

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In the Matter of the Pennsylvania	:	
Public Utility Commission	:	
Implementation of the Alternative	:	Docket No. M-00051865
Energy Portfolio Standards Act of	:	
2004	:	
	:	
and	:	
	:	
Rulemaking Re Electric Distribution	:	Docket No. L-00040169
Companies' Obligations to Serve	:	
Retail Customers at the Conclusion of	:	
the Transition Period Pursuant To 66	:	
Pa.C.S. § 2807(e)(2)	:	

**REPLY COMMENTS OF
CONSTELLATION ENERGY GROUP COMPANIES**

I. INTRODUCTION

On November 18, 2005, the Pennsylvania Public Utility Commission (“Commission”) reopened the public comment period for the proposed Default Service regulations to consider implementation of the Alternative Energy Portfolio Standards Act (“AEPS Act”) and to more fully examine the comments received from the Independent Regulatory Review Commission (“IRRC”). *Default Service Rulemaking New Comment Period Order*, Docket No. L-00040169 (the “November 18 Order”). Constellation Energy Commodities Group, Inc., Constellation Generation Group, LLC and Constellation NewEnergy, Inc. (collectively, “Constellation”) and many other parties submitted comments on March 8, 2006. As described in greater detail below, pursuant to the procedural schedule, Constellation submits Reply Comments in response to the initial comments filed by various parties in this proceeding.

In its initial comments, Constellation urged the Commission to carefully maintain the integrity and competitiveness of wholesale and retail markets.¹ Competitive markets function most efficiently when they reflect demand and supply dynamics and are not driven towards a particular outcome through regulatory or political intervention. Most importantly, in a competitive market, the competitive wholesale and retail suppliers – not the electric distribution companies (“EDCs”) (or their customers) – now bear fuel price, market and technology risks, as well as much of the operational risk for providing delivered energy to consumers. Nevertheless, as Constellation pointed out in its Initial Comments, at times the government appropriately must take the lead in providing structures in the market to encourage development of specific new or experimental technologies because of the common good that will result from advancement of such technology.

In these Reply Comments, Constellation focuses on the following arguments contained in the initial comments of other parties:

- (1) Some parties have recommended that the Commission delay or prolong finalizing the Default Service regulations;
- (2) The Industrial Energy Consumers of Pennsylvania, *et al.*,² recommends that the Default Service regulations require each EDC as Default Service Provider (“DSP”) to offer a fixed price product to large customers;

¹ See *Initial Comments of Constellation Energy Group Companies*, Docket Nos. M-00051865 and L-00040169, March 8, 2006 (“Constellation Initial Comments”).

² The Industrial Energy Consumers of Pennsylvania filed jointly with 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 (collectively, “IECPA”). See *Comments of [IECPA]*, Docket Nos. M-00051865 and L-00040169, March 8, 2006 (“IECPA Initial Comments”).

- (3) Several parties advocate providing EDCs with unfettered discretion to enter into long term contracts for the purchase not only of AEPS-related supply but for all other POLR supply obligations;
- (4) Dominion Retail Inc. (“Dominion”) recommends that the EDCs provide AEPS credits for all customers; and
- (5) All parties, including Constellation, failed to comment on whether there is a need to address any changes to the Commission’s Competitive Safeguard Regulations.

II. THE COMMISSION SHOULD NOT DELAY OR PROLONG FINALIZING THE DEFAULT SERVICE REGULATIONS

A. Reply to Duquesne Light Company

Duquesne Light Company (“Duquesne”) is of the view that the Default Service regulations should not become effective until 2011. Duquesne argues that the “major” EDCs’ transition periods don’t expire until the 2010-2011 timeframe and therefore the regulation effective date need not occur prior to that time frame.³ The Commission should give little weight to Duquesne’s arguments regarding timing. The Commission should instead look to the EDCs with longer transition periods, including PECO Energy Company and Exelon Generation Company, LLC (collectively, “Exelon”) and PPL Electric Utilities Corporation (“PPL”) have argued just the opposite of Duquesne in its respective initial comments. Exelon concludes in its initial comments that the Commission should finalize Default Service regulations “as soon as possible.”⁴ In support of this recommendation, Exelon submits that EDCs need to “plan and

³ *Comments of Duquesne Light Company to February 8, 2006 Issues List*, Docket Nos. M-00051865 and L-00040169, March 8, 2006, at p.6 (“Duquesne Initial Comments”).

