourly pricing option and a fixed price option available through at least May 31, 2007. Duquesne POLR III Reconsideration, pp. 23-24. In continuing the availability of the fixed price option through at least May 31, 2007, the Commission specifically noted the need for Duquesne and its customers to adapt to the new PJM marketplace and "that the extended timeframe should provide sufficient time for the promulgation of statewide POLR regulations, which will likely provide express directives on the nature of POLR products to be offered." Id. at 24. In other words, the PUC clearly recognized that the precedential impact of the Duquesne POLR III decision, even within Duquesne's own service territory, is very limited and ratepayers must await final regulations to determine the true default service process.

In addition, some entities have suggested that, because the last of the EDC's rate caps will not expire until December 31, 2010, the PUC has a "long lead time" in formulating final regulations. See November 18 Order, pp. 2-4. In actuality, however, the December 31, 2010, timeframe fails to account for the actual time required by an EDC to develop a default service plan, receive Commission approval, and implement any procurement process.

For example, PPL Electric Utilities, Inc.'s ("PPL") generation rate cap expires on December 31, 2009, which is approximately three and one-half years away. Pursuant to the

PUC's proposed default service regulations, PPL would need to submit a POLR plan to the Commission fifteen months prior to this date (i.e., October 1, 2008). See December 16 Order, § 54.185. Even though the plan itself is not due for another thirty months, PPL will still need adequate time prior to this date to develop and refine its proposal. Assuming PPL requires approximately one year to develop this plan, PPL will need guidance from final regulations by approximately October 2007. As a result, the Commission must issue final default service guidelines within approximately the next eighteen months for PPL to have the necessary guidance on these issues. In other words, a long lead time does not exist for many EDCs, as generation rate caps continue to expire.

In order to ensure that EDCs are provided the necessary guidance in developing interim and final default service plans, the PUC cannot delay implementation of these final regulations. The PUC can, however, maintain flexibility in these regulations to enable the Commission to revisit and modify regulations in the future in order to respond to any significant changes occurring in the generation market both before and after 2010. In addition, the Commission can carve-out certain provisions in the regulations and address those on a separate track while still providing regulations regarding general default service issues. Accordingly, such a process will provide EDCs with the necessary guidance while still maintaining the flexibility suggested by the IRRC.

D. The Commission Must Modify its Proposed Default Service Regulations to Require DSPs to Offer at Least One Fixed Price Offering to All Customer Classes.

In the PUC's proposed default service regulations, a DSP would only be required to offer large commercial and industrial customers hourly priced default service. While a DSP could voluntarily offer these customers a fixed price service, the regulations do not require such an

offering. See December 16 Order, § 54.187(d). In order to ensure that default service regulations reflect the mandates of both AEPS and EPACT, however, the PUC must modify its proposed regulations to require DSPs to offer large customers at least one fixed and one hourly priced default service offering.

EPACT requires utilities to offer a time-based rate schedule, in order to provide large customers with an opportunity to obtain electricity on a real-time basis. Accordingly, the Commission should require all DSPs to offer at least one hourly priced option for large customers to ensure that the requirements of EPACT are satisfied. EPACT does not, however, require the PUC to implement real-time pricing as the only option for default service. Similarly, EPACT does not prohibit a DSP from offering fixed prices to customers, nor does EPACT exclude the offering of two differently priced POLR options (i.e., both fixed and hourly priced services).

Similarly, AEPS does not prohibit a DSP from offering both fixed and hourly priced services. In fact, in order to ensure that an EDC is able to meet its obligations under Act 213, the EDC must offer all of its customers at least one fixed price option. Conversely, allowing a DSP to only offer hourly pricing options to large customers would severely hinder a DSP's flexibility in meeting the requirements of AEPS.

Specifically, hourly priced service is purchased from the spot energy market, which then flows through the locational marginal price from the energy market to the customer. As a result, it is unclear how hourly spot market purchases could meet the requirements of AEPS, as these spot purchases will almost certainly not have alternative energy attributes. Thus, if a DSP is required to purchase the electricity for all of its large commercial and industrial customers via the spot market (as would occur if the DSP were only permitted to offer these customers hourly

priced service), none of these purchases could contribute to the DSP's AEPS obligations.

Conversely, if a DSP were permitted to offer fixed price service to its large customers, the DSP could enter into contracts in which a portion of this electricity was acquired from alternative energy resources, thereby ensuring the DSP's ability to meet these obligations.

If the DSP does not offer a fixed price service to larger customers, these customers may not have any other means by which to obtain such service. Many large customers are unable to utilize hourly priced service due to production constraints or budgeting issues. If the DSP did not offer fixed price services, these customers would have to depend upon EGSs offering these services. Although EGSs have indicated an interest in serving the markets, competitive alternatives in many EDCs' service territories are at a minimum, and customers have no guarantee that EGSs will offer services in the future. The PUC cannot order an EGS to provide service in the territory or require an EGS to offer fixed price service to customers. Rather EDCs, as the DSPs, will be the only companies legally required to serve customers in the territories. See 66 Pa. C.S. § 2807(e).

