

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Default Service and Retail Electric Markets	:	Docket No. M-00072009
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Default Service and Retail Electric Markets	:	Docket No. L-00070183
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Advance Notice of Final Rulemaking Order In Re: 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
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**REPLY COMMENTS OF THE
CONSTELLATION ENERGY GROUP COMPANIES**

I. INTRODUCTION

Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (collectively, “Constellation”) hereby submit Reply Comments to parties’ initial comments regarding the Proposed Policy Statement on Default Service and Retail Electric Markets (“Policy Statement”)¹ and Advance Notice of Final Rulemaking Order (“Default Service Rules”)² issued by the Pennsylvania Public Utility Commission (“Commission”) on February 8, 2007. Constellation submitted Initial Comments in this proceeding on March 2, 2007.³

¹ *Proposed Policy Statement In Re: Default Service and Retail Electric Markets*, Docket No. L-00070183 (entered Feb. 9, 2007) (“Policy Statement”).

² *Advance Notice of Final Rulemaking Order In Re: 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)*, Commission Docket No. L-00040169 (entered Feb. 9, 2007) (“Default Service Rules”).

³ *Reply Comments of the Constellation Energy Group Companies*, Commission Docket Nos. M-00072009, L-00070183 and L-00040169 (filed Mar. 2, 2007) (“Constellation Initial Comments”).

II. EXECUTIVE SUMMARY

THE COMMISSION'S PROPOSED POLICY STATEMENT AND DEFAULT SERVICE RULES PROVIDE A WORKABLE FRAMEWORK FOR PROVISION OF DEFAULT SERVICE AND THE CONTINUED DEVELOPMENT OF THE COMPETITIVE WHOLESALE AND RETAIL ELECTRIC MARKETS.

Constellation in its Initial Comments recommends some modifications and enhancements that it believes will further help the Commission, Default Service Providers (“DSPs”) and stakeholders achieve the policy objectives set forth in the proposed Policy Statement and Default Service Rules and provide greater regulatory certainty. The proposed Policy Statement and Default Service Rules, together with the improvements discussed in Constellation’s Initial Comments and herein, will provide a framework that balances a variety of interests, should encourage the participation of competitive wholesale suppliers in default service competitive procurement processes, and should lead to the further development of the competitive retail electric market. Constellation in these Reply Comments responds to parties’ initial comments and urges the Commission to:

- Apply the proposed Policy Statement and Default Service Rules as guidelines for default service plans and interim default service plans currently before (and filed in the future with) the Commission, prior to adoption of a final Policy Statement and Default Service Rules, and prior to expiration of all DSPs’ rate caps;
- Require DSPs to provide specificity regarding the default service products they procure in competitive bid processes in order to clarify for winning wholesale bidders the nature of their default service supply requirements;
- Maintain its correct decision to prohibit bilateral contracts for the procurement of default service supply requirements;

- Clarify that DSPs' default service plans should require that winning bidders must meet their pro-rata share of minimum alternative energy portfolio ("AEPS") requirements, as this has proven to be an effective method of encouraging alternative energy investments;
- Affirm that competitive procurements have proven to be and will going forward remain the most appropriate method for obtaining default service supply at competitive prices, and disregard parties' incorrect assessments to the contrary;
- Clarify that interim price adjustments will be made only for reconciliation purposes, and not for changes in energy market prices;
- Clarify that winning bidders' names should be made public no earlier than 90 days after default service contracts are executed between winning bidders and DSPs, and that no further bidder-specific data will be released publicly;
- Uphold its decision to adopt uniform supplier tariffs across the Commonwealth; and
- Maintain its decision to eliminate declining blocks from the rate design of DSPs, as they are counter to current public policy goals of providing incentives for energy efficiency and are a vestige of a time when regulatory policies were focused on getting rate payers to switch from natural gas heating to electric heating.

By maintaining the majority of and modifying only moderately the proposed Default Service Rules and Policy Statement as discussed in more detail in Constellation's Initial Comments and herein, the Commission will fully realize the goals outlined in the Policy Statement as well as encourage a wide array of stakeholders to invest resources into the Pennsylvania wholesale and retail electric markets. These Reply Comments are based upon Constellation's extensive experience in the Commonwealth and other jurisdictions regarding the

establishment of default service rules and policies and will ensure the further development of the Commonwealth's competitive wholesale and retail electric markets, providing enhanced benefits to consumers.

III. REPLY COMMENTS ON DEFAULT SERVICE PROCUREMENT ISSUES

A. Proposed PUC Code §§ 54.185(a) and 69.1802: Prior to Adoption of a Final Policy Statement and Default Service Rules, and Prior to Expiration of All DSPs' Rate Caps, and Thereafter, the Commission Should Apply the Proposed Policy Statement and Default Service Rules as Guidelines for All DSPs' Default Service Plans and Interim Default Service Plans.

In its initial comments, the Office of Small Business Advocate ("OSBA") "recommends that the Commission include language which makes clear when the [proposed Policy Statement and Default Service Rules] will take effect and how, if at all, they will apply to pending cases."⁴ Constellation agrees with the OSBA's recommendation, and asks that the Commission begin utilizing the proposed Policy Statement and Default Service Rules immediately to provide guidance regarding default service plans that are pending or that will be filed at the Commission.

