

COMMONWEALTH OF PENNSYLVANIA



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June 1, 2010

Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Implementation of Act 129 of
October 15, 2008; Default Service
Docket No. L-2009-2095604

Dear Secretary Chiavetta:

Enclosed for filing are the Comments of the Office of Consumer Advocate, in the above-referenced proceeding.

Should you have any questions, please contact our office at the number above.

Respectfully Submitted,

A handwritten signature in black ink that reads "Aron J. Beatty".

Aron J. Beatty
Assistant Consumer Advocate
PA Attorney I.D. # 86625

Enclosure

cc: Elizabeth Barnes, Assistant Counsel (via e-mail only)

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of Act 129 of : Docket No. L-2009-2095604
October 15, 2008; Default Service :

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE
REGARDING PROPOSED MODIFICATIONS
TO THE DEFAULT SERVICE REGULATIONS

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Dated: June 1, 2010

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I. INTRODUCTION

On May 1, 2010, the Commission's Proposed Rulemaking Order Regarding Implementation of Act 129: Default Service was published in the *Pennsylvania Bulletin*. In the proposed Rulemaking Order, the Commission proposed amendments to its default service regulations as required by the enactment of Act 129 in order to make those regulations consistent with the Act. As the Commission noted, Act 129 revises the default service requirements contained in Chapter 28 of the Public Utility Code. Among its many requirements, Act 129 specifically revised the Default Service Providers' (DSPs) obligation so that the DSP must provide default service at the least cost to customers over time.

As the OCA has set forth in its prior Comments on this issue, the design of default service remains one of the most critical tasks facing the Commission. The fundamental goal of the Pennsylvania restructuring law was to provide reliable service to consumers at lower prices than they would pay under the prior regulatory model. The need for lower prices was considered essential for consumer welfare and economic development. As a means of achieving that goal, the 1996 Act sought to ensure that Pennsylvania electric consumers gained access to a competitive generation market. As stated in Section 2802(5) of the Act's Declaration of Policy: "Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."

The underlying premise of the Act was that when competitive market forces are brought to bear on the generation of electricity, those competitive market forces will reduce the *cost* of generation and therefore the *price* of generation service to retail consumers. Under the Act, however, a customer does not have to leave his or her retail electric distribution company ("EDC") in order to get access to competitive market generation. Rather, once the transition

period is over, the customer can choose between purchasing generation at unregulated market prices from an alternative electric generation supplier (“EGS”), or purchasing unbundled generation from the provider of last resort (“POLR”) at a price that is designed to reflect the costs to the POLR of acquiring generation in the competitive wholesale market. Equally important under the Act, electric service is to be available to all customers on reasonable terms and conditions. 66 Pa.C.S. § 2802(16).

At its core, Act 129 affirms and strengthens the obligation of Default Service Providers to bring the benefits of competitive prices in the wholesale market to all customers – including those who remain on default service. The preamble to Act 129 states that one of the main goals of the Act is to reduce the cost and price instability of electric energy:

The General Assembly recognizes the following public policy findings and declares that the following objectives of the Commonwealth are served by this act:

(1) The health, safety and prosperity of all citizens of this Commonwealth are inherently dependent upon the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, taking into account any benefits of price stability over time and the impact on the environment.

Act 129, 66 Pa.C.S. § 2806.1 *et seq.*, pmb1.

As the Declaration of Policy makes clear, the Act was passed in large measure to bring down the cost of power. Act 129 was passed in October 2008, in advance of the end of rate cap protections for most Pennsylvania consumers. In order to ameliorate potential rate increases, and reach the goal of reasonable rates, the Act addresses several aspects of generation procurement as well as customer usage that can impact the price of service. The Act requires DSPs to implement comprehensive energy efficiency programs, develop advanced metering and rate programs, and affirmatively seek out default supplies for customers at least cost over time.

It is from a comprehensive view of the Act that the OCA submits the Commission must implement its changes to the existing default service regulations.

Act 129 provides a comprehensive set of tools designed to provide electric service to customers at reasonable and stable prices. The Act requires EDCs to develop energy efficiency measures to reduce consumption and demand response measures to reduce peak demands and to deploy smart meters that will allow customers access to a greater amount of information about usage and enable greater customer control over usage. In addition, Act 129 requires DSPs to provide customers with the least cost service over time, through a mix of default supplies that best accomplishes that goal. Act 129 severs the Restructuring Act's prior requirement that default service rates must reflect volatile "prevailing market prices," and instead empowers DSPs to actively engage the competitive wholesale market, and bring demand side and energy efficiency resources to bear, as a means of ensuring that non-shopping customers receive reliable, adequate, and stable rates at prices designed to be least cost over time.

The OCA submits that DSPs should purchase default supplies through a portfolio approach to best meet Act 129's requirements. Under a portfolio approach, each DSP will procure power directly from the wholesale market through a variety of products tailored to the specific load. For example, a DSP could procure power in standardized blocks of 'round-the-clock' power (7x24), on peak (5x16), and off peak products commonly traded in the wholesale market. In order to balance the precise load at a given time, the DSP would be able to access the energy balancing services of the PJM (or for Pike, NYISO) Regional Transmission Organization through spot market purchases and sales. A portfolio approach provides the default service provider with the latitude needed to procure the various products available to meet its least cost obligation.

In addition, a portfolio approach will allow the DSP to lower the cost of the supply portfolio when customers participate in Act 129's energy efficiency, demand response and Time of Use (TOU) rate programs. To the extent residential customers reduce usage or can be called at times of peak demand to lower load, the portfolio manager will be able to incorporate those savings into reduced spot purchases and into reduced block purchases, if needed. To the extent that residential customers are able to utilize smart meter technology to reduce peak demand, the portfolio manager will be able to procure less power at peak periods. The end result is a reduction in the supply costs to the portfolio and a reduction in the rates levels needed to ensure that the DSP recovers all of its reasonable costs. The OCA submits that a portfolio approach is consistent with the direction of Act 129 and is in the best interest of residential consumers.

