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June 16, 2010

Via Overnight Mail

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

RECEIVED

JUN 16 2010

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: **Reply Comments of PECO Energy Company on Proposed Amendments
to the Commission's Default Service Regulations –
Docket Nos. L-2009-2095604 and M-2009-2140580**

Dear Secretary Chiavetta:

Enclosed for filing are the original and fifteen (15) copies of the Reply Comments of PECO Energy Company on Proposed Amendments to the Commission's Default Service Regulations in the above-captioned dockets.

Pursuant to Paragraph 6 of the Commission's Order, we have also forwarded an electronic copy to Elizabeth Barnes, Assistant Counsel, Law Bureau.

Kindly return a time-stamped copy of this cover letter in the self-addressed stamped enveloped that is enclosed. Do not hesitate to contact me at 215-841-5974 should you have any questions regarding this filing.

Very truly yours,



Jeanne J. Dworetzky
Assistant General Counsel

JJD/adz
Enclosures

cc: Elizabeth Barnes, Law Bureau (ebarnes@state.pa.us)

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JUN 16 2010

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

IMPLEMENTATION OF ACT 129 OF
OCTOBER 15, 2008; DEFAULT
SERVICE

:
:
:

DOCKET NO. L-2009-2095604

PROPOSED POLICY STATEMENT
REGARDING DEFAULT SERVICE
AND RETAIL ELECTRIC MARKETS

:
:
:
:

DOCKET NO. M-2009-2140580

REPLY COMMENTS OF PECO ENERGY COMPANY
ON PROPOSED AMENDMENTS
TO THE COMMISSION'S DEFAULT SERVICE REGULATIONS

Pursuant to the Notice of Proposed Rulemaking Order (the "Rulemaking Order") entered by the Pennsylvania Public Utility Commission (the "Commission") in the above-captioned docket on January 14, 2010, PECO Energy Company ("PECO" or the "Company") hereby submits its Reply Comments to the Initial Comments filed in response to the Rulemaking Order.¹

Consistent with its Initial Comments, PECO first addresses the comments filed by other parties in response to the Commission's proposed amendments to the default service regulations, 52 Pa. Code §§ 54.181 *et seq.* ("Default Service Regulations"). The Company thereafter addresses the additional comments filed in response to the sixteen questions set forth in the

¹ Initial comments were filed by PECO and the following entities: the Office of Consumer Advocate ("OCA"); Office of Small Business Advocate ("OSBA"); PPL Electric Utilities ("PPL Electric"); Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company ("FirstEnergy Utilities"); Allegheny Power ("Allegheny Power"); Duquesne Light ("Duquesne Light"); Citizens' and Wellsboro Electric Companies ("Citizens/Wellsboro"); Industrial Energy Consumers of Pennsylvania ("Industrial Consumers Group"); Retail Energy Supply Association ("RESA"); PPL EnergyPlus ("PPL EnergyPlus"); Exelon Generation Company and Exelon Energy Company ("Exelon Generation"); PJM Power Providers Group ("PJM Power"); Citizen Power ("Citizen Power"); and the National Energy Marketers Association ("NEMA").

Rulemaking Order regarding the interpretation of certain provisions of Act 129 of 2008 (“Act 129” or “the Act”).

**I. SPECIFIC COMMENTS ON PROPOSED AMENDMENTS TO
DEFAULT SERVICE REGULATIONS IN THE RULEMAKING ORDER**

1. 52 Pa. Code § 54.181 (Purpose)

In the section of the Default Service Regulations describing their purpose, both the OCA and OSBA commented that “prevailing market prices” should be replaced by “least cost to customers over time” to reflect Act 129’s amendments to Section 2807 of the Public Utility Code.

PECO believes the Commission acted appropriately in retaining the concept of “prevailing market price” in the Default Service Regulations. In light of Act 129, PECO understands “prevailing market prices” to refer to (i) the price of generation competitively procured in accordance with an approved procurement plan; and (ii) in the case of contingency procurements prior to approval of a contingency plan, the price of generation purchased in PJM energy markets. PECO therefore does not believe that the “prevailing market prices” concept is inconsistent with Act 129 or that it should be removed completely from this or other sections of the Default Service Regulations. If, however, the Commission does determine that it is appropriate to replace “prevailing market prices” with “least cost to customers over time,” the Commission should make clear that “least cost to customers over time” will be construed as part of the requirements of a “prudent mix” of contracts, *see* 66 Pa. C.S. § 2807(e)(3.4), and not independently of the statutory framework of Act 129.