The OSBA's stated preference, on the other hand, "is that [the final Policy Statement and Default Service Rules] apply for the first time to default service programs for the period beginning January 1, 2011."⁵ Constellation believes, however, that, while the proposed Policy Statement and Default Service Regulations will not be binding on the Commission and DSPs until they are final, they provide valuable guidance to both DSPs and the Commission regarding the appropriate structure for default service plans. The proposed Policy Statement and Default Service Rules are the result of careful consideration by the Commission of all parties' comments to date in proceedings leading up to the current proceeding, the experiences of neighboring

⁴ *Comments of the Office of Small Business Advocate on the Advance Notice of Final Rulemaking and on the Proposed Policy Statement*, Commission Docket Nos. L-00040169 and M-00072009 (filed Mar. 2, 2007) ("OSBA Initial Comments") at p.3.

⁵ OSBA Initial Comments at p.3.

jurisdictions with respect to default service, as well as the Commission's own experience with DSPs' transition plans for default service.⁶ Given that the proposed Policy Statement and Default Service Rules represent the carefully developed positions of the Commission as to the appropriate structure for default service plans, there is no need to wait for the general application of these positions to the Commonwealth's electricity markets. For instance, because of the provisions in the proposed Policy Statement and Default Service Rules which oppose bilateral contracts for default service supply,⁷ in Commission Docket No. P-00072247, it seems appropriate for the Commission to advise Duquesne Light Company to amend and re-file its proposed default service plan – one which, as filed, includes bilateral contracts between Duquesne and its affiliate⁸ – in order to reflect the plan recently approved by the Administrative Law Judge as PPL Electric Company's ("PPL") Competitive Bridge Plan for default service supply⁹ – a plan which more closely follows the proposed Policy Statement and Default Service Regulations.

UGI Utilities, Inc. – Electric Division ("UGI"), meanwhile, states in its initial comments that "the Commission's default service regulations should clearly state that they will not be applied until the conclusion of existing Commission-approved default service settlements and orders."¹⁰ Constellation agrees with UGI that any existing default service plans that are currently

⁶ See Default Service Rules at pp.5-6 (the Commission explains the need for regulation and its consideration of comments, discussions, other jurisdictions and its own experiences); see also Policy Statement at pp. 1-2 (the Commission explains its studies of developments leading up to the current proceeding).

⁷ See Default Service Rules at p.14 (the Commission discusses its decision to prohibit bilateral contracting for default service supply).

⁸ See, generally, *Petition of Duquesne Light Company for Approval of Default Service Plan*, Commission Docket No. P-00072247 (filed Jan. 25, 2007).

⁹ See, generally, *Recommended Decision In Re: Petition of PPL Electric Utilities Corporation for Approval of a Competitive Bridge Plan*, Commission Docket No. P-00062227 (issued Feb. 21, 2007) ("ALJ Decision on PPL").

¹⁰ UGI Initial Comments at p.9.

being implemented – rather than pending before the Commission – should continue as previously approved by the Commission.

In this way, Constellation believes that the Commission may utilize the proposed Policy Statement and Default Service Rules as guidelines for default service plans and interim default service plans currently pending before and filed in the future with the Commission, prior to adoption of a final Policy Statement and Default Service Rules, and prior to expiration of all DSPs' rate caps.

B. The Commission Should Require DSPs to Provide Specificity Regarding the Default Service Products They Procure in Competitive Bid Processes in Order to Clarify for Winning Wholesale Bidders the Nature of Their Default Service Supply Requirements.

The Commission in its proposed Policy Statement and Default Service Rules allows and, for the future, encourages DSPs to submit default service procurement plans in which they not only hold competitive procurement processes to meet their supply requirements, but also actively participate in energy markets by monitoring for, analyzing and making purchases in spot markets.¹¹ Several parties have stated that the Commission should allow DSPs even greater flexibility with respect to the types of products with which they meet their default service supply requirements.¹² For example, the OCA recommends that a DSP also be able to “elect to acquire blocks of power, such as 50 MW blocks or 100 MW blocks rather than load following supply.”¹³ PECO notes that DSPs also should be able to “[solicit] bids for a seasonally priced load-

¹¹ See Proposed PUC Code §§ 54.186(b)(4) and 69.1804.

¹² See *Comments of the Office of Consumer Advocate*, Commission Docket Nos. L-00040169 and M-00072009 (filed Mar. 2, 2007) (“OCA Initial Comments”) and *Comments of PECO Energy Company to the Advance Notice of Final Rulemaking Order and Proposed Policy Statement*, Commission Docket Nos. L-00040169 and L-00070183 (filed Mar. 2, 2007) (“PECO Initial Comments”).