⁴ *Comments of the Exelon Companies to the Commission’s February 8, 2006 Issues List*, Docket Nos. M-00051865 and L-00040169, March 8, 2006, at p.2 (“Exelon Initial Comments”).

prepare well before the end of their rate cap period to ensure a successful transition.”⁵

Constellation agrees and moreover adds that *all* market participants need to plan and prepare for a successful transition. The more certainty regarding rules and processes that market participants have, the better the planning and preparation process will be. Similarly, PPL, whose rate caps are in place through December 31, 2009, recommends that the Commission proceed as “expeditiously as possible” with the rulemaking.⁶

B. Reply to UGI Utilities, Inc. Comments

Like Duquesne, UGI Utilities, Inc. (“UGI”) argues for a delay in implementation of the Default Service regulations.⁷ Again, the Commission should give little weight to UGI’s recommendation and should instead look to the EDCs that have the longest transition plans. Exelon and PPL share the view of Constellation and others in this proceeding that a successful transition to post-rate-cap Default Service depends on regulatory certainty and time to plan and prepare for the transition.

III. THE COMMISSION SHOULD REJECT IECPA’S REQUEST THAT EACH EDC BE REQUIRED TO OFFER A FIXED PRICE PRODUCT TO ALL LARGE CUSTOMERS

IECPA requests, among other things, that the Commission require Default Service providers to offer “at least one fixed price option to large commercial and industrial customers.”⁸ This assertion by IECPA, which has been raised in other forums before the Commission, runs contrary to facts and experiences regarding successful competitive market development. IECPA argues that in the absence of a fixed price default option, EGSs “will have the opportunity to

⁵ Exelon Initial Comments at p.11.

⁶ *Comments of PPL Electric Utilities Corporation*, Docket Nos. M-00051865 and L-00040169, March 8, 2006, at p.3.

⁷ *See Comments of UGI Utilities, Inc.*, Docket Nos. M-00051865 and L-00040169, March 8, 2006 (“UGI Initial Comments”).

⁸ IECPA Initial Comments at p.2.

significantly raise their fixed prices above what the market would otherwise bear....”⁹ In fact, just the opposite is true. Hourly pricing for large industrial customers attracts EGSs who must compete to win customers, which exerts *downward* pressure on EGS fixed price offerings, *not* upward pressure as IECPA alleges.

Furthermore, IECPA claims that customers will be subject to “unjust and unreasonable rates from EGSs”¹⁰ in the absence of a fixed price default option. “Just and reasonable” is a utility rate standard, not an EGS price standard. As the Commission said in its Proposed Rulemaking Order of December 16, 2004, “in a competitive market the prevailing market price is analogous, though not identical, to the ‘just and reasonable’ standard for utility rates.”¹¹ EGSs do not charge rates, they charge prices. These prices are a function of wholesale markets and competition from other EGSs. Unlike the setting of EDC rates, which are a function of the EDC’s cost and a rate of return component, EGSs must compete with each other on the basis of price, product differentiation and customer service in order to win the right to serve a customer. Thus, the prices charged by EGSs are the “prevailing market price” and as such, IECPA is incorrect to assert that by definition EGS rates will not be “just and reasonable” without the existence of a fixed price default option. It simply is improper to compare EGS prices to the setting of EDC bundled rates.

Finally, Constellation disagrees with IECPA’s assertion that a fixed price option is required to assure that the regulations “reflect the mandates of both AEPS and EPACT.”¹² IECPA argues that none of a DSP’s hourly priced purchases would contribute to a DSP’s AEPS

⁹ IECPA Initial Comments at p.19.

