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March 2, 2007

VIA FEDERAL EXPRESS

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

Re: Rulemaking re Electric Distribution Companies Obligation to
Service Retail Customers at the Conclusion of the Transition
Period Pursuant to 66 Pa. C.S. § 2807(e)(2) Advance Notice of
Final Rulemaking Order; Docket No. L-00040169

Default Service and Retail Electric Markets
Proposed Policy Statement; Docket No. M-00072009

Dear Secretary McNulty:

Enclosed please find the original and 15 copies of the Retail Energy Supply Association's
Comments in the above-referenced matter.

If you have any questions regarding this filing, please contact me at your convenience.

Sincerely,



Kevin J. Moody

For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

KJM/jls
Enclosures

cc: Shane Rooney (w/enc) Via E-mail

HAR:71697.1/MID051-242407

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Rulemaking Re Electric Distribution Companies
Obligation to Serve Retail Customers at the
Conclusion of the Transition Period Pursuant
To 66 Pa.C.S. § 2807(e)(2)
Advance Notice Of Final Rulemaking Order

Docket No. L-00040169

Default Service and Retail Electric Markets
Proposed Policy Statement

Docket No. M-00072009

COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

I. INTRODUCTION

At its February 8, 2007 public meeting, the Commission adopted orders in the above-captioned matters that significantly change the Commission's approach to defining the electric distribution companies' ("EDCs") obligations to acquire electricity after the end of the phase-in and transition periods for retail customers not receiving electric generation supply from electric generation suppliers. As the issues addressed by these two orders are intertwined, the Retail Energy Supply Association ("RESA")¹ submits these comments to both orders in both dockets.²

¹ RESA is a non-profit organization and trade association of retail energy suppliers who share the common vision that competitive retail energy markets deliver more efficient, customer-oriented outcomes than regulated utility structures. RESA was formerly known as the Mid-Atlantic Power Supply Association ("MAPSA"), identified in the Commission's advance notice rulemaking order (p. 3) as having previously filed comments in this docket. MAPSA changed its name in 2005 to more accurately describe its purpose and scope of interest. RESA's members include Consolidated Edison Solutions, Inc; Direct Energy Services, LLC; Hess Corporation; Reliant Energy Retail Services, LLC; Sempra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources NA, Inc. and US Energy Savings Corp. The opinions expressed in this filing may not represent the view of all members of RESA.

RESA commends the Commission for its considerable efforts to develop a comprehensive approach to implement regulations and policies to promote the development of the competitive retail electric market in Pennsylvania. Indeed, many of the changes in the Commission's new approach promote the fundamental and overriding purpose of the Electricity Generation Customer Choice and Competition Act,³ namely to provide all retail customers with direct access to the competitive electric generation market.

The Commission's changes generally represent a good first step toward realizing an effective competitive retail electric market. While the new proposal has some positive aspects, from the standpoint of developing a robust competitive market, it also contains a huge weakness which, left unchanged, threatens to eviscerate any positive movement forward on the path of competition – and with it, the attendant positive benefits to customers and Pennsylvania's economy. RESA respectfully submits that the Commission's modified default service plan will fall far short of complying with the Electric Choice Act's requirement that post-rate cap Default Service rates be based on "prevailing market prices" unless the regulations are further modified to require Default Service Providers ("DSPs") to acquire a substantial portion of their portfolio for residential and small business customers through shorter term competitive procurements (monthly or quarterly).

Otherwise, RESA submits that permitting reliance primarily upon long-term, laddered supply contracts for Default Service will negate the positive changes adopted or proposed by the

² RESA is submitting separate comments to the other order adopted February 8, 2007 relating to these issues. *Policies to Mitigate Potential Electricity Price Increases*, M-00061957, Tentative Order entered February 13, 2007.

³ 66 Pa. C.S. §§ 2801-2812 ("Electric Choice Act" or "Act").