¹³ OCA Initial Comments at p.15.

following product that may include a modest (i.e., up to 5%) spot market-based service component (e.g, basis-adjusted index price).”¹⁴

As expressed in its Initial Comments, Constellation generally supports default service structures in which DSPs are relieved from this type of responsibility to actively manage a portfolio of supply contracts and products to meet their load obligations.¹⁵ PPL agrees with Constellation’s position, stating in opposition to active portfolio management that:

[t]he Commission’s inclusion of spot energy markets as part of the procurement portfolio requirements for DSPs raises some concerns with regard to implementing the default service program. The addition of spot energy market purchases and sales will require the DSP to manage this risk either by establishing a trading operation or obtaining this service from the competitive market. In addition, purchasing generation supply in the spot energy markets can create potentially large energy rate adjustments for default service customers.¹⁶

West Penn Power dba Allegheny Power supports Constellation’s position as well, noting in its initial comments that:

procuring some default service supply outside the Auction or RFP framework undercuts supplier interest, and therefore competition, in those competitive procurements. In other words, taking supply out of the competitive procurement process will tend to drive up prices for the load left in the procurement, thus again imposing higher prices on customers.¹⁷

That said, if the Commission nevertheless requires DSPs to make spot market purchases or allows DSPs to procure some of their default service supply through other products in order to supplement the full requirements default service supplies that they obtain through competitive procurement processes, Constellation reiterates that the Commission should require DSPs to

¹⁴ PECO Initial Comments at p.9.

¹⁵ See Constellation Initial Comments at p.12.

¹⁶ *Comments of PPL Electric Utilities Corporation to Final Rulemaking Order*, Commission Docket No. L-00040169 (filed Mar. 2, 2007) (“PPL Initial Comments on ANFRO”) at p.12.

¹⁷ *Comments of Allegheny Power*, Commission Docket Nos. M-00072009, L-00040169 and M-00061957 (filed Mar. 2, 2007) (“Allegheny Initial Comments”) at p.8.

carve out in their proposed default service procurement plans a specific fixed portion of their load for which they will meet requirements through spot market purchases.¹⁸ Metropolitan Edison Company, Pennsylvania Power Company and Pennsylvania Electric Company (collectively, “FirstEnergy”) agree that, “[t]o the extent that a DSP’s plan contains use of the spot market, the Commission should make a definite decision regarding its use.”¹⁹ PPL adds that the Commission “may want to consider strictly limiting a DSP’s reliance on spot market purchases in its procurement of default service supply.”²⁰

As explained in detail in Constellation’s Initial Comments, the Commission could mandate that under each DSP’s default service procurement plan, the DSP at all times will meet 5% of its default service load through spot market purchases, and the remaining 95% through bids awarded in its competitive procurement process; each of these percentages would be load-following in nature.²¹ PPL similarly “recommends that the Policy Statement set an upper limit on the portion of generation supply that can be acquired through such arrangements . . . and allow the DSP to manage its supply portfolio to that limit.”²² Other parties similarly advocated that specified percentages be laid out in a DSP’s proposed plan, providing more certainty regarding the DSP’s mix of supply and the particular product sought by the DSP.²³

¹⁸ Constellation Initial Comments at p.14.

¹⁹ *Comments on Behalf of Metropolitan Edison Company, Pennsylvania Electric Company and Pennsylvania Power Company*, Commission Docket Nos. L-00040169 and L-00072009 (filed Mar. 2, 2007 (“MetEd Pennelec Initial Comments”)) at p.10.

²⁰ PPL Initial Comments on ANFRO at p.12.

²¹ Constellation Initial Comments at p.14.

²² *Comments of PPL Electric Utilities Corporation to the Proposed Policy Statement*, Commission Docket No. M-00072009 (filed Mar. 2, 2007) at p.7.

²³ *See, e.g., Comments of Hess Corporation*, Commission Docket Nos. L-00040169 and M-00072009 (filed Mar. 2, 2007) (“Hess Initial Comments”) at p.5 (Hess recommends that the Commission require DSPs’ default service supply portfolios to be split up into set percentages of supply products); *see also* PECO Initial Comments at p.9 (PECO recommends that only a small, specified percentage of the load for residential and small commercial customers be obtained through spot market purchases).

With such specified percentages, bidders will have certainty regarding the base product – *i.e.*, their share of the DSP’s total default service load – on which they are bidding and for which they will be obligated to supply energy. This certainty can best be provided in this way through product structures and contractual provisions that indicate clearly that a supplier’s load obligation will not be adversely affected by any such spot market purchases by the DSP. In turn, consumers benefit from this certainty because wholesale suppliers are able to more precisely define their obligations and hence better manage their costs, resulting in more competitive bids.

C. Proposed PUC Code § 54.186: The Commission Should Maintain its Correct Decision to Prohibit Bilateral Contracts for the Procurement of Default Service Supply Requirements.

The Commission in the proposed Default Service Rules states that:

[p]ermitting the routine use of bilateral contracts would allow [a DSP] to negotiate a contract with its affiliate, with all the potential risks and conflicts of interest this would entail. Requiring competitive procurements largely eliminates the risk that [a DSP’s] wholesale energy affiliate would be given some preference in the procurement of default service supply.²⁴

Constellation agrees with Strategic Energy, Inc.’s (“Strategic Energy”) “[support for] the Commission’s decision to limit the use of bilateral contracts for default service procurement to contingency situations, such as in the event of supplier default.”²⁵

Several parties, however, appear to misunderstand the procurement structures and benefits as well as the fact that DSPs generally do not own generation, and inappropriately ask the Commission to allow the use of bilateral contracts. For instance, the Industrial Energy Consumers of Pennsylvania group (“IECPA”) states that the Commission should allow the use of long-term bilateral contracts with affiliates, arguing that:

²⁴ Default Service Rules at p.14, FN4.

