BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Policies To Mitigate Potential Electricity Price Increases	:	**Docket No. M-00061957**

COMMENTS OF INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA, PJM INDUSTRIAL CUSTOMER COALITION, 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

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I. INTRODUCTION

On February 8, 2007, the Pennsylvania Public Utility Commission ("PUC" or "Commission") adopted a Tentative Order setting forth "[p]olicy changes and plans for future action" intended to "mitigate the size and impact of recent and expected increases in retail electric rates" upon the expiration of rate caps ("Mitigation Order"). See Mitigation Order, p. 3. The Commission seeks public comment on the Mitigation Order.

Industrial Energy Consumers of Pennsylvania ("IECPA") is an association of energy-intensive industrial companies operating facilities across Pennsylvania. IECPA's members annually consume in excess of 25% of the industrial electricity in Pennsylvania and employ approximately 75,000 workers at nearly 120 facilities across the Commonwealth. IECPA actively participated in the stakeholder process that led to the drafting of the Competition Act that established Pennsylvania's retail choice program and participated in many generic rulemakings initiated to implement the Competition Act.

Also sponsoring these Comments are coalitions of industrial customers receiving service from most of the Commonwealth's electric distribution companies: Duquesne Industrial Intervenors ("DII"), Met-Ed Industrial Users Group ("MEIUG"), Penelec Industrial Customer Alliance ("PICA"), Penn Power Users Group ("PPUG"), Philadelphia Area Industrial Energy Users Group ("PAIEUG"), PP&L Industrial Customer Alliance ("PPLICA"), and West Penn Power Industrial Intervenors ("WPPII").

PJM Industrial Customer Coalition ("PJMICC") is an ad hoc coalition consisting exclusively of large commercial and industrial ("C&I") end-users of electricity. PJMICC members operate manufacturing and institutional facilities in Pennsylvania and throughout the expanded PJM Interconnection, L.L.C. ("PJM") footprint, which encompasses all or parts of

Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, Ohio, Tennessee, Virginia, West Virginia, and the District of Columbia. Several PJMICC members also operate manufacturing and institutional facilities located in parts of Virginia and North Carolina encompassed by the PJM South region. PJMICC member companies consume more than 9.5 billion kilowatt-hours of electricity annually. Several PJMICC members are currently also voting participants of the PJM Members Committee and actively participate in the PJM committee structure. Given the direct interplay between the wholesale and retail markets, PJMICC joins IECPA, DII, MEIUG, PICA, PPUG, PAIEUG, PPLICA, and WPPII (collectively, "Industrial Customers") in these Comments to share its experience in participating in the PJM stakeholder process and at the Federal Energy Regulatory Commission ("FERC") regarding wholesale market issues that impact the cost for electricity paid by ultimate customers.

Because Industrial Customers use substantial volumes of electricity in their manufacturing and operational processes, electric costs represent a sizeable component of overall operating costs. The Industrial Customers participated in the Commission's 2006 en banc hearing and submitted Comments and Reply Comments in this proceeding to convey concerns regarding the dramatic electric price increases that have occurred and will occur in Pennsylvania as the generation rate caps expire and to urge the Commission to actively advocate for changes to the wholesale market design to mitigate the anticipated impact of rate cap expiration. [1]

The Mitigation Order represents the third prong in the Commission's multi-faceted approach to developing a "comprehensive strategy" for addressing the realities of the post-

[1] See Comments on behalf of the Industrial Energy Consumers of Pennsylvania, PJM Industrial Customer Coalition, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Uses Group, PP&L Industrial Customer Alliance, and West Penn Power Industrial Intervenors (hereinafter, "Comments of Industrial Customers") (filed June 25, 2006); see also Reply Comments of Industrial Customers (filed July 20, 2006).

restructuring era.[2] In light of the direct and substantial impact that the expiration of rate caps will have on the cost of operating their respective manufacturing and production facilities, Industrial Customers submit these Comments in order to highlight areas of particular continued concern to large C&I customers.[3]

As detailed more fully herein, Industrial Customers respectfully request the Commission to: (1) develop an action plan to improve the operation of the wholesale market in Pennsylvania within its statutory jurisdiction; (2) modify the agenda for the education campaigns to exclude information on the "true cost of electricity" and "why electricity rates change" that would inappropriately endorse PJM's flawed wholesale market design; and (3) abandon the proposal to recover education costs through the customer assistance program charge.