Moreover, EGSs will be cognizant of that fact that some larger customers may be unable to utilize hourly priced service. If a DSP is not offering a fixed price service to these customers, EGSs will have the opportunity to significantly raise their fixed prices above what the market would otherwise bear merely because the "competitive" market would be the only option for customers seeking fixed-price options. Customers would be subject to unjust and unreasonable rates from EGSs as a direct result of the lack of a fixed-price option for POLR rates.

If EDCs are only required to provide hourly priced POLR service for large customers, the EDC will be procuring large amounts of electricity with little ability to procure this electricity in a manner that would ensure accompanying AECs. Similarly, larger customers may be

detrimentally impacted if a DSP does not offer a fixed price service. Thus, in order to meet the requirements of EPACT, the obligations of AEPS, and the needs of large customers, the Commission must require all DSPs to provide at least one fixed and one hourly priced default service option to all large commercial and industrial customers.

E. In Examining Additional Cost Recovery Issues under Act 213, the Commission Should Include a Provision Allowing for Exemption of Customers With AEC Ownership.

Under the terms of Act 213, EDCs and EGSs must meet certain compliance requirements with respect to procuring a percentage of electricity from alternative energy sources. See 73 Pa. P.S. § 1648.3. While EDCs and EGSs may register for ownership of AECs, other entities may also create and register AECs. For example, many large commercial and industrial customers are already utilizing alternative energy sources, in order to reduce electricity costs, through participation in Demand Side Management ("DSM") programs or implementation of Energy Efficiency ("EE") projects.

Act 213 permits an EDC to recover from its ratepayers all costs related to the purchase of electricity generation from alternative energy sources and payments for AECs. Id. As a result, if an EDC must purchase electricity from an alternative source to obtain AECs, the EDC can flow the costs of these purchases through to its ratepayers. Some customers, especially large commercial and industrial customers, will have ownership of AECs through the implementation of various DSM programs and EE projects. The PUC should permit these customers to request exemption from the flow-through of any costs related to AEC procurement if the customer is willing and able to provide the EDC with AECs to cover the EDC's obligation with respect to procurement of electricity from alternative sources for purposes of that customer's energy needs. Because these customers have already expended numerous resources in developing and

implementing these alternative sources, they should not be charged for the procurement of additional AECs by the EDC if the customer is willing and able to provide these AECs to the EDC in the form of a "self-exemption."⁵

Such exemption is especially important in light of the Commission's continued review of cost recovery applicable to alternative compliance payments. Under AEPS, if an EDC or EGS fails to comply with the Act by obtaining the necessary AECs, the EDC or EGS must make alternative compliance payments, which are set at \$45 per credit. See 73 Pa. P.S.

§ 1648.3(f). On July 14, 2005, the PUC entered an Order ("Implementation Order II") to address, among other issues, the ability of EDCs to flow the costs of these payments through to customers. In this Order, the Commission indicated an intent to not allow EDCs to flow through the costs of these compliance payments to ratepayers; however, the Commission is still reviewing this issue.

If an EDC is not permitted to flow through the costs of alternative compliance payments, but is permitted to flow through the costs of acquiring AECs, the EDC is more likely to purchase AECs, at potentially much higher prices, to be able to flow through these costs to customers. In such an instance, customers who are producing AECs should not be charged by the EDCs for procurement of AECs when the customers are producing their own AECs.

Because many customers may have implemented various alternative energy projects and programs in order to reduce energy costs, these customers should be rewarded by receiving a "self-exemption." Specifically, the EDC should not be permitted to flow through the costs of purchasing AECs to meet these customers' electricity requirements, if these customer are willing

⁵ This exemption would apply to the type of AEC created by the customer and required by the EDC. For example, if the customer had only Tier II AECs, and the EDC had to purchase Tier I AECs for compliance purposes, then the self-exemption would not apply to the flow through of costs related to the Tier I credits.

to provide these AECs to the EDC in exchange for an exemption from these costs. In doing so, the Commission can ensure that the customers are adequately compensated for efforts to implement alternative generation, rather than charged twice for this procurement.

F. In Examining Additional Cost Recovery Issues under Act 213, the Commission Must Ensure that EDCs Do Not Inappropriately Contract Away AECs to their Generation Affiliates.

A final issue to consider with respect to AEPS cost recovery is the ability of an EDC to "contract away" AECs to its generation affiliate. The PUC must ensure that any type of contracting between an EDC and its generation affiliate with respect to AECs is just, reasonable, and appropriate. Without such a finding, ratepayers may be detrimentally affected.