²⁵ *Comments of Strategic Energy*, Commission Docket Nos. L-00040169 and L-00070183 (filed Mar. 2, 2007) at p.11.

[b]ecause many affiliates of [DSPs] in Pennsylvania continue to own lower fuel cost, highly depreciated generation facilities in [PJM Interconnection, LLC (“PJM”)], negotiating a long-term, bilateral contract based on the affiliate generator’s actual costs may produce the lowest reasonable rates for customers. The Pennsylvania consumers who have paid the stranded costs associated with this generation should not be deprived of this option.²⁶

IECPA fails to understand that DSPs cannot require their generation-owning affiliates to provide supply directly to a consumer under a long-term contract. Nothing in the proposed Policy Statement or Default Service Rules, however, limits the ability of IECPA’s constituents to enter into long-term contracts directly with retail suppliers who own or have contracted for local generation.

Duquesne also argues that it should be permitted to utilize bilateral contracts because “Duquesne . . . is not in the same situation as ‘most Pennsylvania [DSPs]’ since it does not have energy supply affiliates that possess substantial generation assets.”²⁷ Duquesne misunderstands the reasoning behind the Commission’s prohibition of bilateral contracting. The prohibition is meant to protect against any preference toward any DSP-affiliate, *regardless* of whether such affiliate owns generation. As noted above, the Commission correctly finds that requiring competitive procurements and prohibiting bilateral contracts “largely eliminates the risk that [a DSP’s] wholesale energy affiliate would be given some preference in the procurement of default service supply.”²⁸ Duquesne itself concedes that “bilateral contracts with an affiliate may require more regulatory oversight to assure fairness”²⁹ There is no reason why DSP-affiliates

²⁶ *Comments of Industrial Energy Consumers of Pennsylvania, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Users Group, PP&L Industrial Customer Alliance, and West Penn Power Industrial intervenors*, Commission Docket No. L-00040169 (filed on Mar. 2, 2007) (“IECPA Initial Comments”) at p.18.

²⁷ *Initial Comments of Duquesne Light Company*, Commission Docket Nos. L-00040169 and L-00070183 (filed Mar. 2, 2007) (“Duquesne Initial Comments”) at p.14.

²⁸ Default Service Rules at p.14, FN4.

²⁹ Duquesne Initial Comments at p.14.

should not be subject to the same competitive pressures as other market participants, which competition can only lead to the most competitive prevailing market prices for power, to the benefit of consumers. Moreover, requiring DSPs to procure power from generators would have a number of unintended consequences – for example a DSP’s credit rating could be affected because it could acquire unique obligations and risks under a power purchase agreement (such as operational, environmental, congestion and credit risks), which risks would otherwise be borne by wholesale suppliers under a competitive procurement process.

For these reasons, Constellation supports the Commission’s decision to prohibit bilateral contracts.

D. Proposed PUC Code § 54.185(d)(1): The Commission Should Clarify that DSPs’ Default Service Plans Should Require that Winning Bidders Must Meet Their Pro-Rata Share of Minimum AEPS Requirements, as this Has Proven to Be an Effective Method of Encouraging Alternative Energy Investments.

In Proposed PUC Code § 54.185(d)(1), the Commission provides that a DSP’s procurement plan should “identify the means of satisfying the minimum portfolio requirements of the Alternative Energy Portfolio Standards Act, 73 P.S. § 1648.1, *et seq.*, for the period of service.”³⁰ Constellation in its Initial Comments recommends that the Commission should revise Proposed PUC Code § 54.185(d)(1) to specifically require that DSPs’ procurement plans provide that a supplier that contracts with a DSP to provide default service load must meet its respective share of the DSP’s minimum portfolio requirements.³¹ Constellation states that:

[c]oupled with the presence of PJM’s Generator Attribute Tracking System, a well-established platform for tracking and transacting renewable energy attributes [(“RECs”)], this method of compliance has worked well in other jurisdictions. This method provides the appropriate market

³⁰ Proposed PUC Code § 54.185(d)(1).

³¹ Constellation Initial Comments at p.15.

incentives for suppliers to invest in or enter into contracts that facilitate investment in the development of renewable energy markets³²

Direct Energy, LLC (“Direct Energy”) similarly states in its initial comments that it:

has witnessed the development of renewable resources around the country based on market dynamics such as simple demand and “Credit Cap and Trade” type programs. Direct Energy has itself signed long-term purchase agreements for off-take for several hundred megawatts from wind-energy farms.³³

However, several parties in their initial comments seek to encourage other methods of meeting AEPS requirements, which would likely cause a greater burden on consumers than the market-driven approach outlined above. For instance, PennFuture and PPM both suggest that the Commission allow DSPs to enter into long-term contracts with alternative energy generators in order to meet AEPS requirements.³⁴ The National Energy Marketers Association argues that “[a]lternative energy suppliers should contract directly with PJM to provide the power, and DSPs can purchase the power as needed to fulfill their obligation.”³⁵ Meanwhile, the OCA states that “the Commission should allow a DSP to enter into bilateral contracts with non-affiliated generation entities without having to engage in an RFP or auction process” in order to meet AEPS requirements.³⁶ Moreover, PV Now “recommends that separate solicitation processes be

³² Constellation Initial Comments at p.15.