Commission.⁴ This long-term laddered portfolio approach essentially guarantees that Default Service rates will *not* reflect prevailing market prices on a current and continuing basis, and thus will continue the EDCs as providers of "first resort" for residential and small business customers throughout Pennsylvania. Also, without the assurance that Default Service rates will reflect prevailing market prices on a current and continuing basis, EGSs will not have sufficient incentive to commit the considerable resources necessary to develop the competitive retail electric market "end-state" envisioned by the Electric Choice Act because there will not be the market structure (or regulatory certainty) required for the development of sustained, robust retail competition and customer choice, especially for residential and small business customers.⁵ RESA therefore offers several recommendations in these comments to ensure that the Commission's revised approach can meet the fundamental "prevailing market prices" requirement of the Electric Choice Act for all customers.

As RESA has commented previously, post-rate cap Default Service rates for small business and residential customers should be based on monthly procurements or indexed adjustments, and rates for large business customers should be hourly (with no fixed price option), to maintain the relationship to prevailing wholesale energy market prices and conditions that is appropriate and necessary to provide these customers with timely and accurate price signals, and to enable the development of sustained, robust retail competition. Effective competition and customer choice – not long-term laddered procurements – will provide customers with the tools

⁴ FERC views any wholesale supply contract over one year in duration as a "long-term wholesale contract." See, e.g., *Notice of Proposed Rulemaking* (July 26, 2001), FERC Docket No. RM-01-8-000 at 4, n. 1 (*citing* Prior Notice Order, 65 FERC ¶ 61,984).

⁵ The less prescriptive approach and increased flexibility also guarantees a whole new series of time consuming, expensive post-rate cap proceedings for EGSs as each EDC crafts its own unique plan, with the potential for requests for waivers of various provisions of the regulations. These proceedings would not be necessary under a more prescriptive approach.

to efficiently manage their electricity use and mitigate energy price increases. RESA respectfully submits that the Commission's proposed quarterly and monthly adjustments of rates resulting from long-term laddered procurements will not maintain the connection to prevailing wholesale energy market prices and conditions (i) required to enable sustained, robust retail competition to develop and (ii) required by the Electric Choice Act.

II. THE COMMISSION HAS ADOPTED MEASURES TO PROMOTE RETAIL ELECTRIC COMPETITION AND CUSTOMER CHOICE.

Much of the Commission's new approach adopts or proposes measures recommended by the competitive suppliers, including, but not limited to:

- Relying almost exclusively upon competitive (and multiple) procurements and spot energy market purchases to ensure that Default Service supply is acquired at prevailing market prices
- Regular adjustments to Default Service rates to ensure that the rates track prevailing market prices
- A single Default Service rate for each customer class, and no Default Service options offered by the Default Service Provider ("DSP")
- Default Service rates "fully loaded" with all costs of providing Default Service, and the removal of such costs from distribution rates
- Simplified rate design (no demand charges, declining energy blocks, etc.) to promote energy conservation, efficient energy use and demand side management programs
- Elimination of barriers to retail competition, such as switching rules and generation rate adjustments (GRAs)
- Permitting entities other than EDCs to be DSPs without obtaining a certificate of convenience⁶
- Additional measures to enhance customer choice and facilitate the development of competitive retail electric markets: (i) common standards and processes for access to retail electric customer information and data; (ii) rate ready billing; (iii) EGS receivables purchase programs; (iv) retail customer referral programs; (v) uniform

⁶ RESA does not support an alternate DSP being subject to regulatory assessments. These assessments are currently recovered through the EDCs' distribution rates, and that should not change if an EGS replaces the EDC as the DSP because all the electricity, whether supplied by the DSP or an EGS, will continue to be delivered by the EDC.

supplier tariffs; and (vi) a retail choice ombudsman at each EDC and the Commission.

It is important to note, however, that these changes alone will not be sufficient to: (1) overcome the anti-competitive effects of the long-term laddered portfolio procurement approach; (2) achieve the overriding "direct access" purpose of the Electric Choice Act; and (3) provide retail customers with the benefits of a properly functioning and workable competitive retail electric market.