Through these Comments, the OCA will discuss in more detail the proposed modifications to the default service regulations and will identify areas where modifications to the regulations are needed to better ensure that customers are provided with service at the least cost over time. In Section II, the OCA will provide responses to the key areas identified in the Commission's sixteen questions. From the OCA's perspective, the Commission's questions identify the critical issues that must be answered before finalizing any changes to the existing Regulations. In Section III, the OCA will discuss each individual regulation and present the key recommended changes to the proposed regulations.

II. SPECIFIC COMMENTS TO IDENTIFIED TOPICS RAISED IN THE COMMISSION'S ORDER

In its Order, the Commission raised several specific topics for Comment. The selected topics were raised in a series of sixteen questions. Order at 16-17. The OCA submits that the questions developed by the Commission for additional comment directly identify the key issues that must be addressed in order to bring the full benefits of Act 129 to customers. From the OCA's perspective, these questions represent the core issues surrounding default service going forward.

In this section, the OCA provides its response to the each of the Commission's questions. The OCA will discuss specific recommendations regarding these topics when it provides a discussion of each regulation in Section III.

Commission Question 1. What is meant by “least cost to customers over time?”¹

OCA RESPONSE:

Act 129 eliminated the requirement that DSPs procure power to serve default customers at “prevailing market prices” and replaced that requirement with the obligation of DSPs to procure power at “least cost to customers over time.” The OCA submits that understanding what the repealed language required helps to provide an understanding of the current legal requirement. While the prevailing market prices standard provided the DSP with some latitude in what was to be procured, it did not explicitly require the DSP to develop a plan with the paramount goal of keeping costs down over time for its customers. There were a number of different market products and prices available for DSPs to meet their default service obligation. The prior language allowed each DSP to procure default supplies in the market, regardless of the type, and allowed for the recovery of those costs as long as they matched the “prevailing market price” of the relevant product at that time.

The language “least cost over time” changes the role of the DSP from that of a passive purchaser of default supplies at market prices and places on the DSP an affirmative obligation to assess which products will produce the lowest costs to customers. The key element of this language change is the shift of the DSP from simply matching its purchases to market prices at a particular point in time to seeking a mix of resources at the least cost to customers over time. The OCA submits that the new standard requires that a DSP develop a procurement plan that will capture the benefits of the competitive wholesale market and bring power to its default customers at rates that reflect the lowest costs to customers over the term of the plan and beyond. Such prices may be higher or lower than the prevailing market prices at any given point in time. But the overarching goal is to provide service to customers at the least cost over the

¹ See 66 Pa. C.S. § 2807(e)(3.2), (3.4) and (3.7).

course of time. When developing its procurement plan, each DSP should avoid sole reliance on short term purchases in order to develop continuity in rates over the years. As explicitly noted in the Preamble to the Act, while the DSP must focus on least cost, it should also consider the benefits of rate stability.

As detailed in these Comments, the OCA supports a portfolio approach for each DSP to meet its statutory obligation under Act 129. Act 129 places an affirmative obligation on each DSP to manage its load to ensure that energy efficiency goals are met, smart meter plans work efficiently, time of use programs are available, and default service supplies are obtained on a least cost basis over time. A portfolio approach will allow the DSP to capture the comprehensive benefits of Act 129, thereby meeting its least cost obligation.

Commission Question 2. What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time?

OCA RESPONSE:

The OCA submits that the time frame for evaluating whether a DSP's plan will produce the "least cost over time" will vary between service territories. The key inquiry will be whether each DSP has established a procurement plan by which it will actively engage the wholesale market to procure the best mix of products to meet its particular default service customers. For example, for a larger DSP with an anticipated large default service load, a mix of products that includes a substantial purchase of longer term resources may be appropriate. A large DSP may have access to a wider pool of suppliers and to suppliers that have an interest in locking up substantial power commitments over a longer time horizon. In contrast, a smaller DSP such as Pike County Light and Power may not have a large enough base of default load to draw the interest of such suppliers. In that case, a shorter time horizon would be appropriate to determine if the plan will meet the least cost over time test.

In all cases, the key element for review must be whether the DSP has taken an active role in evaluating all available market alternatives and will pursue a reasonable approach designed to bring its default customer the benefits of its procurement plan over that period of time.

Commission Question 3. In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission's default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania?

OCA RESPONSE:

To the extent that new generation may be beneficial in order to ensure reliability and meet the least cost standards of Act 129, the Commission's regulations should incorporate the acquisitions that will support the construction of needed generation. Under the 1996 Electric Restructuring Act, the Commission retained the authority to ensure reliability. See 66 Pa.C.S. § 2804(1). Under Act 129, the Commission must ensure that each DSP's supply mix is designed to ensure adequate and reliable service. See 66 Pa.C.S. § 2807(e)(3.4). Act 129 specifically provides for the approval of contracts of 20 years or longer in order to ensure adequate and reliable service at least cost to customers over time and the regulations should enable necessary acquisitions. Although Act 129 prohibits the Commission from ordering a DSP to procure power from new generation only (or a specific fuel type), See 66 Pa.C.S. Section 2813, it can approve of contracts for new generation as part of a least cost procurement plan. The OCA submits that long term contracts can be designed to facilitate new construction that will help ensure adequate and reliable service at stable rates. The Commission should take a longer term view of default service given its obligation to ensure adequacy of service, coupled with Act 129's requirements for least cost service over time.

The OCA would support Commission policies to enable new generation construction to ensure adequacy and reliability of service. In order to accomplish this objective, the Commission should require DSPs to utilize competitive procurement processes, such as an

RFP for long term contracts. As part of its supply mix, a DSP could issue a Request for Proposal for the long-term delivery of power that could include newly constructed generation.

Commission Question 4. If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised?

OCA RESPONSE:

Under Act 129, the DSP has an affirmative duty to file a plan that ensures adequate and reliable supply at the least cost to customers over time. Each DSP must assess its options for meeting this obligation when developing its procurement plan. The Commission's regulations cannot require that construction of a generating unit with a specific fuel type be part of a DSP's procurement plan. See 66 Pa.C.S. § 2813. The Commission is also prohibited from requiring that a DSP procure power from new generation only. Id. The Commission is not prohibited, however, from requiring DSPs to design long term competitive procurements that may facilitate new construction in order to help ensure adequate and reliable service at stable rates over time.