³³ *Comments of Direct Energy Services, LLC*, Commission Docket Nos. L-00040169 and M-00072009 (filed on Mar.2, 2007) (“Direct Energy Initial Comments”) at p.12.

³⁴ *See Comments of Citizens for Pennsylvania’s Future (PennFuture) Regarding Advance Notice of Final Rulemaking Order*, Commission Docket No. L-00040169 (filed on Mar. 2, 2007) at p.1 (PennFuture states that “[the Commission should] [p]rovide assurance in the marketplace by including specific language authorizing use of long-term contracts for procuring alternative energy supplies”); *see also Comments of PPM Energy*, Commission Docket No. M-00072009 (filed on Mar. 2, 2007) at p.2 (PPM states that, “[b]ecause of the price stability that long-term contracts with renewable resources can provide and because long-term contracts of at least 10 to 15 years are essential to the financing and development of new renewable resources, PPM asks that the final order regarding Default Service and Electricity Markets specifically include language sanctioning contracts of this duration”).

³⁵ *Comments of the National Energy Marketers Association*, Commission Docket No. L-00040169, (filed on Mar. 2, 2007) at p.6.

³⁶ OCA Initial Comments at p.12.

adopted for the procurement of [default service] load and for the procurement of AEPS solar RECs.”³⁷

Constellation continues to believe that these alternative methods are unnecessary, given the success of the market-based methodology supported by Constellation, which has seen success in jurisdictions throughout PJM. In the same way that the market-based system created appropriate incentives for Direct Energy itself to sign “long-term purchase agreements for off-take for several hundred megawatts from wind-energy farms,”³⁸ Constellation has been encouraged to and has entered into long-term purchase agreements with alternative energy generators.

By encouraging wholesale and retail suppliers themselves to enter into such long-term contracts with alternative energy generators, a market-based system – *i.e.*, one which relies on winning wholesale bidders in competitive default service procurements as well as retail suppliers serving load in Pennsylvania to be responsible for their proportionate share of AEPS requirements – encourages proper investment in renewable resources without placing excessive burdens and risks directly on consumers by forcing DSPs to contract directly for AEPS resources. In addition to ensuring future investment by the market participants with the appropriate levels of capital and incentives, this structure ensures that it is the suppliers, and not the consumers, who bear the compliance risk and costs associated therewith, such as the penalties for failure to comply.³⁹

³⁷ Comments of PV Now in Cooperation with the Mid-Atlantic Solar Energy Industries Association, Commission Docket No. M-00072009 (filed Mar. 2, 2007) at p.3.

³⁸ *Direct Energy Initial Comments* at p.12.

³⁹ Constellation notes, however, that under a contract awarded to a wholesale supplier for the right to supply default service load to a DSP, the wholesale supplier should be responsible for those AEPS requirements in place at the time of the contract’s execution. The wholesale supplier should not bear the burden of increased AEPS requirements over the term of the contract, as such an obligation would cause bidders to add increased premiums to their bids to account for such regulatory risk. PPL’s Competitive Bridge Plan, as approved by the

E. Proposed PUC Code § 54.186: The Commission Should Affirm that Competitive Procurements Have Proven to Be and Will Going Forward Remain the Most Appropriate Method for Obtaining Default Service Supply at Competitive Prices, and Disregard Parties' Incorrect Assessments to the Contrary.

Constellation agrees with the Commission's assessment that a competitive bid process is one of the best methods for acquiring electricity through direct exposure to market forces.⁴⁰ Duquesne in its initial comments, however, attempts to refute the Commission's position by pointing inaccurately to procurements that previously have failed, lacked in participation or resulted in large rate increases for consumers. As Constellation explains in more detail below, Duquesne with respect to its own previous procurements, correctly identifies such failed procurements but ignores the specific circumstances surrounding those examples which led to its procurements' lack of success, and, in other cases inaccurately identifies several successful procurements as "failures." Constellation notes, in addition, that the Commission has taken or can take particular steps to prevent the specific circumstances that may have led to unsuccessful implementation of procurements.

Duquesne, for instance, notes that it "is concerned that repeated attempts to conduct RFPs limited to its service area have not produced a sufficient pool of bidders to establish a viable competitive wholesale market."⁴¹ Duquesne adds that it "did not receive any bids from wholesale suppliers at any price in its structured supply procurement process completed in March 2006 and only one bid in its procurement process completed in May 2006."⁴² The procurements Duquesne refers to were procurements for the supply of default service load for

ALJ, appropriately addresses this issue, providing that winning bidders are responsible to meet the AEPS requirements in effect at the time of execution for the delivery period in 2010. *See* ALJ Decision on PPL at p.10.

⁴⁰ Default Service Rules at p.14.