¹⁰ IECPA Initial Comments at p.19.

¹¹ *Proposed Rulemaking Order*, Docket Nos. M-00041792 and L-00040169, December 16, 2004, at p.7.

¹² IECPA Initial Comments at p.18.

obligations. Constellation disagrees. The DSP, like any other load serving entity, would meet its AEPS obligation by making a demonstration that, out of the total energy consumption by its customer base, an appropriate percentage of that load was served using AEPS resources. The MWh load of hourly customers would appropriately be included in such calculation. IECPA is confusing an hourly price with a load based measurement. Surrounding states (e.g., Maryland and New Jersey) offer hourly pricing as the default for the largest customers. These states also have renewable portfolio requirements. EDCs and competitive suppliers in those states have not had a problem reconciling the two characteristics.

IV. EDCS SHOULD NOT HAVE UNFETTERED DISCRETION TO ENTER INTO LONG-TERM CONTRACTS FOR ALL OTHER DEFAULT SERVICE SUPPLY OBLIGATIONS

A. Reply to Duquesne

In its initial comments, Duquesne submits that the proposed Default Service regulations are seriously flawed.¹³ As with other arguments in its initial comments, Duquesne veers far from the input this Commission requested in its November 18 Order.¹⁴ It is improper for Duquesne to provide such proposals in response to the Commission's request for input specifically on incentives necessary to get alternative energy projects built in Pennsylvania. Moreover, in criticizing Pennsylvania's wholesale competitive procurement process, with particular focus on Pike County,¹⁵ Duquesne completely neglected its own success with this model, through which over 90% of eligible large customers and 92% of eligible large customer load is being served by

¹³ Duquesne Initial Comments at p.2.

¹⁴ On page 10 of its initial comments, Duquesne uses the opportunity presented by the November 18 Order to again attack the broader Default Service regulations rather than focus on alternative energy as requested by this Commission.

¹⁵ See Duquesne Initial Comments at pp.2-3.

an EGS as of December 31, 2005.¹⁶ Duquesne states that it desires “greater flexibility” to meet its Default Service obligation, not unlike the assertions that were made by Duquesne in its POLR III filing.¹⁷ However, this proposal was previously rejected by the Commission.

Finally, it is unclear what Duquesne hopes to achieve by responding to questions not asked by the Commission in its November 18 Order, particularly given the success of retail choice within its service territory. As discussed in Constellation’s Initial Comments, to the extent that Duquesne desires to enter into long-term contracts and build new generation in order to serve its own customers on a rate-based basis, the Commission must carefully consider the potentially deleterious effects of such rate-based long-term commitments on the current Pennsylvania market.

B. Reply to UGI Utilities, Inc.

UGI states in its comments that it does not yet know how the market for alternative energy will develop but that if price signals ultimately do not result in sufficient construction of new plants, and long-term contracts are required, Default Service providers should be assured of cost recovery through means such as non-bypassable cost recovery mechanisms.¹⁸ Constellation agrees with UGI that long-term contracts are problematic in the current Pennsylvania market design for a number of reasons, as detailed in Constellation’s Initial Comments. As stated in Constellation’s Initial Comments, therefore, we believe this Commission should explore alternative mechanisms to incent construction of new alternative energy sources, to the extent

¹⁶ See Duquesne 4th Compliance filing relating to its POLR service, Docket No. P-00032071. See also, the Motion of Vice Chairman James H. Cawley, Public Meeting FEB-2006-C-0004 (Feb. 9, 2006). In this motion, while requesting comments concerning reporting requirements to be implemented to allow the Commission to learn more about the progress of retail choice, the Vice-Chairman reflected surprise at the success of the retail market for commercial and industrial customers within Duquesne’s service territory.

¹⁷ See generally, Duquesne Presentations and Filings, Docket No. M-00041792.