The OCA submits that, as part of its evaluation, each DSP could be required to review the possibility of supplying a portion of its default load through long term contracts that could encourage the construction of needed generation. Such contracts generally should be procured through competitive processes to ensure that they comply with the least cost requirements of Act 129.

Commission Question 5. Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time?

OCA RESPONSE:

The OCA strongly supports the use of a portfolio approach for providing service to residential customers. The OCA has advocated the use of a portfolio approach in numerous default service proceedings. In those proceedings, the OCA has not seen any convincing argument to support continued heavy reliance on full requirements contracts to meet the “least cost over time” standard under Act 129.

Under a portfolio approach, the DSP will procure power from the wholesale market through a variety of products tailored to the specific load. For example, a DSP could procure power in standardized blocks of ‘round-the-clock’ power (7x24), on peak (5x16), and off peak products commonly traded in the wholesale market. In order to balance the precise load at a given time, the DSP would be able to access the energy balancing services of the PJM (or for Pike, NYISO) Regional Transmission Organization through spot market purchases and sales. The DSP should also include longer term block or unit purchases to provide greater stability and potentially lower prices.

In contrast to a portfolio approach, full requirements contracts shift the obligation to meet default service load to third party suppliers. These suppliers are obligated to meet a fixed percentage of the default load at both on-peak and off-peak hours. In addition, these suppliers are required to provide service to a set percentage of default load regardless of the level of retail shopping that takes place in the service territory. The risks associated with the variation of load are assigned a cost by bidders and are priced into the winning bids and paid for by default service customers. Finally, winning suppliers must incorporate a profit margin to make their

participation meaningful. These profit margins are in addition to the profit margins the generation suppliers build in to their supply of the product to the full requirements middlemen. While the bidding process will identify the bidder that prices the risk premium and profit at the lowest level, it will not eliminate the need for full requirements suppliers to incorporate these costs into their bids.

Under the Portfolio Approach, the DSP can directly access the generation products available in the wholesale market without the need to pay an extra level of profit and risk premiums to full requirements suppliers. As noted above, the OCA is unaware of any quantitative analysis showing full requirements products to be least cost products. Indeed, it should come as no surprise that the introduction of a third party middleman to take on the default supplier obligation would add, rather than subtract, costs.

On the contrary, the OCA submits that evidence from recent procurements may demonstrate that the procurement of default supplies through a portfolio approach is a lower cost alternative to using a full requirements approach. There have been several procurements made by DSPs for future default service where block products were purchased along with full requirements products. The OCA recognizes that block purchases do not include all of the product attributes and costs that are included in full requirement purchases and must be incorporated in a comprehensive portfolio (including capacity, ancillary services and load shaping costs) in order to determine the total cost to customers. In addition, prices will vary based on the timing of purchases, location, RTO, and ratemaking differences. Even when taking into account these variations, the OCA submits that the use of a broader portfolio of products has had a positive impact on the procurements done to date in Pennsylvania.

On April 22, 2010, PPL Electric Utilities issued a press release in which it released the results of procurements made earlier that month. For residential customers, PPL procured both full requirements contracts and 25 MW round-the-clock blocks of power for delivery from January 2011 through February 2012. The price of the block purchases for that delivery period averaged \$46.59 per MWh. The winning bid price for the full requirements tranches during that same period was \$74.82 per MWh.

PECO also procured both block energy products and full requirement products in order to serve its post-rate cap default service load. PECO's publicly released information shows that the average winning bid price for its residential full requirements tranches in its Spring 2009 solicitation was \$88.61 per MWh. In its Fall 2009 solicitation, the average winning bid price for its residential full requirements tranches was \$79.96 per MWh. PECO released the aggregate results of its residential block energy purchases from the Spring 2009 and Fall 2009 solicitations, where the average winning bid price was \$61.74 per MWh. PECO's publicly available rate information can be found on its website, <http://pecoprocurement.com/index.cfm?s=background&p=previousResults>.

In addition, Met-Ed and Penelec procured both full requirements contracts and block products for residential customers in early 2010. For full requirements tranches to meet January through May 2011 residential load, the average price result was \$77.76 per MWh for Met-Ed, and \$64.34 per MWh for Penelec. For the 50 MW, round-the-clock block of power procured to serve residential load for the 48 month period beginning June 2011 and ending in May 2015, the Met-Ed and Penelec block prices were \$59.77 per MWh and \$54.38 per MWh, respectively. Importantly, these block purchases are for round-the-clock service for a four-year period.

While comparisons of block and full requirements products cannot be made on an “apples to apples” basis, the OCA submits that Pennsylvania DSPs have been able to purchase a variety of block power products at reasonable prices. At the very least, this evidence suggests that block and spot purchases should be a part of the prudent mix of products required in order to ensure that default service is “least cost to customers over time.”²

There also has been movement away from full requirements approaches in other states. In Illinois, the state rejected exclusive reliance on full requirements contracts and instead created a state power agency. As part of this effort, the Illinois Power Agency retained consultants to conduct block power supply RFPs for Ameren and Commonwealth Edison Company. As a result of the Illinois Power Agency block purchasing strategy, rates have been reduced for residential customers. As the OCA’s witness testified in testimony in the recent Met-Ed and Penelec DSP proceeding:

The Illinois Power Agency retained consultants to conduct block power supply RFPs for Ameren and Commonwealth Edison Company (“Com Ed”), Illinois’ two principal investor-owned utilities. I emphasize the Com Ed results in this discussion since that company is part of the PJM footprint, whereas Ameren is part of the Midwest ISO (“MISO”). The Agency reports prices for Com Ed’s supply ranging from \$33.51 per MWh to \$53.66 per MWh during various months for on-peak energy and \$21.39 to \$27.23 MWh for the off-peak energy. Since Com Ed already has existing supply contracts that will continue over the next two years for most of its default load, this recent procurement will only provide about one-third of the required power supply. Nonetheless, even though this recent procurement will provide only a portion of supply, the contracts are so favorably priced that they will produce estimated residential bill reductions of about 7.5 percent (\$6.36 per month) when blended in with the existing higher cost contracts, according to the Company.