⁴¹ Duquesne Initial Comments at p.6.

large industrial customers.⁴³ Constellation notes that Duquesne in fact saw participation and received bids for its procurement the first time it was run, in October of 2004. However, later procurements may not have been successful due to the structure of the product sought by Duquesne and the nature of Duquesne's industrial customer load. For instance, in the later procurements identified by Duquesne, much of Duquesne's industrial load already had migrated to retail suppliers, leaving a very limited amount of load on default service at the time when wholesale suppliers would need to submit bids for the right to supply the fixed-price default service product. Importantly, industrial customers remaining on default service by default were placed on hourly-priced service, and would have to affirmatively "opt-in" to the fixed-price product for which wholesale suppliers were to submit bids.⁴⁴ In addition, industrial customers had the ability to opt back into the default service fixed-product after bidding had begun,⁴⁵ which would have left wholesale suppliers – who were bidding on the right to supply all of Duquesne's default service load – exposed to the risk that many industrial customers might during the term of the suppliers' contracts switch back to default service. Therefore, wholesale suppliers did not have adequate certainty regarding the potential size of their load responsibility. Such a structure was not conducive to a successful default service procurement process. The structural problems became more apparent after the first auction, leading to significantly diminished participation in subsequent auctions. The structural problems could have been remedied, for instance, by initially

⁴² Duquesne Initial Comments at p.10, FN10.

⁴³ See *Duquesne Light Company RFP Guidelines to Obtain Supply for Large Commercial and Industrial Customers on Fixed Price Service*, Commission Docket P-0032071 (filed Sept. 27, 2004); as modified by *Opinion and Order*, Commission Docket No. P-0032071 (issued Sept. 30, 2004) ("Duquesne RFP").

⁴⁴ See Duquesne RFP at p.2 (noting that Large Commercial and Industrial Customers on Duquesne's POLR II service as of Dec. 31, 2004 would default to Hourly Price Service and have the option to choose Fixed Price Service).

⁴⁵ See Duquesne RFP at pp.2-3 (explaining that Large C&I Customers had the option to elect Fixed Price Service on or before Jan. 31, 2005, at the retail rates based on the winning RFP bids obtained in October of 2004, or at any time thereafter at refreshed rates).

placing customers, by default, on the fixed-price product, and offering the hourly-priced product as the “opt-in” product.

Duquesne incorrectly identifies as ‘failures’ several successful procurements, pointing out incorrectly that high prices resulting from procurements indicate that such procurements were unsuccessful. Duquesne states that:

In Maryland, the results from a March 2006 RFP resulted in significant rate increases for customers. PEPCO’s residential customers faced an increase of 39% for a typical bill , for Delmarva Power & Light a 35% annual increase, and for Baltimore Gas & Electric, 72%. In Delaware, Delmarva Power & Light’s proposed rates for residential customers resulting from a structured solicitation process increased the total annual bill by about 59% on average . . . In Pennsylvania, Pike County Light & Power customers faced a 129% increase in rates from their structured solicitation process.⁴⁶

The rate increases noted by Duquesne do not reflect failures of these procurements. Rather, these procurements for the most part saw ample participation, but resulted in rate increases because rates had been previously frozen for a number of years and/or a large a portion of DSPs’ load was being procured at a single point in time, leading to a significant overexposure to market prices at such point in time. Hess shares this conclusion, noting that:

As the Commission details in the [Default Service Rules], the results of Pike County’s default service procurement, held in October 2005 for default service supply for 2006-2007, stem from a series of unique and unfortunate events.¹³ The default supply procurement was conducted two months after Hurricane Katrina disrupted wholesale energy markets, which resulted in very high wholesale electric prices. The default supply procurement for a two-year period (2006-2007) was held at a single point in time (October 2005), locking customers in at October 2005 prices for 2006 and 2007 even though wholesale prices subsequently lowered from their late 2005 peaks. The Pike County service territory is a very small service territory — geographically and in composition of residential, commercial and industrial customers within the territory thereby making it difficult to attract both wholesale energy suppliers and a wide cross-section of EGSs. All of these factors combined to produce a total bill

⁴⁶ Duquesne Initial Comments at p.10, FN9.

increase of 75% and generation rate increase of 129% for Pike County customers in 2006.”⁴⁷

Similar facts apply to the cases of Maryland and Delaware. The Commission, however, has addressed this issue of timing in its proposed Policy Statement and Default Service Rules by instructing parties to couple laddered contracts with multiple procurements leading up to the date of default service delivery (for residential and non-residential customers with up to 500 kw in maximum demand), much like the structure recently approved by the Administrative Law Judge for PPL’s Competitive Bridge Plan for default service supply.⁴⁸ In addition, with respect to smaller EDCs, Hess notes that:

[t]he Commission . . . has devised an additional remedy for Pike County and other small Pennsylvania EDCs with loads of 50 MW or less that Hess supports — exploration of combining their default service procurement with neighboring larger Pennsylvania EDCs. The combination of default service procurement structures between smaller, sub-50 MW Pennsylvania EDCs with more sizable neighboring EDCs, while not by itself a cure-all remedy, can potentially go a long way towards removing barriers discouraging entry by wholesale suppliers and a wider cross-section of competitive [retail suppliers].”⁴⁹

Wholesale competitive procurements, structured and implemented correctly, utilizing carefully developed documents – for instance, based on the documents utilized in New Jersey, Maryland – will effectively balance risks between suppliers and DSPs and meet consumers’ needs for competitive pricing.⁵⁰ For these reasons, the Commission should affirm that competitive procurements have proven to be and will going forward remain the most appropriate

⁴⁷ Hess Initial Comments at pp.7-8.

⁴⁸ See ALJ Decision on PPL.