II. COMMENTS

In the Mitigation Order, the Commission presents several "policy changes and plans for future action" intended to "mitigate the size and impact of recent and expected increases in retail electric rates" upon the expiration of rate caps ("Mitigation Order"). See Mitigation Order, p. 3. These proposals include: (1) the establishment of statewide and electric distribution company ("EDC")-specific education programs that inform ratepayers about various issues, including the "true cost of electricity"; (2) exploring conservation and demand side response measures; (3) developing alternatives to abrupt price increases; (4) assuming a stronger advocacy role with respect to Low Income Heating Assistance Program funding levels; and (5) actively participating in proceedings before the FERC and collaboratives with other state regulators on wholesale market issues.

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[2] See Default Service and Electric Markets, Docket No. L-00070183, p. 2 (Proposed Policy Statement) (entered Feb. 8, 2007).

Industrial Customers appreciate the difficulty and complexity of the important task before the Commission. Upon the expiration of retail rate caps, the Commonwealth will begin the final phase of its restructuring initiative. Based on the experience of neighboring states and certain areas within the Commonwealth, the transition to a fully restructured market is expected to have a dramatic, negative impact on retail rates. The stakes are high for all customers, and large C&I customers in particular. As such, it is critical that the Commission directly confront the issues presented by the impending expiration of rate caps and develop a concrete plan to address these issues. Although the Mitigation Order ensures that customers will be aware of the impending increases, it does not rise to the challenges presented by the post-restructuring period to actually mitigate (i.e., make less severe) the rate increases that customers will experience, especially the increases for large C&I customers. To mitigate the increases, the Commission must fulfill its promise of "aggressive representation" of Pennsylvania's consumer and economic development interests at FERC and in the context of Regional Transmission Organization ("RTO") processes. See Mitigation Order, p. 19. A key aspect of this zealous advocacy must be targeted at reforming the underlying wholesale market design flaws that threaten to exacerbate the negative cost impact expected when retail rate caps expire.

A. Consistent with its Statutory Mandate, the Commission Should Develop an Action Plan To Improve the Operation of the FERC-Approved Wholesale Market in Pennsylvania.

In some ways, the problems faced by Pennsylvania retail customers go beyond the charge that the Commission set for itself in this proceeding. See Investigation Order on Policies to Mitigate Potential Electricity Price Increases, Docket No. M-00061957 (Order entered May 24,

(continued footnote)
[3] On March 2, 2007, IECPA, et al. filed Comments in the proceedings at Docket No. L-00040169 and Docket No. L-00070183.

2005) (to "address issues and develop policies to mitigate potential electricity price increases upon the expiration of the generation price caps"). This does not mean, however, that the Commission can remain a passive bystander in the debates at FERC and within the RTOs regarding the wholesale market design. In light of the magnitude of the anticipated rate increases in the post-restructuring era and given the Commission's obligation to safeguard the interests of Pennsylvania's ratepayers, the Commission should expand the scope of its mission in the instant proceeding to include the development of measures to reduce electricity prices in the Commonwealth by, inter alia, taking steps to modify and improve the operation of the FERC-approved wholesale market in Pennsylvania.

As detailed in the Comments of Industrial Customers, the success of Pennsylvania's retail market hinges on a vibrant and functional wholesale market; however, serious problems in the wholesale market exist. These problems include:

- A locational marginal pricing ("LMP") market structure that is highly sensitive to steep and volatile natural gas prices and results in a small percentage of natural gas-fired generating units that are "on the margin" driving up market prices for billions of kWh generated by lower-cost coal and nuclear facilities.

- LMP-based wholesale and retail markets that prevent long-term bilateral contracting and only result in contracts based on forward natural gas curves.

- An unbundling initiative that has resulted in greater revenue streams than the previously bundled service and has created more opportunity for gaming of the market rules to create excessive revenues for generators, at the expense of retail customers.