² The OCA also submits that a portfolio approach is more appropriate to meet the Commission’s obligation to ensure adequacy of supply. As noted in response to questions 3 and 4, above, the OCA supports the use of long term contracts to facilitate new generation construction. Under a portfolio approach, the Commission could integrate these types of long term contracts into a DSP’s procurement plan. It is unclear that such contracts could work under a full requirements approach.

See Testimony of Matthew I. Kahal, entered into the record in the Met-Ed/Penelec 2011-2013 Default Service Proceeding at Docket Nos. P-2009-2093053 & P-2009-2093054 (footnotes omitted).

By way of contrast, the OCA submits that New Jersey's continued reliance on 100% full requirements contracts has produced results that have not been as responsive to recent downturns in wholesale market pricing. In the Met-Ed/Penelec DSP case, the OCA's witness explained these concerns as follows:

New Jersey's four major electric utilities conduct an annual procurement for full requirements supply contracts for Basic Generation Service ("BGS") using three-year overlapping contracts and a descending clock auction similar to that proposed by the Joint Petitioners. The most recent auction was completed in February 2009.

The auction was successful in filling all specified load tranches but at prices that seem disappointingly high. The resulting market clearing fixed prices range from 10.35 cents per Kwh to 11.27 cents per Kwh, despite the plunging energy commodity costs as compared to the first half of 2008. The New Jersey experience seems to show that Joint Petitioners' proposal is workable and technically feasible but not necessarily attractive in terms of the final pricing result.

Id. (footnotes omitted).

The OCA submits that a portfolio approach is most consistent with both the supply and the demand aspects of Act 129. Act 129 requires that each DSP shall include a prudent mix of resources. 66 Pa.C.S. § 2807(e)(3.2). A portfolio approach allows the discretion to include a variety of resources and products and affords the flexibility to incorporate new products into the supply mix when available. Through the incorporation of a portfolio approach, each EDC will be able to bring the full benefits of Act 129's energy efficiency, demand response, smart meter, and time of use rate requirements to retail customers. To the extent

residential customers reduce usage and peak load, for example, the DSP will be able to incorporate those savings into reduced spot purchases, and into reduced block purchases if needed. To the extent residential customers are able to utilize smart meter technology to reduce demand, the DSP will be able to procure less power at peak periods. The end result is a reduction in the supply costs to the portfolio, and a reduction in the rate levels needed to ensure that the DSP recovers all of its reasonable costs.

The Commission recently recognized the inconsistency between a default service procurement plan that relied exclusively on full requirements products and the other provisions of Act 129. On March 9, 2010, the Commission entered its Order in the PPL Time of Use Rate proceeding at Docket No. R-2009-2122718. In that proceeding, PPL filed a Time of Use Rate proposal as required by Section 2807(f)(5) of Act 129. In its Order, the Commission rejected the Company's proposal to recover the "savings" achieved by customers shifting usage from on-peak to off-peak hours from all default service customers through future rates. Chairman Cawley explained how there would be no reduction in wholesale costs under PPL's proposal, as follows:

Because all the payments to PPL's wholesale default service suppliers are based on a fixed rate regardless of when the energy is used by the customer, the wholesale market cost reductions from shifting demand from on-peak to off-peak periods is not passed directly on to default service customers, but to default service suppliers.

Statement of Chairman Cawley, Re: PPL Electric Utilities Corporation Supplement No. 71 to Tariff Electric-Pa. P.U.C. No. 201 Regarding Its Proposed Time-of-Use Rate Program, Public Meeting of January 28, 2010, Docket No. R-2009-2122718 (2122718-OSA).

As the Chairman stated, under PPL's proposal, load shifted from high cost to low cost periods would not reduce the EDC's actual cost of default supply. If PPL had adopted a

portfolio approach that included block and spot purchases, however, the shifting of usage from high cost to low cost periods would result in reduced supply costs. As a result, the savings enjoyed by customers who shift usage would have produced savings in PPL's wholesale supply costs, eliminating the shortfall that PPL was seeking to recover in rates. In the PPL Time of Use proceeding, OCA witness Richard Hahn detailed the cause of the problem, and explained how a portfolio approach would resolve the issue, as follows:

Under the Company's proposal, any reductions in peak loads due to TOU rates will result in reduced costs to the full requirements suppliers who provide default service power supplies. Yet, the revenues these full requirements suppliers receive from PPL will not change because the total amount of KWH consumed is unchanged due to TOU rates, and these supplies are provided at fixed rates that do not vary by season. Thus, the proposed TOU rates will increase the profits of the competitive suppliers providing default service power supplies. None of the benefits of the TOU rate program flows through to PPL or to PPL ratepayers on an aggregate basis.

It should be noted that, if the Company had procured default service power supplies using a managed portfolio, such a shortfall would not exist. A managed portfolio is a prudent mix of long term contracts, shorter term peak and off-peak block purchases, and spot market purchases. Under this structure, the benefits of load shifting due to TOU rates would manifest themselves directly in lower purchased power costs, which would be passed on to ratepayers. With full requirements, load following, fixed price contracts, these benefits are not passed on to consumers.

See Testimony of Richard S. Hahn, entered into the record in the PPL Time Of Use Rate Proceeding at Docket No. R-2009-2122718.

The OCA submits that a portfolio approach would allow customers to benefit from energy efficiency and peak demand reductions, as was intended under Act 129.

For these reasons, and those detailed throughout these Comments, the OCA strongly submits that a portfolio approach is more likely to produce lower rates over time than the full requirements approach.

Commission Question 6. What is a “prudent mix” of spot, long-term, and short-term contracts?