⁴⁹ Hess Initial Comments at pp.7-8.

⁵⁰ Note that Duquesne misconstrues the balance of risks under other states’ competitive bid process. For instance, Duquesne *incorrectly* states in a footnote to its initial comments that the New Jersey and Maryland procurements place the risks of defaults by wholesale suppliers on those states’ consumers. In fact, in those states, incremental costs for replacing supply that would have been provided by a defaulting supplier are passed on to that defaulting supplier – not to consumers – using two-way default provisions and appropriate damages provisions under the New Jersey and Maryland default service supply contracts.

method for obtaining default service supply at competitive prices, and disregard Duquesne's incorrect assessments to the contrary.

F. Proposed PUC Code §§ 54.188(f) and 69.1809: The Commission Should Clarify that Interim Price Adjustments Should Be Made Only for Reconciliation Purposes, and Not for Changes in Energy Market Prices.

Constellation again urges the Commission to affirm and clarify that the interim price adjustments to the PTC required under Proposed PUC Code §§ 54.188(f) and 69.1809 will be made only for reconciliation purposes – *i.e.*, to account for new supply mix blended into a DSP's default service load and in order to reconcile default service costs and revenues – and not for changes in published and/or estimated market prices for energy. PPL agrees in its initial comments, noting that “[t]he point of [such] adjustments, if allowed at all, should not be to track changes in current market prices, but to reflect incremental changes in the portfolio.”⁵¹

The Commission states in its Policy Statement that interim adjustments to the PTC will be made for two reasons: (1) to reflect changes in costs to the DSP for default service load due to acquisition of energy through multiple procurements,⁵² and (2) to account for “variation between [DSPs’] revenues received and costs incurred on a month to month basis”⁵³ (both collectively referred to herein as “reconciliation” purposes). Constellation supports the Commission’s above stated reasons for interim adjustments to the PTC. However, Constellation, as explained in more detail in its Initial Comments, urges the Commission to be clear that interim adjustments to the PTC will not be made to account for changes in published and/or estimated market prices for energy.⁵⁴

⁵¹ OCA Initial Comments at p.20.

⁵² Policy Statement at pp.7-8.

⁵³ Policy Statement at p.8.

⁵⁴ See Constellation Initial Comments at p.12 (Section IV.F.).

G. Proposed PUC Code § [XXXX]: The Commission Should Clarify that Winning Bidders' Names Should Be Made Public No Earlier than 90 Days After Default Service Contracts Are Executed Between Winning Bidders and DSPs, and that No Further Bidder-Specific Data Will Be Released Publicly.

The Commission notes in its proposed Policy Statement that:

[s]upplier participation, bid prices, and retail rates may be impacted by protecting certain information, including, but not limited to, the identity of winning and losing bidders, the number of bids submitted, bid prices, the allocation of load among winning bidders, etc. At the same time, the Commission recognizes that there is a legitimate public interest in knowing some of this information when there is no possibility of any prejudice to ratepayer interests.⁵⁵

In response to the Commission's statement, the Office of Consumer Advocate ("OCA") states in its initial comments that:

the Commission should provide for the release of the bid information to the public at the appropriate time. Information that should clearly be released would be the winning bidder(s), the winning bid price(s), and the number of bidders. It is only through this disclosure that the public can be properly informed as to the basis of the rates.⁵⁶

The OSBA concurs with OCA, noting that the Commission should "release the names of the winning bidders and the winning bid prices."⁵⁷

Constellation agrees with OCA and the OSBA regarding winning bidders' names, but clarifies that only aggregate and average price information should be released, rather than individual bidders' specific bid prices. As discussed in its Initial Comments, Constellation submits that the Commission should modify the proposed Default Service Rules and Policy Statement to only allow for the release of winning bidders' names no earlier than 90 days after execution of the applicable SMA by a winning bidder and a DSP. The Commission also should refrain from considering any public release of information regarding particular bidders' specific

⁵⁵ Proposed PUC Code § 69.1807(7).

⁵⁶ OCA Initial Comments at pp.43-44.

prices because such information significantly compromises winning bidders' ability to negotiate and transact in the wholesale markets, as their competitors will gain access to winning bidders' competitively sensitive information. The more a competitor understands regarding the requirements and load supply obligations of a winning bidder, the more leverage such competitors may have in negotiations with such winning bidder for transactions that may be used to meet such winning bidder's default service supply obligations.

The OSBA goes on, however, to state that it:

recommends that Section 54.186(c)(5) be amended to make clear that the statutory advocates will have access . . . [at the very least] to the methodology (*e.g.*, determination of the maximum acceptable bid) by which those bids will be evaluated.⁵⁸

Constellation has no objection to the release of the methodology by which bids will be evaluated, but notes that the Commission itself already has proscribed such methodology – *i.e.*, that the lowest cost bids will be chosen in each procurement.⁵⁹ Constellation notes that the Commission itself will have access to all bidding information, and that the Commission already has determined that competitive bid processes shall be monitored by *independent* procurement managers.⁶⁰ Such independent regulatory oversight by the Commission and third party procurement managers will best serve to instill confidence in consumers and the market that competitive bid processes will be run fairly and appropriately.

H. Proposed PUC Code § 69.1816: The Commission Should Uphold its Decision to Adopt Uniform Supplier Tariffs Across the Commonwealth.