2. 52 Pa. Code § 54.182 (Definitions)

The OCA supported the Commission’s proposed modification to “default service provider” (“DSP”) and addition of “bilateral contract” in order to match definitions provided in

Act 129. Duquesne Light also expressed support for these modifications, but commented that for thoroughness and clarity, the actual substance of definitions for “default service provider” and “bilateral contract” should be recited. The OCA further suggested that the definition of “prevailing market price” be removed. Finally, Citizens/Wellsboro commented that the Commission should specifically confirm that a bilateral contract may be used for physical or financial transactions.

PECO agrees with some but not all of these comments. First, for reasons described in Section 1, the Company does not agree with the OCA proposal to remove the “prevailing market prices” concept from the Default Service Regulations. However, PECO agrees that reciting the “default service provider” and “bilateral contract” definitions in the Regulations would provide additional clarity and that the Commission should confirm that the definition of bilateral contracts encompasses both physical and financial transactions.

3. 52 Pa. Code § 54.183 (Default Service Provider)

The OCA agreed with the Commission that no changes were needed for this section of Default Service Regulations. Duquesne Light commented that, in light of the revision to definition of “default service provider,” the Commission may want to consider revising 54.183(a) to correspond with the new definition.

PECO agrees with the OCA that no changes are necessary for this section of the Default Service Regulations. PECO does not agree with Duquesne Light that modifications should be made to 54.183(a) in light of the new definition of “default service provider” since the existing provision is consistent with the Commission’s proposed definition of “default service provider.”

4. 52 Pa. Code § 54.184 (Default Service Provider Obligations)

The OCA and Duquesne Light both expressed support for the Commission’s proposed amendments. The OSBA commented that the addition of a reference to Act 129 in 54.184(d) is

redundant because the mandate for energy efficiency programs is part of the Competition Act. Citizens/Wellsboro proposed that an additional type of competitive procurement process should be recognized – namely, purchases of products in the markets and auctions operated by the applicable regional transmission organization (“RTO”).

Three parties who submitted additional specific comments – PPL Electric, Allegheny Power, and RESA – addressed the allocation of DSP obligations in the event that an alternative DSP is selected or an EDC fails to meet particular statutory obligations. PPL Electric first noted that subsection (d) states the Commission will determine the allocation of universal service and energy conservation responsibilities between an EDC and an alternative DSP when an EDC is relieved of its DSP obligation. PPL Electric commented that it believes that very few, if any, of those obligations should remain with the incumbent EDC. Allegheny Power also commented that subsection (d) assumes that energy conservation programs are always the responsibility of the DSP, which does not hold true in circumstances where an EDC fails to achieve energy efficiency and conservation reductions and the Commission decides to contract with a conservation service provider.

RESA’s comments were focused on subsection (a), proposing that the Commission’s new language be deleted or clarified to acknowledge that other entities may be assigned the DSP role. RESA explained that if the Commission wishes to adopt a benchmark level of migration for determining when it may be appropriate to phase out default service or assign the default service obligation to another entity, RESA believes that a 100% migration level is unreasonable. If the Commission is unwilling to delete the addition, RESA recommended that the “100%” language be replaced with: “until the Commission determines that it is no longer necessary to have a

default service option, or until the Commission determines that it is appropriate to assign the default service obligation to another entity.”

PECO agrees with some but not all of these comments. PECO agrees with the OSBA that the new reference to Act 129 in 54.184(d) is redundant and also agrees with Citizens/Wellsboro that it is appropriate to recognize purchases of products in the markets and auctions operated by the applicable RTO as an additional type of competitive procurement process.

With regard to the comments by PPL Electric and Allegheny Power concerning the allocation of EDC and DSP obligations in the event that an alternative DSP is selected, PECO believes that the Commission should consider the appropriate allocation on a case-by-case basis as part of the reassignment procedure detailed in § 54.183. Finally, PECO disagrees with RESA’s proposed change to subsection (a). The Company agrees with the Commission that an EDC maintains the responsibility for default service until 100% of that EDC’s customers have electric choice or until the Commission has reassigned the default service obligation in accordance with the process detailed in § 54.183.

5. 52 Pa. Code § 54.185 (Default Service Programs and Periods of Service)

The OCA, PPL, and Duquesne Light expressed support for the Commission’s proposed amendments. RESA proposed the following addition to 54.185(b), to be inserted after the language regarding holding hearings: “to ensure that the plan is reasonably likely to promote sustainable retail market development by resulting in market-reflective and market-responsive default service rates and including all the costs of provisioning default service in the default service rate.” RESA also commented that a Default Service Plan should be deemed least cost “provided that consumers have competitive retail alternatives to default service.”