OCA RESPONSE:

The prudent mix of contracts would vary from DSP to DSP and vary depending on market conditions. What constitutes a prudent supply mix of supply for PPL could be substantially different from what would be a prudent mix of supply for Pike County Light & Power Company.

For example, for a larger DSP with a stable and sizeable default load, a prudent mix may include significant reliance on longer term contracts. A larger DSP can absorb greater variation in load, making these types of contracts more viable.

By contrast, a small DSP may not be able to “break up” its default load into enough pieces to allow it to procure as diverse a mix of commonly traded wholesale products. For a small DSP, the prudent mix of supplies may involve less variation in the products purchased. For these reasons, it is not possible to prescribe what constitutes a prudent mix of supplies without knowing the characteristics of the load that is being served.

Commission Question 7. Does a “prudent mix” mean that the contracts are diversified and accumulated over time?

OCA RESPONSE:

Yes. The OCA strongly supports the diversification of supply contracts both in terms of products procured and the timing of purchases. The OCA supports a portfolio approach to supply residential default customers. As with any well managed portfolio, no DSP should rely exclusively on one product nor should all of the products be procured at one time. The OCA submits that, in order to meet its least cost obligation, each DSP is required to look at all reasonably available products for meeting its default load.

Commission Question 8. Should there be qualified parameters on the prudent mix? For instance, should the regulations preclude a DSP from entering into all of its long-term contracts in one year?

OCA RESPONSE:

The OCA supports the use of a portfolio approach for the acquisition of default service supply. As part of its portfolio, each DSP should develop a product mix that is designed to ensure least cost to customers over time. The product mix of supplies developed by each DSP will likely vary between service territories. As a result, the OCA does not support an overly prescriptive set of parameters around the product mix achieved by each DSP. A DSP should be expected to incorporate “best practices” in the industry to ensure diversity of supply and limit over-reliance on any single product.

While regulations could be developed that would prohibit clearly troublesome procurement practices, such as the “all eggs in one basket” 2005 Pike County procurement, the OCA submits the Commission can protect against such procurement practices as part of its review process. Rather than attempt to list prohibited mixes of supply through regulations, the Commission should focus on its review of filed plans to ensure their compliance with the goals of Act 129.

Commission Question 9. Should the DSP be restricted to entering into a certain percentage of contracts per year?

OCA RESPONSE:

No. As discussed in questions 6 and 8, above, the DSP should be guided by its obligation to procure least cost power to its customers over time. The Commission should not restrict the DSP's ability to enter into market transactions that would help it achieve its statutory obligation to meet some pre-determined threshold.

It is important to note, however, that the OCA would strongly caution against approval of a procurement plan that produces excessive amounts of supply contracts *expiring* in a single year. In other words, a DSP should not position its procurements such that all, or nearly all, of its supply expires at the same time. Such a portfolio design would not be prudent because it would expose customers to potentially significant price spikes if market conditions were unfavorable at the time all new contracts had to be procured.

Commission Question 10 Should there be a requirement that on a total-DSP basis, the “prudent mix” means that some quantity of the total-DSP default service load must be served through spot market purchases, some quantity must be served through short-term contracts, and some quantity must be served through long-term contracts?

OCA RESPONSE:

No. As discussed in its response to the Commission’s questions and throughout these Comments, the OCA supports the development of supply plans that are tailored to the specific load to be served. The OCA submits that there is no pre-set mix of products that will produce least cost to customers over time for each service territory, during all market conditions.

The OCA strongly urges, however, that all three types of purchases be considered. For example, 100% reliance on short term, full requirements contracts leaves DSPs unable to take full advantage of the energy efficiency, demand response, and TOU rate programs required under Act 129. In order to maximize the benefits of these programs, the DSP must be able to maximize savings in the cost of supply. A DSP using a well designed portfolio will be able to adjust the purchases of products in a timely and efficient manner, maximizing the savings to the cost of the portfolio and passing those savings on to DSP customers. The OCA submits that Act 129’s energy efficiency, demand response, and smart metering programs were enacted to bring benefits to retail customers, and the portfolio approach provides the best means to pass those benefits to those customers.

Commission Question 11. Should there be a requirement that some quantity of each rate class procurement group's load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely on only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP?

OCA RESPONSE:

The OCA submits that that statutory language indicates a preference for a mix of all categories of supply (long term, short term and spot). The OCA further submits, however, that the Act requires that the supply mix be prudent. In reconciling these provisions, the OCA submits that the ultimate purpose of the Act is to achieve “least cost to customers over time.”

The appropriate mix may vary by customer class, particularly given differing expected retail shopping levels. For residential customers, the OCA generally supports the inclusion of all categories of products unless such procurements will clearly result in higher costs.

Commission Question 12. Should the DSP be required to hedge its positions with futures including natural gas futures because of the link between prices of natural gas and the prices of electricity?

OCA RESPONSE:

As detailed earlier, the OCA supports a Portfolio Approach for procuring default supplies. The exact products of each default provider's portfolio should be tailored to the needs of that service territory. Hedging products should be a type of product considered for inclusion in the portfolio if they can assist in meeting the goals of the Act, particularly as to price stability.

The OCA submits that products exist that would address the link between natural gas costs and electric generation prices. The OCA has provided testimony before the Commission concerning products that would hedge against volatility in the gas market. (See Allegheny d/b/a West Penn, Docket No. P-00072342, Direct Testimony of Richard Hahn). As explained by the OCA in the Allegheny Power 2007 DSP proceeding, a Heat Rate Index contract is an agreement to purchase a specified amount of electric energy at a price that is derived from two components: a natural gas price in \$/million BTU and a heat rate in million BTUs/MWh. The multiplication of the gas price by the heat rate yields the electric price. In these types of agreements, the price of electric energy is indexed to the natural gas price by the heat rate. For example, if the natural gas price is \$8.00/million BTU and the heat rate is 10 million BTUs/MWh, then the electric price is \$80 per MWh. Such contracts may have multi-year terms and can be made for on-peak, off-peak, and around-the-clock time periods, but the price is typically set or "locked in" on a monthly basis.