III. THE PURPOSE OF THE ELECTRIC CHOICE ACT IS DIRECT ACCESS TO AN EFFECTIVE COMPETITIVE RETAIL ELECTRIC MARKET.

The pro-competitive changes identified above show that the Commission recognizes the fundamental and overriding purpose of the Electric Choice Act, which is "to create direct access by retail customers to the competitive market for the generation of electricity while maintaining the safety and reliability of the electric system for all parties."⁷ This purpose is made clear in other provisions of the Electric Choice Act.⁸ While the Act also declares that "electric service should be available to all customers on reasonable terms and conditions,"⁹ with respect to post-rate cap Default Service that declaration must be interpreted in the context of overriding purpose of the Act and Section 2707(e)(3)'s directive that post-transition Default Service supply must be acquired at prevailing market prices. That declaration must also be interpreted in the context of

⁷ 66 Pa. C.S. § 2802(12). In this eleventh year after enactment of the Electric Choice Act, it is clear that direct access poses no threat to maintaining the safety and reliability of the electric system.

⁸ 66 Pa. C.S. §§ 2802(3) (direct access is in the public interest); 2802(13) (fair and orderly transition from regulated rate structure to direct access structure); 2804(2) (alternative electric services to be available from EGSs to retail customers through direct access).

⁹ 66 Pa. C.S. § 2802(9).

the legislative finding that "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity."¹⁰

Thus, the "end-state" envisioned by the Electric Choice Act is various electricity products and related services being provided to retail customers primarily by EGSs based upon the operation of competitive market forces – with EDCs distributing the electricity and providing electric generation supply *only* as a backstop to customers not receiving supply from EGSs,¹¹ that is, only as a "last resort."

The argument that customers should not be "exposed" to prevailing energy market prices, even if it is necessary to enable retail competition to develop, ignores the demonstrated customer benefits of competition in other industries, and the other significant benefits of choice in the retail electric market and, more important, to customers – new and innovative products and services, renewable energy products, incentives to reduce energy costs, and customer hedging of energy prices in line with the needs of their particular businesses. Lower prices may be one of the many benefits of customer choice, but such lower prices are not necessarily the only goal of a competitive retail market. It is through the confluence of **all** the benefits that competitive retail markets provide – *i.e.*, lower prices, customer choice and greater congruence between customer need and electric supply product – that long-term energy costs are minimized. But this cannot happen unless sustained, robust retail competition is permitted to develop. RESA respectfully

¹⁰ 66 Pa. C.S. § 2802(5). In its comments to the Default Service NOPR, the Independent Regulatory Review Commission ("IRRC") encouraged the Commission to focus on this principle and to further incorporate this principle into the final regulation. IRRC Comments, ¶ 1. RESA submits that the Commission has heeded IRRC's advice but, as explained below, should revise its new approach to rely even more on competitive market forces to address concerns of mitigating post-rate cap rate increases.

¹¹ The Commission's change to the definition of "Default service" correctly reflects this end-state: "Electric generation supply service provided by a default service provider to a retail electric customer **who is not receiving generation service from an EGS.**" Advance Notice Of Final Rulemaking Order (ANOFR"), Annex A, § 54.182 (Emphasis added).

suggests that the Commission's new long-term laddered portfolio approach will not permit sustained, robust competition to develop.

IV. THE NEW LONG-TERM PORTFOLIO APPROACH WILL NOT ENABLE THE DEVELOPMENT OF SUSTAINED, ROBUST RETAIL ELECTRIC COMPETITION.

Despite the Commission's adoption of the measures identified above to promote the development of the competitive retail electric market in Pennsylvania and recognition that the Act requires direct exposure to competitive market forces,¹² RESA respectfully suggests that the Commission's new approach undervalues competitive market forces as a means of mitigating post-rate cap rate shock and providing customers with tools to address post-rate cap price increases. For example, in identifying "Retail Market Issues" that can enhance customer choice and promote the development of the competitive retail markets, the Commission states that "[r]obust, effective markets are [a] vital *element* of any post-rate cap price mitigation strategy."¹³ RESA submits that robust, effective markets are the *solution* to providing retail customers with the means to address post-rate cap price increases, manage electricity use and exert downward pressure on wholesale and retail energy prices – and the means to achieve the end-state envisioned by the Electric Choice Act.

