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COPY

April 7, 2006

James McNulty
Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
2nd Fl., 400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

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Re: Implementation of the Alternative Energy Portfolio
Standards Act of 2004 – Docket No. M-00051865

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

Dear Secretary McNulty:

On behalf of Direct Energy Services, LLC, enclosed for filing please find an original and 15 copies of its Reply Comments with regard to the above referenced matter.

Very truly yours,



Daniel Clearfield

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

DC/lww
Enclosure

HAR:65195.1/DIR023-216494

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Implementation of the Alternative Energy Portfolio Standards Act of 2004	:	Docket No. M.-00051865
Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. Section 2807(e)(2)	:	Docket No. L-00040169

PENNSYLVANIA PUBLIC UTILITY COMMISSION
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REPLY COMMENTS OF DIRECT ENERGY SERVICES, LLC

I. INTRODUCTION

These Reply Comments are submitted by Direct Energy Services, LLC ("Direct") to Comments submitted to the Pennsylvania Public Utility Commission ("Commission" or "PUC") in the above captioned docket. For ease of reference, Direct's comments will be organized around the questions that the Commission promulgated in its February 8, 2006, Secretarial Letter.

Overall, Direct's position is that the additional issues to which the PUC's questions are directed do not pose impediments to implementing a default service pricing model which reflects "prevailing market prices" in a way that provides for the best competitive results for retail customers. Only a pricing scheme that reflects changes in energy markets on a "real time" basis – hourly or monthly pricing – will achieve this result. Given the recent controversies and problems caused by default service price increases using fixed, long-term wholesale procurement contracts, it should be plain that new approaches are called for. The Commission should implement its Act 213 obligations while approving a default service pricing mechanism that has the best chance of avoiding or eliminating these types of issues: A default service priced on an hourly or monthly basis.

II. ISSUES

Question 1 – Should Act 213 cost recovery be addressed in the Default Service regulations as opposed to a separate rulemaking? Is it necessary to consider Act 213 cost recovery regulations on a different time frame in order to encourage development of alternative energy resources during the "cost recovery period"?

Several commenters¹ indicated that, while cost recovery for Act 213 compliance and for Default Service could be addressed in a single rulemaking, the statutory requirements of the two Acts were separate and that AEPS cost recovery did not have to meet the standards set forth in the Electric Choice Act. This is an important point and one with which Direct strongly agrees.

Specifically, Act 213 cost recovery should not be held to the "prevailing market price" standard that governs the cost recovery for Default Service established in the Electric Choice Act.² Act 213 and the Electric Choice Act are two different statutes and have different goals and objectives. The Commission has stated that the purpose and intent of Act 213 is to "support . . . and encourage[e] the development of alternative energy resources in Pennsylvania,"³ while the purpose of the Electric Choice Act default service provisions was to assure a reliable source of electricity for retail customers in a manner that fosters a robust retail market for electricity.⁴

¹ See, Comments of PPL at 2-3.

² Electricity Generation Customer Choice and Competition Act ("Electric Choice Act").

³ *Re: Implementation of the Alternative Energy Portfolio Standards Act of 2004*, M-00051865, Proposed Policy Statement, Order Entered November 16, 2005, at 2.

⁴ *Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant To 66 Pa. C.S. §2807(e)(2)*, Docket No. L-00040169, Order entered December 16, 2004, at 5 (emphasis added) ("The Commission . . . finds that an appropriately crafted regulatory framework for POLR service **will serve the public interest by fostering a robust retail market for electricity**. The General Assembly's policy findings regarding the overall costs of electricity, disparities in rates across service territories, and the importance of reasonable

Accordingly, and as indicated below, the recovery of Act 213 costs do not need to be justified on the ground that they satisfy a "prevailing market price" standard.

Question 2. Do the prevailing market conditions require long-term contracts to initiate development of alternative energy resources? May Default Service Providers employ long-term fixed price contracts to acquire alternative energy resources? What competitive procurement process may be employed if the Default Service Provider acquires alternative energy resources through a long-term fixed prices contract?

Several commenters responded to this question by insisting that long-term contracts will be necessary in order to enable the development of alternative energy resources.⁵ As indicated above, Direct does not believe that the "prevailing market prices" standard need be applied to alternative energy cost recovery. However, any conclusion that long-term contracts are necessary for the development of all types of alternative energy electricity generation projects lacks factual foundation or support. Indeed, based upon Direct's observation of various competitive electric markets around the county, alternative generation is being sold to retail EDCs (acting as the default service provider) under contracts of varying lengths and terms.⁶ It may be more accurate to state that some types of alternative energy projects – *e.g.*, coal

rates in attracting and retaining businesses **can best be addressed by ensuring the continued formation of a competitive marketplace for electricity.**")

⁵ See, *e.g.*, Comments of PPL at 4.