These products provide residential customers with the potential for protection against rate shock in the event natural gas prices spike unexpectedly. Under a portfolio approach, the portfolio manager may find such products to be beneficial in meeting its least cost

obligation and in stabilizing rates. The OCA agrees that these types of products should be considered, but not mandated.

Commission Question 13. Is the “prudent mix” standard a different standard for each different customer class?

OCA RESPONSE:

The OCA submits that Act 129 requires that the prudent mix standard for residential customers generally requires that the DSP procure spot, short term, and long term energy as part of its default service portfolio of supplies. As detailed in its response to question 6, the prudent mix of contracts would vary from DSP to DSP, and vary depending on market conditions. A prudent mix of contracts may also vary from one class of customers to another. What constitutes a prudent mix of supply for residential customers could be substantially different than what would be a prudent mix of supply for industrial customers where nearly all such customers are expected to shop. In these Comments, the OCA is addressing primarily default service for residential customers.

Commission Question 14. What will be the effects of bankruptcies of wholesale supplier to default service suppliers on the short and long term contracts?

OCA RESPONSE:

We interpret this question to address the relationship between wholesale suppliers and default service providers. Each Default Service Plan has a contingency plan that addresses what will happen in the event that a wholesale energy supplier is unable to provide the power for which it contracted. In the case of a managed portfolio, the portfolio manager should procure replacement power through competitive means on the wholesale market. This procurement of replacement power could result in a gain or a loss depending on market conditions at the time of replacement. The OCA would note that this issue demonstrates the need for diversity of contracts through a portfolio approach because portfolio managers, who are active in wholesale markets, will be better able to address defaults than a Company without such expertise (such as a utility who utilizes only full requirements contracts).

All contracts for wholesale supply should contain provisions addressing the recovery of losses resulting from defaulting on a contract.

*Commission Question 15. Does Act 129 allow for an after-the-fact review of the “cost reasonableness standard” in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase?*³

OCA RESPONSE:

The OCA cautions against using the standards of Act 129 (re: least cost) as a means for an after-the-fact prudence review based on a comparison of the portfolio price to short term or spot market pricing. A procurement plan that has been approved and purchases that have been made in implementing that plan should not be second guessed. At any point in time, default service rates may be higher or lower than would otherwise be indicated by then-prevailing market prices.

The exception to this rule, which would be applicable to all procurements, is where there is a demonstration of fraud, collusion, or market manipulation, or where the DSP has unilaterally failed to follow its approved procurement plan. See Act 129, 66 Pa.C.S. § 2807(3.8). A DSP should not be immune from a disallowance of costs if it can be shown that those costs were a result of fraud, collusion or market manipulation or were inconsistent with the approved procurement plan.

³ See Section 2807(e)(3.9), which provides the EDC with the right to recover “all reasonable costs” incurred under Section 2807 and under an approved competitive procurement plan.

Commission Question 16. How should the requirement that “this section shall apply” to the purchase of AECs be implemented. Section 2807(e)(3.5) states that “. . . the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc.”

OCA RESPONSE:

The OCA submits that each DSP is required to meet its AEPSA requirements in a manner that is the “least cost to customers over time.” In other words, the DSP must actively engage the market for alternative energy and/or credits in order to fulfill its obligations under Act 129 in the same manner that it would procure non-AEPSA compliant energy supplies.

III. SPECIFIC COMMENTS ON EACH REGULATION

A. Introduction.

In this section, the OCA will address each specific regulation in light of the discussion provided above. All of the redlined edits in this section represent the OCA's proposed modifications. For the purposes of this document, where the Commission has proposed to modify the existing regulations, the OCA has accepted those changes before proposing its own modifications. The OCA underlined its additions and utilized strikethrough for its deletions to the Commission's modifications.

B. Section 54.181. Purpose.

The Commission has not proposed to modify the language of this section. The OCA submits that the "purpose" section needs to be modified to state the policy objective of the regulations. As the Commission clearly notes in its Order, Act 129 changed the policy goal for default service providers from acquiring power at "prevailing market prices" and explicitly replaced that language with the "least cost over time" standard. As a result, the "purpose" section should be modified to reflect the changes made by Act 129. The OCA would propose the following modification:

§ 54.181. Purpose.

This subchapter implements 66 Pa.C.S. § 2807(e) (relating to duties of electric distribution companies), pertaining to an EDC's obligation to serve retail customers at the conclusion of the restructuring transition period. The provisions in this subchapter ensure that retail customers who do not choose an alternative EGS, or who contract for electric energy that is not delivered, have access to generation supply at the least cost over time ~~prevailing market prices~~. The EDC or other approved entity shall fully recover all reasonable costs for acting as a default service provider of electric generation supply to all retail customers in its certificated distribution territory.

The OCA submits that this modification properly captures the current legislative language and should be adopted.

C. Section 54.182. Definitions.

In this section, the Commission proposes to amend the definition of Default Service Provider to match verbatim the definition found in Act 129. In addition, the Commission proposes to add the term “bilateral contract” into the regulation, matching the term verbatim as it is found in Act 129. The OCA supports the Commission’s inclusion of these definitions in the regulation exactly as they are found in the Act.

The Commission has, however, retained the term “prevailing market price” in its definitions. The OCA submits that the Commission correctly noted in its Order that Act 129 explicitly repealed the prevailing market prices standard. Order at 4. As such, the OCA submits that there is no longer the need to define the statutory term “prevailing market price.” The OCA submits that the definition of prevailing market price should be removed from the regulations.

D. Section 54.183. Default service provider.

The Commission does not propose any changes to this section. The OCA submits that no changes are needed.

E. Section 54.184. Default service provider obligations.

Section 54.184 sets forth the obligations of the default service provider. In its proposed regulations, the Commission proposes to conform the regulations to the language of Sections 2807(e)(1) and (e)(3.1) of Act 129. Of particular note, the Commission proposes to incorporate the provisions of Act 129 that detail the competitive processes by which a DSP shall procure supplies for default customers. The OCA supports the inclusion of Act 129’s requirements in this regulation.