¹⁸ UGI Initial Comments at pp.2-3.

such additional incentive is at all necessary. If, however, long-term contracts are ultimately deemed necessary by this Commission, Constellation believes that the Commission, instead of providing for exit fees and switching restrictions that are problematic in a market where retail choice and switching are encouraged, should determine how best to recover the costs associated with such long-term contracts. As stated in Constellation's Initial Comments, if the Commission decides to utilize long-term contracts, the Commission must: (a) reconcile such use within the Default Service procurement process adopted by this Commission; (b) design a process that ensures that the contracts are competitively procured and not automatically awarded to the EDC; (c) meet the standards set forth by the Federal Energy Regulatory Commission in *Boston Edison Re: Edgar Electric Co.*, 55 FERC ¶ 61,382 (1991); and (d) limit the amount of default load available and limit the length of such contracts to no more than 10 years. Indeed, in many well-developed competitive markets we have witnessed such contracts being executed without the imposition of any regulatory mandates.¹⁹

V. ALL MARKET PARTICIPANTS SHOULD BE RESPONSIBLE FOR AEPS COMPLIANCE

Dominion recommends that the EDCs be responsible for providing AEPS credits for all customers regardless of whether they are shopping. Dominion makes this recommendation due to the fact that only the EDCs have the ability to pass through AEPS costs on a non-bypassable basis. According to Dominion, since EGSs do not have the same ability to pass through such costs, prices to compare become distorted. While Constellation agrees with Dominion that the price to compare may become somewhat distorted due to EDCs refunding overcollections or charging for undercollections, nevertheless, Constellation is of the view that all market

¹⁹ See, e.g., April 5, 2006 Press Release from Maine Mountain Power regarding the agreement of Constellation NewEnergy, Inc. to buy all of the output from its proposed 90-megawatt Redington Wind Farm near Sugarloaf Mountain in Maine.

participants should participate in meeting AEPS responsibilities. The greater the number of market participants that are creating and trading AEPS credits, the more robust and liquid the market for AEPS credits will be. The development of a robust and liquid AEPS credits market will benefit both customers and the environment in the Commonwealth of Pennsylvania.

Constellation agrees with Dominion's observation that the Commission, in implementing both Default Service and AEPS cost recovery regulations, must adopt regulations such that shopping customers are not required to pay twice for AEPS costs.

VI. THE COMMISSION'S COMPETITIVE SAFEGUARD REGULATIONS

Constellation notes finally that it is indeed unfortunate that none of the commenters, including Constellation, responded to Commissioner Pizzigrilli's Motion of December 16, 2004 in which she invited comment on further changes that may be needed to the Commission's Competitive Safeguard Regulations. Constellation is of the view that these important regulations, developed early in Pennsylvania's transition to competitive energy markets, are ripe for review. Accordingly, we recommend that the Commission establish a forum in which all market participants can work to review and revise as appropriate the current Competitive Safeguard Regulations.

VII. CONCLUSION

In considering the initial comments and reply comments from the parties to this proceeding, the Commission should continue with the steady hand and leadership that it has shown in guiding the restructuring of Pennsylvania's electric market. If the Commission adopts the appropriate regulations regarding implementation of the AEPS Act, Pennsylvania has the ability to be a leader in the encouragement of environmentally friendly generation in restructured

states. In fashioning the regulations to be adopted in this proceeding, the Commission must strike an appropriate balance within the current regulatory constructs of the electric market.

Respectfully submitted,

/s/

Lisa M. Decker
Constellation Energy Group Companies
111 Market Place, Suite 500
Baltimore, MD 21202
410-468-3792
Lisa.Decker@constellation.com

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CERTIFICATE OF SERVICE

I hereby certify that pursuant to Sections 5.75 and 1.54 of Pennsylvania Code Chapter 52 I have served all participants in this proceeding by regular mail.

/s/

Divesh Gupta

*Attorney for Constellation Energy Group
Companies*