Proposed PUC Code § 69.1816 states that:

⁵⁷ OSBA Initial Comments at p.8.

⁵⁸ *OSBA Initial Comments* at pp.7-8.

⁵⁹ *See* Default Service Rules at p.16 (the Commission states that “[i]t is our expectation that the energy suppliers who submit the lowest priced bids, providing they have met all bidder qualification criteria, will be awarded generation contracts by the DSP”).

[t]he public interest would be served by the adoption of supplier tariffs that are uniform as to both form and content. Uniform supplier tariffs may facilitate the participation of [retail suppliers] in Pennsylvania’s retail market, and reduce the potential for mistake or misunderstandings between [retail suppliers and DSPs].⁶¹

PPL in its initial comments, however states that it:

does not agree that . . . customer classes should be identified on the basis of . . . peak demand designations. Under [PPL’s] retail tariff, this approach cuts across a number of rate schedules . . . Accordingly, PPL . . . proposes that the Commission allow each DSP to develop its own customer class designations based upon the unique circumstances of its retail tariff and customer demographics.⁶²

Constellation urges the Commission to reject PPL’s request, and agrees with OCA “that uniformity of many supplier tariff procedures across Pennsylvania would reduce the potential for mistakes and misunderstandings.”⁶³ While it may take some effort, initially, for PPL to acclimate its customers and modify its tariffs to reflect statewide, standard form tariffs with customer classes defined on the basis of peak load cutoffs, the end result will be a market structure more easily understood by potential retail suppliers. With greater interest and participation of retail suppliers in all of Pennsylvania’s markets, the Commonwealth’s consumers will benefit through a broader variety of retail offerings and competitive choices.

⁶⁰ See Proposed PUC Code § 54.186(c)(3).

⁶¹ Proposed PUC Code § 69.1816.

⁶² PPL Initial Comments on ANFRO at p.16.

⁶³ OCA Initial Comments at p.73.

I. Proposed PUC Code § 54.187(c): The Commission Should Maintain its Decision to Eliminate Declining Blocks from the Rate Design of DSPs, as They Are Counter to Current Public Policy Goals of Providing Incentives for Energy Efficiency and Are a Vestige of a Time when Regulatory Policies Were Focused on Getting Rate Payers to Switch from Natural Gas Heating to Electric Heating.

Constellation is pleased to note that many respondents, most notably the OSBA as well as a number of Default Service Providers,⁶⁴ agree with the Commission’s proposal to eliminate “declining blocks” as a rate design. They agree with Constellation that the use of “declining blocks” contravenes public policy goals oriented toward energy efficiency and its affect on reduced emissions. Moreover, this rate design inhibits the ability of customers to make easy comparisons between the cost of default service and service from alternative suppliers. This latter point is emphasized by the OSBA.

Constellation notes that the defense of “declining blocks” put forth by IECPA appears to confuse the marginal increased use of energy in an air conditioning cycling program within an hour to restore cooling temperatures with the overall energy savings that occur during the maximum peak of a day.⁶⁵ While the energy within an hour (*e.g.*, hour 2000) to restore temperatures to normal may be higher, the net effect of reductions during the maximum peak (*e.g.*, hours 1100 through 1600) is decidedly to reduce energy use over the day even though the energy use within a particular hour (*e.g.*, 2000) may be higher. This effect of peak shaving in the cycling of HVAC has been well documented in a variety of studies. As a consequence of this effect, energy production needs are reduced which can lead to fewer needed additions to generation. The prices shown to a customer with a flat rate during peak should provide

⁶⁴ See OSBA Initial Comments at p.8 (“[t]he OSBA agrees with the Commission that demand charges and declining blocks are inconsistent with the way DSPs acquire energy in the wholesale market and that they complicate comparison shopping, particularly for small business customers”).

⁶⁵ See IECPA Initial Comments at p.9.

incentives for the aggressive management of energy use which leads to the most efficient overall energy use and ultimately reduces demand for generation and reduced emissions.

PECO also makes an assertion that elimination of declining block rates may have a disruptive effect on customer bills.⁶⁶ However, Constellation does not believe this justifies the continuation of a rate design that is so at odds with currently stated public policy objectives of energy efficiency. Simply because something was done in the past does not provide a rationale for its continued use in the present or future, especially when it can directly undermine other stated policy goals such as energy efficiency.

IV. CONCLUSION

Constellation appreciates this opportunity to submit its Reply Comments to parties' initial comments regarding the Commission's proposed Default Service Rules and Policy Statement for default service in the Commonwealth. Constellation is confident that its above suggestions, coupled with those in its Initial Comments, will ensure the most competitive default service prices from wholesale markets through robust, competitive processes, while at the same time encouraging development of the Commonwealth's retail markets, both to the benefit of Pennsylvania's consumers.

⁶⁶ PECO Initial Comments at p.11 (PECO states that, “[b]ecause demand charges and load factor-based declining block rates are a vital component of PECO’s existing rate design, and because, in many instances, customers have made important operational or purchasing decisions based on those rate design features, it necessarily follows that their elimination will have a disruptive effect on individual customers’ bills”).

Respectfully submitted,

/s/

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*On Behalf of Constellation NewEnergy, Inc. and
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