- The PJM market's vulnerability to the exercise of market power and the apparent absence of the hallmarks of competitive markets in the PJM region.

- LMP's failure to stimulate necessary infrastructure investment.

See Comments of Industrial Customers, infra note 1, pp. 6-12. As a result, rates for large C&I customers have increased substantially, even during the rate capped transition period, while

generation owners continue to realize windfall profits. See id. at 12-17. Thus, Pennsylvania is on track to have a retail market in which electric service will not be available to all customers "on reasonable terms and conditions" as contemplated under the Competition Act. See 66 Pa. C.S. § 2802(9). Absent corrective action, post-rate cap increases will be dramatic and will have a correspondingly dramatic impact on the Commonwealth's business and industry (and in turn, further negative impact on employment, state and local tax revenues, and contributions to state and local economies).

Due to the close nexus between wholesale and retail prices, it is critical for the Commission to investigate and determine which market design and structure deficiencies undermine the Commission's duty to ensure just and reasonable retail rates. The wholesale platform upon which "competition" occurs is critical to the success of the Commonwealth's restructuring initiative to harness competitive forces to produce lower energy costs than regulation. Thus, the challenge facing the Commission is improving the platform upon which wholesale and retail competition occurs without intruding on FERC's jurisdiction.

Industrial Customers commend the Commission's commitment to actively participate in proceedings before FERC and collaboratives with other state regulators on wholesale market issues. See Mitigation Order, pp. 19-20. As the Commission may be aware, FERC recently announced the reconstitution of the federal-state initiative on cross-jurisdictional issues related to competitive power procurement between FERC and the National Association of Regulatory Utility Commissioners ("NARUC"). See "FERC, NARUC Resume Dialogue on Competitive Procurement" (Feb. 2, 2007) available at http://www.ferc.gov/press-room/press-releases/2007/2007-1/02-02-07.asp (last visited Mar. 5, 2007). Given the relevance of this

FERC-NARUC dialogue to the issues at stake in this proceeding, Industrial Customers urge the Commission to clarify its intention to be an active participant in this process.

The Mitigation Order, however, does not go far enough in developing specific measures to improve the operation of the wholesale market in Pennsylvania. As detailed in the Comments of Industrial Customers, the Commission should, among other things:

- Facilitate the construction of low-cost generation in Pennsylvania, including the identification of locations that have been "pre-approved" for the siting of new generation facilities;
- Promote demand response by eliminating provisions in EDC tariffs that impede participation;
- Encourage generators to execute long-term forward contracting at prices other than LMP, such as cost plus pricing, with Pennsylvania-based customers;
- Require EDCs to offer long-term fixed-price electrical supply contacts to industrial customers as a form of default service;
- Investigate the viability of a Commonwealth public power authority to take advantage of the low-cost fuel resources available in the Commonwealth that need to be retained on a cost plus basis, as opposed to a spot market LMP basis; and,
- With respect to Commonwealth-assisted projects, require respondents to requests for proposals ("RFPs") to specify percentages of generation in Pennsylvania in order to encourage diversity and ownership of generation resources.

See Comments of Industrial Customers, infra note 1, p. 24; id. at 32-35. Measures such as these appear to be well within the Commission's statutory authority; however, the Mitigation Order does not engage Industrial Customers' recommendations.

While Industrial Customers do not presume to have all the answers, it is clear that serious problems exist. The Mitigation Order does not take a proactive approach necessary to rise to the challenges presented by the post-restructuring period. In other words, the Commission must not simply resign itself to the fact that exorbitant rate increases will follow the expiration of rate caps

and channel its efforts on mitigating such rate increases. Rather, the Commission should focus on developing a strategy to reduce the expected rate increases using every reasonable measure within the Commission's jurisdiction and then address the means by which to alleviate any actual rate increases. Accordingly, Industrial Customers respectfully request the Commission to modify the Mitigation Order as discussed herein and presented in more detail in their Comments and Reply Comments.

B. As Proposed, the Education Campaigns Inappropriately Endorse PJM's Wholesale Market Design and, Thus, Must Be Modified.