RESA submits that the Commission's new long-term portfolio approach will negate the pro-competitive measures identified above and thus continue the role of the EDCs as providers of "first resort" for most retail customers throughout Pennsylvania, especially residential and small business customers. Indeed, the purpose of the legislative finding that EDCs should continue in the role of "provider of last resort" is "to ensure that availability of universal electric

¹² ANOFR at 14-15.

¹³ Proposed Policy Statement at 9-10 (emphasis added).

service to low-income customers,¹⁴ not to ensure the lowest, long-term rates for *all* retail customers.¹⁵ The market structure created by the ANOFR and proposed Policy Statement essentially guarantees that Default Service rates will *not* reflect prevailing market prices on a current and continuing basis – so EGSs will not have the incentive to commit, or to continue to commit, the considerable resources necessary to develop the competitive retail electric market because they will not have the market structure or regulatory certainty required for sustained, robust retail competition.

The Commission's new, less prescriptive approach provides even more flexibility for EDCs to "craft" Default Service programs tailored to their individual circumstances. However, in the post-rate cap transitional period, a *more* prescriptive approach – and, thus, more certainty – is what is needed to ensure that the retail market can develop so that EGSs, **and not EDCs**, become the electricity providers of first resort.¹⁶ The Commission's ANOFR and proposed Policy Statement refer to "changes in retail and wholesale markets" as the primary reason for this less prescriptive, more flexible approach, but "change" is one of the attributes of markets that will always be present – and one that cannot be managed or regulated by this, or any other, Commission – yet it appears that a contrary belief underlies the Commission's new approach:

In reviewing the comments and considering the revisions to the proposed default service rules, the Commission recognized that **there were practical limits to its regulation of large, complex energy markets.**¹⁷

¹⁴ 66 Pa. C.S. § 2802(16).

¹⁵ ANOFR, Annex A, § 54.186(b)(1).

¹⁶ This is not meant to preclude electric distribution utilities from participating in the competitive generation market; they simply need to do it via their own affiliated EGSs.

¹⁷ Policy Statement at 2 (emphasis added).

The Electric Choice Act does not require (or contemplate) the Commission regulating energy markets for the provision of Default Service. Rather, the Act requires the Commission to ensure that Default Service Providers ("DSPs") *respond* to the energy markets after the phase-in and transition periods by requiring the acquisition of Default Service supply at "prevailing market prices" – and not for *all* retail customers, but only for those retail customers not receiving generation service from EGSs. The "end-state" of primarily EGSs providing generation supply to retail customers cannot and will not develop unless this directive of the Act is implemented in a manner consistent with the overriding purpose of the Act – direct access by *all* retail customers to the competitive market for generation of electricity.

RESA respectfully suggests that the lack of opportunities for customers to exercise their right to shop during the rate cap period should not determine post-rate cap Default Service supply procurement rules: "We suggest different procurement strategies for different customer classes, consistent with the level of energy knowledge, financial resources, and **opportunity to shop associated with these groups.**"¹⁸ A retail customer's *right* to shop is the overriding purpose of the Electric Choice Act and a right guaranteed to all retail customers by the Act.¹⁹ And, as the Commission recognizes,²⁰ *all* customers should be provided with the level of energy knowledge necessary for them to exercise their right to shop. Therefore, retail customers' right

¹⁸ Policy Statement at 5 (§ 69.1805) (emphasis added). This statement appears to reflect the view that customers should not be "exposed" to wholesale energy price changes. This view is inconsistent with the direct access purpose of the Act. Wholesale prices determine retail prices, so direct access to the retail market also "exposes" customers to the wholesale market. If customers do not see prevailing wholesale energy market prices on a reasonably current and continuing basis through their retail rates, they will not receive accurate market price signals and will be disincented to embrace energy efficiency and conservation measures and demand side management programs.

¹⁹ 66 Pa. C.S. §§ 2802(12); 2803 ("Direct access").