⁶ Both New Jersey and Delaware have renewable energy portfolio requirements, but, to the best of Direct's knowledge, neither has specifically approved or authorized long-term contracts for the acquisition of such renewable energy.

gasification plants – may require long-term contracts in order to justify the large capital investment necessary to build such facilities. On the other hand, smaller projects such as small wind turbines or a solar project may not require such contracts at all.

The overriding concern of Direct is that if EDCs are permitted to enter into long-term contracts to secure the necessary alternative energy to satisfy Act 213, the Commission must make absolutely sure that such contracts do not create a competitive disadvantage with EGSs who must compete with the resulting default service/AEPS cost rate.⁷

More troubling to Direct is that several commenters used their answer to this question to assert that long-term contracts should also be authorized not only for alternative energy resources but also to obtain some or all of their supply requirements for default service. In Direct's view, such a long-term contract approach for the procurement of default services is simply inconsistent with the statutory requirement that default service be provided by "acquir[ing] electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs."⁸ Several commenters continue to claim, however, that as long as the price for energy is obtained "through the market" such a price satisfies this statutory section regardless of the length of the contract utilized. So, they argue, a 20-year contract for the purchase of electricity would satisfy the prevailing market price standard as long as the price was procured through some kind of competitive market process.⁹

⁷ One possible solution to this problem would be to adopt the suggestion of some of the commenters and to order that the alternative energy costs resulting from EGS responsibilities under the Act be recovered in the EDC's Act 213, 1307-type surcharge.

⁸ 66 Pa. C.S. § 2807(e)(3).

⁹ *See*, Comments of Industrial Energy Users at 15; Comments of OCA at 2.

This argument simply does not bear up under closer scrutiny. Such an interpretation requires that the word "market" be given a superior emphasis while ignoring the word "prevailing." In the context of the section, the phrase "prevailing market price" clearly reflects a legislative intention to require that the price reflect the market price *at the time that the power is actually used by the customer*. That the General Assembly was seeking to require the electric prices would reflect the market price at the time the customer utilized the power can be seen from considering the phrase in the context of the entire subsection:

If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.¹⁰

Since the price established under a long-term contract could only be the "prevailing market price" for a customer that was being served by the default service provider at the time that the long-term contract was entered into, and could never reflect prevailing market prices for any new customers, such a contract could not possibly satisfy the prevailing market prices standard in the Act. Therefore, a price established under a long-term electric supply contract would only reflect the price of energy for, at most, the first few months after the contract was entered into and cannot be the "prevailing market price" for the entire duration of the contract.

The arguments of those who advocate the use of a long-term contract would have more weight if an accurate determination of the "prevailing market price" for electric energy for a customer at any particular time did not exist. However, for all customers in Pennsylvania hourly priced service is available and permits the identification of the prevailing market price on a real

¹⁰ 66 Pa. C.S. § 2807(e)(3).

time basis. In light of the existence of an actual "real time" prevailing market price, a rate established via a long term contract simply can't be a "prevailing market price."

In addition to these legal impediments, the Commission should be well aware of the problems of setting a default service price based on longer-term contracts. The experience of the Commission in the Pike County matter should provide ample evidence of the results of establishing fixed default service price on a longer-term basis in today's volatile and ever-changing energy markets. Only a monthly energy price would have assured that Pike customers would have automatically received the benefits of mitigating energy prices that began to emerge shortly after the Pike County default service was established.

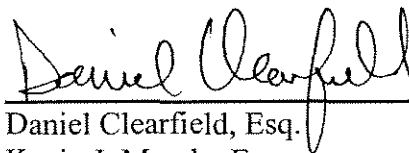
OCA is incorrect in its suggestion that a "portfolio" of contracts of varying lengths would ameliorate the type of crisis that Pike customers are currently experiencing.¹¹ A portfolio of long-term contracts simply provides a different "non-market based" answer, and presents as much of a "crap shoot" as establishing the default service price on the basis of a single one, two or three-year contract. Moreover, it adds an additional artificial element because the terms of the "portfolio" would have to be dictated by the Commission rather than being established through the competitive market. Again, whenever regulatory fiat is used in place of competitive forces, competition suffers and unanticipated negative results frequently occur.

Question 6. May a Default Service Provider enter into a long-term fixed price contract for the energy supplies produced by coal gasification based generation if the resulting energy costs reflected in the tariff rate schedules are limited to the prevailing market prices determined through a competitive procurement process approved by the Commission?

¹¹ OCA Comments at 10.

While Direct has no evidence to support the assertion in the Commission's question, it would not oppose the use of a long-term contract for coal gasification based generation as long as before such long-term contract was entered into adequate proof was presented to the Commission to support a finding that such projects could not go forward without a long-term contract of this nature. Permitting such arrangements, however, should not be used as justification for mandating general default service pricing on the basis of long term contracts. Moreover, as noted previously, the price produced by such a contract would not have to meet the "prevailing market price" standard, assumed in the question. Nonetheless, if the price for the gas from the coal gasification plant reflected the monthly market price of natural gas, it would satisfy the prevailing market price standard, whether the standard applied or not.

Respectfully Submitted



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Dated: April 7, 2006