As discussed more fully in Section II.E., supra, an EDC must purchase a certain amount of its electricity from an alternative generation source, with the costs of this purchase allocated to customers. Some EDCs, however, may already have ownership of AECs stemming from previously built alternative generation. For example, if an EDC previously built a windfarm, and increased customers' rates to fund this farm, then any AECs resulting from this windfarm should be used by the EDC to offset its obligations under AEPS. If, however, the EDC contracts away these AECs to its generation affiliate, and is required to purchase additional generation to meet its obligations, customers will be detrimentally impacted, as they will lose the benefits of the AECs from the windfarm, which they funded, and they will be forced to pay for the EDC's procurement of additional AECs to replace those contracted away to the generation affiliate. Accordingly, the Commission must ensure that any "contracting away" by EDCs to an affiliate provides appropriate remittance to ratepayers.

The potential for this issue has already arisen in a current proceeding before the PUC. Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec") filed

a Petition for a Declaratory Order with the PUC to determine ownership of AECs resulting from previously entered Purchase Power Agreements ("PPAs") with Non-Utility Generators ("NUGs"). See Petition for a Declaratory Order Regarding the Ownership of Alternative Energy Credits and Any Environmental Attributes Associated with Non-Utility Generation Facilities under Contract to Pennsylvania Electric Company and Metropolitan Edison Company; Docket No. P-00052149. While not an original petitioner, PPL also joined this proceeding, as it has PPAs with NUGs that are at issue.

In the course of this proceeding, the Office of Trial Staff ("OTS") argued that the proceeds from the sale of AECs associated with the PPAs should be flowed through to the EDCs' ratepayers, as the ratepayers have been paying the above-market costs under these PPAs, and therefore the ratepayers should reap the benefits of any resulting sale of the AECs. PPL, however, submitted testimony in response to this argument, claiming that PPL sold the electrical output from its NUG contracts to its unregulated affiliate, PPL EnergyPlus, LLC ("PPL EnergyPlus"), through a Power Sales Agreement ("Agreement"). Under the Agreement, PPL claims that PPL EnergyPlus, as the purchaser of the NUG output, now owns the AECs associated with that output. As a result, ratepayers will not reap any benefits from the sale of these AECs.

PPL notes that this agreement was accepted by the Federal Energy Regulatory Commission ("FERC") as a Service Agreement under the FERC Electric Tariff; however, PPL does indicate whether the PUC has approved this Agreement. Because implementation of Act 213 will raise many new and novel issues, the PUC must ensure that appropriate review is occurring with respect to these issues. Similarly, ratepayers must be protected from any inappropriate and unreasonable actions by a utility with respect to the sale of AECs. While PPL's sale of these AECs to PPL EnergyPlus is not at issue in this proceeding, PPL's actions

raise a concept of which the PUC must be aware. As a result, the Commission must consider this issue when examining cost issues related to AEPS.

Under Section 2102 of the Public Utility Code, "[n]o contract or arrangement providing for the...purchase, sale, lease, or exchange of any property, right, or thing...made or entered into...between a public utility and any affiliated interest shall be valid or effective unless and until such contract or arrangement has received the written approval of the commission." 66 Pa. C.S. § 2102(a). Accordingly, the Commission has the power to review and approve any contract between a public utility and an affiliated interest that would result in the sale of AECs by the public utility to the affiliated interest.

As part of any final POLR regulations, the Commission should require all EDCs to file with and receive approval for any contracts regarding the sale of AECs between the EDC and an affiliate prior to this sale occurring. Specifically, the Commission must review these agreements to ensure that ratepayers are adequately compensated for the sale of these AECs. If adequate compensation is not occurring, then ratepayers will be further impacted when the EDC must purchase additional AECs to replace those provided to its generation affiliate.

EDCs are permitted to enter into contracts with their generation affiliates, and implementation of AEPS should not hinder this ability. The PUC must ensure, however, that such contracts do not result in harm to ratepayers, especially as the AEPS market is in its infantile stages. As a result, the Commission must utilize its powers under the Public Utility Code to review such contracts in order to ensure that ratepayers are being treated justly and reasonably. If the PUC does not provide such review, the possibility exists that ratepayers will be funding AECs for the EDC's generation affiliate's AEC obligations, as well as the EDC's own AEC obligations.

III. CONCLUSION

WHEREFORE, the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, the PP&L Industrial Customer Alliance, and the West Penn Power Industrial Intervenors respectfully request that the Pennsylvania Public Utility Commission consider and adopt, as appropriate, the foregoing Comments.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

/s/ Charis Mincavage

By _____

David M. Kleppinger
Derrick Price Williamson
Charis Mincavage
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717)232-8000
Fax: (717)237-5300

Counsel to the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, the PP&L Industrial Customer Alliance, and the West Penn Power Industrial Intervenors

Dated: March 8, 2006