PECO disagrees with RESA's proposals as they would improperly modify the statutory standard against which default service plans would be evaluated. Section 2807(e)(3.4) of Act 129 provides that a DSP's prudent mix of default service supply contracts shall be designed to ensure adequate and reliable service at the least cost to customers over time. The phrase "least cost to customers over time" is not itself defined in the Act, but the Act does provide that "[c]osts incurred through an approved competitive procurement plan shall be deemed to be the least cost over time as required under paragraph (3.4)(ii)." 66 Pa. C.S. § 2807(e)(3.6). By inserting language requiring findings of "market-reflective" and "market-responsive" rates as well as "competitive retail alternatives" in order for a plan to be approved and cost recovery granted, RESA's proposal is plainly inconsistent with Act 129.

6. 52 Pa. Code § 54.186 (Default Service Procurement and Implementation Plans)

For clarity and organization, PECO has broken down this section into subparts. To the extent not addressed below or in its Initial Comments, PECO agrees with the Commission's proposed amendments.

a. § 54.186(a)

Both the OCA and Duquesne Light commented that "prevailing market prices" should be replaced by the "least cost" standard to reflect Act 129's changes to the goals of the default service. For the reasons described in Section 1, the Company does not agree that is necessary to remove the "prevailing market prices" concept from the Default Service Regulations.

b. § 54.186(b)

The OCA and OSBA both made proposals with respect to 54.186(b)(2)(iii). The OCA proposed that the reference to subparagraph b(1)(iii) be replaced with "§ 54.184(c)" in order to reference the requirements for competitive procurement. The OSBA proposed that the reference

to subparagraph (b)(1)(iii) be replaced with “(b)(1)” as (b)(1)(iii) only relates to long-term contracts. PECO supports the OCA proposal because it would be most appropriate to cite to the competitive procurement requirement in 54.184(c) when discussing the design of a prudent mix of contracts.

The OSBA made two additional comments on this subsection. First, for 54.186(b)(5), the OSBA noted that the language was unclear as to whether the requirement for competitive procurement applies to each of the possible products itemized in (b)(5). Second, for 54.186(b)(1)(iii), the OSBA proposed adding language that the Commission hold a hearing before determining that long-term contracts may constitute more than 25% of default service load in order to be consistent with 66 Pa. C.S. § 2807(e)(3.2). PECO agrees with both OSBA comments. The language in (b)(5) should be revised to clearly indicate that all products itemized should be acquired through competitive processes and the long-term contracts discussion in (b)(1)(iii) should include the hearing requirement which is set forth in Act 129.

Both the Industrial Customer Groups and Citizens/Wellsboro commented that the provision allowing a DSP to offer a negotiated rate to large customers (54.186(b)(1)(iii)(A)) may be better situated in proposed Section 54.187, which addresses issues of rate design and cost recovery. Citizens/Wellsboro also commented that in 54.186(b)(1)(iii), the Commission should define “long-term contract” to include a contract “of at least four years but not longer than 20 years.” PECO agrees that Section 54.187 is a preferable location for the provision addressing negotiated rates for large customers. PECO does not agree with the definition for “long-term contract” proposed by Citizens/Wellsboro as it is inconsistent with Act 129. The Act states that long-term contracts are those of **more than** four and not more than twenty years. *See* 66 Pa. C.S. § 2807(e)(3.2)(iii) (emphasis added).

c. § 54.186(d)

In addition to earlier proposals with respect to “prevailing market prices” and “least cost over time” discussed *supra*, the OCA submits that the monitoring of wholesale markets by a DSP required by 54 Pa. C.S. § 54.186(d) to ensure that a procurement plan continues to reflect the incurrence of reasonable costs “will best be implemented by a portfolio manager.” OCA Comments, p. 36. As discussed *infra* in response to Question Nos. 1 and 5, Act 129 does not mandate a particular procurement strategy, and OCA has offered no basis to conclude that a DSP using a procurement strategy other than a managed portfolio approach is unable to properly monitor wholesale markets for purposes of determining whether to propose amendments to its default service procurement plan.

7. **52 Pa. Code § 54.187 (Default Service Rate Design and the Recovery of Reasonable Costs)**

To the extent not addressed below or in its Initial Comments, PECO agrees with the Commission’s proposed amendments.