As previously stated, Industrial Customers recognize the importance of customer education in the restructured market. See Comments of Industrial Customers, infra note 1, pp. 30-31. With effective customer education, customers are empowered to make informed decisions about their energy options and plan appropriately for price changes. Notwithstanding, Industrial Customers take issue with the Commission's proposal to educate customers about the "true cost of electricity" and "why electric rates change."

As discussed above and in more detail in the Comments and Reply Comments of Industrial Customers, the PJM wholesale market design suffers from serious flaws, the result of which negatively impact retail rates in the Commonwealth. The PJM wholesale market structure does not ensure that customers experience rates reflecting the "true cost of electricity" and, rather, results in customers seeing rates that reflect the "cost" of the marginal generating unit in the particular hour. As detailed in the Comments of Industrial Customers, in a disproportionate number of hours each year, this market clearing price, which is based on natural gas prices, ensures that owners of coal and nuclear generating units are paid an inflated compensation in excess of their "true costs." See Comments of Industrial Customers, infra note 1, p. 7. An educational campaign cannot inform customers about the "true cost of electricity" or "why

electric rates change" without at least implicitly endorsing the flawed PJM wholesale market design. Thus, Industrial Customers urge the Commission to delete these aspects of the statewide and EDC-specific education campaigns.

C. The Commission Should Not Attempt To Recover Education Costs in a Manner That Contravenes the Commission's CAP Order.

In the Mitigation Order, the Commission proposes to apportion the cost of the education campaigns among the EDCs "based on their total number of residential and small business electric customers." See Mitigation Order, p. 9. The Commission further proposes that "costs for both the EDC-specific and statewide education campaigns be fully recovered through the same surcharge mechanism used to recover the costs of customer assistance programs." Id. at 10. The Commission seeks input on these proposals, recognizing that they represent a departure from past PUC policy.

Industrial Customers oppose the Commission's funding proposal, because it would inappropriately recover universal service costs from business customers, in direct contravention of the Commission's final order in the Customer Assistance Program ("CAP"). See Customers Assistance Programs: Funding Levels and Cost Recovery Mechanisms, Docket No. M-00051923, p. 31 (Final Investigatory Order entered Dec. 18, 2006) ("CAP Order").

According to the Commission, the costs related to the education campaign contemplated by the Mitigation Order fall under the definition of "universal service and energy conservation," per Section 2803 of the Public Utility Code. See Mitigation Order, p. 10; see also 66 Pa. C.S. § 2803. In the CAP Order, the Commission stated:

> The issue being considered is whether the Commission should depart from its long-standing policy of collecting CAP costs only from residential customers so that commercial and industrial customers would now also begin to pay for CAP programs.

[...]

> After careful consideration of the comments and arguments presented, the Commission will continue its current policy of allocating CAP costs to the only customer class whose members are eligible for the program – residential customers. The Commission believes that we should not initiate a policy change that could have a detrimental impact on economic development and the client for business and jobs within the Commonwealth.

CAP Order, p. 31 (emphasis added). As a threshold matter, Industrial Customers question the propriety of collecting education costs through a charge created for another purpose. According to Section 2803, "universal service and energy conservation" describes "[p]olicies, protections and services that help low-income customers to maintain electric service." 66 Pa. C.S. § 2803. Education costs do not appear to fall within the scope of Section 2803, as education costs would not be expended solely for the benefit of low-income customers. The costs of the education campaign should not be hidden in a surcharge that was created for a different purpose. Moreover, as the Mitigation Order recognizes, the proposal to recover education campaign costs from business customers, if implemented, would represent a gross departure from the Commission's recent determination in the CAP Order.

The CAP Order reflects sound public policy. Thus, Industrial Customers submit that the Commission should abandon its new proposal to recover education costs through the CAP mechanism.

III. CONCLUSION

WHEREFORE, Industrial Energy Consumers of Pennsylvania, PJM Industrial Customer Coalition, 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 respectfully request that the Pennsylvania Public Utility Commission consider and adopt, as appropriate, the foregoing Comments.

Respectfully submitted,

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