²⁰ *See, Policies to Mitigate Potential Electricity Price Increases*, M-00061957, Tentative Order entered February 13, 2007.

to direct access – and the requirement that DPSs acquire the electricity at prevailing market prices to serve those retail customers that are not receiving generation supply through direct access – should determine the Commission's regulatory approach and the DSP's procurement strategy, not vice versa. That is, the procurement strategy should not be developed on the basis of post-rate cap price mitigation concerns or the lack of *current* opportunities for customers to exercise their right of direct access, because default service rates during the phase-in and transition periods have *not* reflected prevailing market prices – and, as a result, retail competition has not developed.

The Commission's new long-term portfolio approach essentially guarantees that post-rate cap Default Service rates will be based primarily upon one, two, three or more year wholesale laddered supply contracts.²¹ The monthly or quarterly price adjustments to these Default Service rates due to laddering these long-term contracts will not maintain the required connection to prevailing energy market prices and conditions, and will not ensure that Default Service rates track prevailing wholesale energy prices sufficiently to enable retail competition to develop.

Permitting the application of a Section 1307(f) gas cost type reconciliation process, which the Commission has determined to be a barrier to retail competition,²² to the proposed Default Service rate adjustments will further disconnect the Default Service rates from prevailing energy market prices and conditions. If the procurement of Default Service supply is not made in a manner that reflects prevailing market prices on a current and continuing basis, then the costs that are reconciled will not produce rates that reflect prevailing market prices on a current

²¹ Fixed-term laddered procurements may extend even beyond the term of the EDC's Default Service program. ANOFR, Annex A, § 54.186(b)(3).

²² Docket No. I-00040103, Report o the General Assembly on Competition in Pennsylvania's Retail Gas Supply Market, at 61.

and continuing basis. In other words, adjustments based on long-term ladder procurements will not produce adjustments that mirror prevailing energy market prices and conditions.

Similarly, if rate design is simplified to remove incentives for customers to use more energy, that will still not be sufficient to promote efficient energy use and energy conservation if Default Service rates are based primarily upon long-term laddered contracts because retail customers will not actually see the true cost of electricity – that is, the prevailing market prices of electricity. RESA submits that under the long-term portfolio approach, retail customers will not receive appropriate price signals because the Default Service rates will consist of a *blend* of the costs of long-term contracts that can extend even beyond the term of the Default Service program.²³ The long-term portfolio approach thus undermines the Commission's efforts to promote energy conservation, efficient energy use and demand side management programs.

Accordingly, RESA respectfully submits that although the many pro-competitive changes identified above represent a few positive steps forward, the long-term portfolio approach represents one significant step backwards on the road to effective retail competition and full customer choice after the rate caps expire. The EDCs will continue to serve the vast majority of customers as they have during the transition period, and EGSs will not have the necessary incentives to come into the market – and those EGSs that have entered and remained in the market, based on the expectation of full direct access based on competitive market forces and Default Service rates based on prevailing market prices after the rate cap period, may very well decide they can't wait any longer for Pennsylvania's retail market to develop.

RESA respectfully submits that the Commission's new less "prescriptive" approach to defining the manner of acquisition of supply for Default Service in the post-rate cap period is

²³ ANOFR at 5, 17; Annex A, § 54.186(b)(3). RESA absolutely opposes permitting contracts for Default Service supply to extend beyond the term of the Default Service program.

exactly the opposite of what the market – and EGSs – require for the competitive retail market to develop. Creating a properly functioning and workable post-rate cap competitive retail electric market under the Electric Choice Act should not be a negotiable question or exercise, because a competitive wholesale market exists in Pennsylvania. Either the Default Service design ensures Default Service rates that reflect prevailing wholesale market prices and conditions to enable effective retail competition, or it does not. RESA submits that despite the Commission's best efforts and intentions, the new long-term portfolio approach does not.

V. ONLY MORE FREQUENT DEFAULT SERVICE PROCUREMENTS WILL SATISFY THE PREVAILING MARKET PRICES REQUIREMENT AND ACHIEVE THE PURPOSE OF THE ELECTRIC CHOICE ACT.