F. Section 54.185. Default service programs and periods of service.

In this section, the Commission modifies its regulations to comply with Act 129's statutory timeframe for the approval of default service plans. Specifically, Section 2807(e)(3.6) provides that the Commission must issue a final order within nine months of the plan being filed. The OCA submits that the proposed modification to the regulation is reasonable.

G. Section 54.186. Default Service Procurement and Implementation Plans.

In this section, the Commission clarifies its regulations to incorporate Act 129's requirements that a prudent mix of long term, short term, and spot purchases be acquired. In addition, the proposed modification to the regulation attempts to capture the requirements of Section 2807(e)(3.2-5). The OCA provides the following comments to the PUC-proposed modifications to the regulation.

1. Subsection 54.186(a).

In this subsection, the Commission retains the existing reference to "prevailing market prices." As discussed above, Act 129 explicitly removed all references to "prevailing market prices" from the default supplier obligation. Under the Act, the DSP is required to procure supply through competitive processes, in order to meet a least cost procurement obligation. For these reasons, the OCA would propose the following changes to the regulation:

§ 54.186. Default service procurement and implementation plans.

(a) A DSP shall acquire electric generation supply at least cost over time ~~at prevailing market prices~~ for default service customers in a manner consistent with procurement and implementation plans approved by the Commission.

The OCA submits that this modification is necessary to bring the regulation into compliance with Act 129.

2. Subsection 54.186(b)(1).

In this subsection, the Commission lists the types of purchases that should be included in the prudent mix of supplies for default service. The regulation follows the language contained in Act 129. Included in this section are two exceptions contained in the Public Utility Code to the long term contracts under Act 129. These provisions appear as a subsection of Section 54.186(b)(1)(iii). The OCA submits that the proposed modifications to this subsection are reasonable.

3. Subsection 54.186(b)(2).

The Commission proposes to add language in the proposed regulation to ensure that the prudent mix of contracts is procured consistently with Act 129. The proposed subsection 54.186(b)(2) follows closely Section 2807(e)(3.4) of Act 129. Section 3.4 of Act 129 requires that:

the prudent mix of contracts entered into pursuant to paragraphs (3.2) and (3.3) shall be designed to ensure:

- (i) Adequate and reliable service.
- (ii) The least cost to customers over time.
- (iii.) Compliance with the requirements of paragraph (3.1).

The requirements of paragraph (3.1) define the obligations of the DSP to procure power through competitive processes. The requirements for competitive procurement are laid out in these proposed regulations at 54.184(c).

In the proposed regulation 54.186(b)(2), the language appears to capture the types of products that must be procured, not procurement methodology. For these reasons, the OCA proposes the following changes to the proposed regulation:

- (2) A prudent mix of contracts shall be designed to ensure:
 - (i) Adequate and reliable service.
 - (ii) The least cost to customers over time.

(iii) Compliance with the requirements of
§ 54.184 (c) subparagraph (b)(1)(iii).

This modification will allow the regulations to more closely follow the Act.

4. Subsection 54.186(b)(5).

This subsection describes the processes by which electric generation supply shall be acquired. The Commission has proposed modifications that would add short term, long term, auctions and bilateral contracts to the types of contracts that would be permissible under a procurement plan. The OCA submits that the Commission's proposed language incorporates the procurement processes detailed in Act 129 and should be adopted.

5. Subsection 54.186(d).

The Commission proposes to retain the existing language of Section 54.186(d). The existing language contains a reference to the prevailing market price standard that was repealed under Act 129. The OCA proposes the following modification to bring this section into compliance with Act 129:

(d) The DSP may petition for modifications to the approved procurement and implementation plans when material changes in wholesale energy markets occur to ensure the acquisition of sufficient supply at least cost to customers over time ~~prevailing market prices~~. The DSP shall monitor changes in wholesale energy markets to ensure that its procurement plan continues to reflect the incurrence of reasonable costs, consistent with 66 Pa.C.S. § 2807(e)(3) (relating to duties of electric distribution companies).

The OCA submits that this provision will best be implemented by a portfolio manager as through the purchasing of supplies in the wholesale market. A portfolio manager must "monitor changes in wholesale energy markets" to ensure that the mix of products continues to be reasonable and achieves the least cost standard.

6. Subsection 54.186(e).

The Commission proposes a new Section 54.186(e) in which it details the specific findings that the Commission must make when approving a default service plan. The proposed regulation mirrors the requirements of Act 129. The OCA supports inclusion of this language in the regulations.

H. Section 54.187. Default service rate design and the recovery of reasonable costs.

1. Subsection 54.187(a).

In this subsection, the Commission adds to its regulations Act 129's language concerning the recovery of costs. In particular, in this subsection, the Commission details when it is permissible to disallow costs that a DSP seeks to recover as part of its procurement plan. The Act provides the Commission with the discretion to disallow costs, or modify contracts, when a DSP has failed to comply with its approved plan, or acted in bad faith. The Commission's proposed subsection 54.187(a) mirrors Act 129, and the OCA supports its inclusion in the regulations.

2. Subsection 54.187(b).

In this subsection, the Commission modifies its regulations to allow a DSP to recover costs through a reconcilable automatic adjustment clause under Section 1307 of the Public Utility Code. The proposed regulation correctly provides the DSP with the option, at its discretion, to utilize a Section 1307 recovery mechanism. To fully comply with Act 129, the Commission further deletes the current regulatory language that requires each DSP design rates based on the average cost to acquire supply for each class. The OCA supports these modifications that make the regulation consistent with Act 129.

3. Subsection 54.187(g).

Here, the Commission deletes the references to the recovery of costs through a Section 1307 type charge. The Commission adopted language regarding this issue in new Subsection 54.187(b). The OCA supports this change.

4. Subsection 54.187(i).

In its existing regulations, each DSP is required to change default service rates for all customer classes with a maximum peak load of under 25 kW (such as residential customers) on a quarterly, or more frequent, basis. The existing regulation further provides that such frequent changes are designed to ensure the recovery of costs at prevailing market prices. Act 129, however, provides that the DSP shall offer residential customers a generation rate that “shall change no more frequently than on a quarterly basis.” 66 Pa.C.S. §2807(e)(7).