As RESA has commented previously, in this docket and others, post-rate cap Default Service rates for small business and residential customers should be adjusted monthly based on monthly procurements or indexed adjustments, and rates for large business customers should be hourly (with no fixed price option), to maintain the relationship to prevailing wholesale energy market prices and conditions that is appropriate and necessary to provide these customers with timely and accurate price signals, and to enable the development of sustained, robust retail competition. Effective competition and customer choice – not long-term laddered procurements – will provide customers with the tools to efficiently manage their electricity use and mitigate energy price increases. The more the proposed quarterly and monthly rate adjustments are based upon long-term laddered procurements, the more disconnected from prevailing wholesale energy market prices and conditions the adjusted Default Service rates will be. Under these circumstances, the adjustments will not maintain the connection to prevailing market prices required by the Electric Choice Act, and necessary to enable sustained, robust retail competition to develop.

VI. ADDITIONAL MEASURES TO PROMOTE THE DEVELOPMENT OF THE COMPETITIVE RETAIL MARKET SHOULD BE ADOPTED.

As stated above, RESA supports the measures identified in the proposed Policy Statement to enhance customer choice and facilitate the development of competitive retail electric markets.²⁴ However, there are additional measures that will enhance customer choice and promote the development of competitive retail markets that should be adopted as well. As rate ready billing is incompatible with variable-priced products that many EGSs currently provide, especially to large business customers, bill ready billing should be available from all EDCs – in addition to rate ready billing – to enable increased customer choice of EGS products.²⁵

RESA submits that the development of competitive retail electric markets will be advanced, and the public interest served, by the adoption of rules that make EDC/EGS operations more efficient for the benefit of customers, such as decreasing the time for customer enrollments and drops. As the Commission's Code of Conduct has not changed since its adoption in 2000, it should be strengthened to address lessons learned and experiences during the past few years, especially concerning affiliate transactions and relationships. This is consistent with the Commission's commitment to examine utility Default Service and distribution service cost allocations.

²⁴ These measures are: (i) common standards and processes for access to retail electric customer information and data; (ii) rate ready billing; (iii) EGS receivables purchase programs; (iv) retail customer referral programs; (v) uniform supplier tariffs; and (vi) a retail choice ombudsman at each EDC and the Commission. Policy Statement, proposed §§ 69.1812 - 69.1817.

²⁵ RESA's understanding is that only Allegheny Power and the FirstEnergy EDCs (MetEd, Penelec and Penn Power) provide both rate ready and bill ready EDC consolidated billing options, and that Duquesne and UGI provide only rate ready EDC consolidated billing.

VII. AT MOST, ONLY ONE SHORT, ADDITIONAL TRANSITION PERIOD SHOULD BE PERMITTED.

The Commission's new approach essentially provides for at least another two to three year transition period for the EDCs because the Default Service programs after the initial programs are expected (but not required) to rely more on shorter duration procurements and spot market purchases. If the Commission does not adopt monthly adjusted Default Service rates for residential and small business customers, and hourly Default Service rates with no fixed price option for large business customers, RESA suggests that the Commission's new portfolio approach should at least be modified to require shorter term procurements (one year or less) as an additional transition mechanism for the first two years after the rate caps expire.²⁶ This will restore some measure of regulatory certainty that Default Service rates will, within a set time period, move to reflect prevailing energy market prices and conditions on a current and continuing basis so that EGSs have a basis to believe that a properly functioning and workable competitive retail electric market will develop throughout Pennsylvania.

²⁶ If the Commission adopts the long-term portfolio approach in the final regulations, RESA supports the inclusion of elements of that Default Service framework in the non-prescriptive Policy Statement.

VIII. CONCLUSION

RESA respectfully requests that the Commission modify the ANOFR and proposed Policy Statement consistent with the comments herein to ensure that the competitive retail electric market develops in Pennsylvania to deliver the many benefits of competition to all retail customers in the post-rate cap period.

Respectfully submitted,



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