The OCA proposes the following changes to the Commission’s proposed regulation:

(i) Default service rates shall be adjusted no more frequently than on a quarterly basis for all customer classes with a maximum registered peak load up to 25 kW, to ensure the recovery of costs reasonably incurred in acquiring electricity at the least cost to customers over time ~~prevailing market prices and to reflect the seasonal cost of electricity.~~ DSPs may propose alternative divisions of customers by maximum registered peak load to preserve existing customer classes.

The OCA submits that Act 129 prohibits a DSP from changing rates more frequently than quarterly, but does not prohibit a DSP from offering more stable rates. The Act could have easily been written to require quarterly changes if that was the General Assembly’s intent. The OCA submits, however, that Act 129 places an emphasis on rate stability. As such, a DSP must offer a residential rate that changes no more frequently than quarterly, but it may provide additional stability through even less frequent rate changes.

The OCA also notes that the Commission-proposed language retains the repealed “prevailing market prices” standard. The OCA submits that this language should be replaced with the “least cost” standard set forth in Act 129.

5. Subsections 54.187(j) and 54.187(k).

In subsections 54.187(j) and 54.187(k), the existing regulations retain the repealed “prevailing market prices” standard. The OCA submits that this language should be replaced with the “least cost to customers over time” standard set forth in Act 129.

6. Subsection 54.187(l).

The Commission does not propose to modify this regulation concerning a DSP’s obligation to procure replacement power if needed upon a wholesale supplier’s failure to deliver generation supply. The existing regulation contains the repealed “prevailing market prices” standard. The OCA submits that the Commission must modify this section to bring it into compliance with Act 129. The OCA proposes the following changes:

(l) When a supplier fails to deliver electric generation supply to a DSP, the DSP shall be responsible for acquiring replacement electric generation supply consistent with its Commission-approved contingency plan. When necessary to procure electric generation supply before the implementation of a contingency plan, a DSP shall acquire supply at least cost to customers ~~prevailing market prices~~ and fully recover all reasonable costs associated with this activity that are not otherwise recovered through its contract terms with the default supplier. The DSP shall follow acquisition strategies that reflect the incurrence of reasonable costs, consistent with 66 Pa.C.S. § 2807(e)(3) (relating to duties of electric distribution companies), when selecting from the various options available in these energy markets.

The OCA submits that the DSP must actively pursue the least cost products available when purchasing replacement power when a supplier fails to deliver. The OCA’s proposed changes to this section clarify this obligation, as required under Act 129.

I. Section 54.188. Commission review of default service programs and rates.

1. Subsection 54.188(a).

In this subsection, the Commission adds language that requires each DSP to file a plan for competitive procurements that comply with those standards detailed in Act 129. The OCA supports the Commission's modifications on this issue.

2. Subsection 54.188(b).

In this subsection, the Commission modifies the existing regulations that call for a 7 month review period of all filed plans. The Commission proposes to modify the regulation to comply with Act 129's requirement that plans should be reviewed over a 9 month period. The OCA submits that the Commission's modifications to this subsection are appropriate.

3. Subsection 54.188(d).

In this subsection, the Commission has removed language concerning the manner in which it reviews, and approves, wholesale purchases. The Commission then adds language consistent with Act 129 that clarifies the Commission's role in determining what source and/or type of generation may be used to meet a DSP's obligation. The Commission incorporates the language of Section 2807(e)(3.7) of Act 129, requiring the Commission to make certain findings with respect to a DSP's procurement plan. The OCA submits that the Commission's modifications to this subsection are appropriate.

4. Subsection 54.188(f).

The existing subsection 54.188(f) requires each DSP to file tariff supplements in order to revise default service rates to ensure recovery of costs at prevailing market prices. The Commission proposes to modify the subsection by removing the reference to prevailing market prices. The OCA submits, however, that the proposed new regulation still contains references to

quarterly or more frequent rate changes that are prohibited by Act 129. As noted in the OCA's revised changes to proposed subsection 54.187(i), above, Act 129 prohibits a DSP from changing rates more frequently than quarterly, but does not prohibit a DSP from offering more stable rates.

The OCA proposes the following modifications to this subsection:

(f) A DSP shall submit tariff supplements on a no more frequent than quarterly ~~or more frequent~~ basis, consistent with § 54.187(h) and (i) (pertaining to default service rate design and recovery of reasonable costs), to revise default service rates to ensure the recovery of costs reasonably incurred in acquiring electricity. The DSP shall provide written notice to the named parties identified in § 54.185(b) of the proposed rates at the time of the tariff filings. The tariff supplements shall be posted to the DSP's public internet domain at the time they are filed with the Commission. A customer or the parties identified in § 54.185(b) may file exceptions to the default service tariffs within 20 days of the date the tariffs are filed with the Commission. The exceptions shall be limited to whether the DSP has properly implemented the procurement plan approved by the Commission and accurately calculated the rates. The DSP shall post the revised PTC for each customer class within 1 business day of its effective date to its public internet domain to enable customers to make an informed decision about electric generation supply options.

The OCA submits that this change is necessary to comply with Act 129. This proposed modification is consistent with the OCA proposed modification to Subsection 54.187(i).

5. Subsections 54.188(g), 54.188(h) and 54.188(i).

The Commission proposes to incorporate Act 129 sections 2807(e)(4), (5), and (7) into the default service regulations at Subsections 54.188(g), 54.188(h) and 54.188(i), respectively. The OCA submits that the Commission's modifications to this subsection are appropriate.

J. Section 54.189. Default service customers.

The Commission does not propose any changes to this section. The OCA submits that no changes are needed.

IV. CONCLUSION

The OCA appreciates this opportunity to submit Comments on these proposed regulations. The OCA looks forward to working with the Commission to develop default service provisions that benefit Pennsylvania consumers and that are consistent with the principles of Act 129 and the Electricity Generation Customer Choice and Competition Act.

Respectfully Submitted,



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