Both the OCA and Duquesne Light commented in this section that “prevailing market prices” should be replaced by “the least cost to customers over time” to reflect Act 129’s changes to the goals of the default service. For the reasons described in Section 1, the Company does not agree that is appropriate to remove the “prevailing market prices” concept from the Default Service Regulations.

8. **52 Pa. Code § 54.188 (Commission review of default service programs and rates)**

PECO agrees with the Commission’s proposed amendments, as set forth in its Initial Comments.

II. RESPONSES TO RULEMAKING ORDER QUESTIONS

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

In its Initial Comments, PECO emphasized that the “least cost to customers over time” standard is not a “one-dimensional” test and the Commission must consider a variety of factors to determine whether a proposed procurement plan is consistent with Act 129’s requirements of a “prudent mix” of default service supply. These factors include the degree to which a plan includes appropriate protection to default service customers from risks that could impact the cost of generation over time and takes into account the benefits of price stability. The Commission’s determination as to whether a plan is compliant with “least cost” requirements is also an individualized, fact-based assessment that considers the specific needs of a DSP’s customers and service territory. *See* PECO Comments, pp. 4-6.

Most of the Initial Comments reflect broad agreement with this understanding of “least cost.” However, several parties suggest additional requirements or interpretations of “least cost” which PECO believes are not consistent with Act 129 and should not be adopted by the Commission in revising the Regulations.

First, PECO does not agree with RESA and other parties who assert that a default service procurement plan should only be approved as “least cost” if it will result in default service rates that are “as close as possible to the market price of energy.” *See* RESA Comments, p. 15; *see also* NEMA Comments, p. 4 (advocating a “monthly-adjusted, market-based commodity rate” for small commercial and residential customers). In fact, Act 129’s statutory provisions make clear that a “prudent mix” of supply contracts can potentially include a range of spot market-priced supply, short-term contracts of less than four years in length, and long-term contracts of more than four years. *See* 66 Pa. C.S. § 2807.3(e)(3.2). Such a “market price” requirement

would also conflict with Act 129's objective of achieving "least cost" default supply that takes into account the benefits of price stability.² Price stability benefits are very important to some customer groups, so an interpretation of "least cost" that mandates subjecting all default service customers to significant price volatility through general reliance on short-term market pricing would be inconsistent with both Act 129's objectives and plain statutory text.

More broadly, Act 129 does not require default service plans to be structured to promote retail competition to achieve an "end state" goal where customers receive little to no generation services from a DSP. *Cf.* RESA, p. 9. Act 129 built upon the statutory framework of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801 *et seq.* (the "Competition Act"), to continue to require DSPs to regularly propose procurement plans for Commission review, and directs the Commission to ensure that each plan includes "prudent steps necessary to obtain least cost generation" for default service customers. 66 Pa. C.S. § 2807(e)(3.7). However, PECO does not believe that procurement of default service supply "at least cost over time" must necessarily result in a diminished commitment to retail competition as the OSBA suggests;³ instead, the individualized review of each procurement plan provides both DSPs and the Commission flexibility to develop plans that appropriately address the needs of default service customers while also enhancing retail competition.⁴

² See Act 129 (Preamble).

³ See OSBA Comments, pp. 11-14 (discussing Commission approval of accelerated procurement by West Penn Power Company during period of low market prices and subsequent potential for inhibition of residential shopping).

⁴ PECO also does not agree with RESA's contention that the definition of "least cost over time" also means that all costs related to the provisioning of default service must be recovered in the default service rate. See RESA Comments, p. 16. To the extent that the Competition Act requires unbundling of default service charges, those requirements are better addressed through ratemaking processes than by layering additional meaning into "least cost," which is a

Second, PECO believes it is important for the Commission to affirm that a procurement plan based upon full requirements contracts is consistent with “least cost” standards. In its comments, the OCA asserts that Act 129 imposes an “affirmative obligation” on DSPs to “assess which products will produce the lowest costs to customers.” OCA Comments, p. 6. While the OCA acknowledges that default service rates may be higher or lower than market prices, PECO believes it is important to recognize that “least cost” also does not mean the lowest expected price for default service generation supply during the term of a default service plan. As PECO explained in its Initial Comments, some products (such as fixed-price, full requirements contracts) that provide price stability and other benefits for customers are often designed to protect customers from risks that could increase price levels. The fact that prices do not increase during a particular time period does not mean that it was not valuable to procure such contracts to have protection in place against these risks. *See* PECO Comments, pp. 7-8.

Finally, the Commission should confirm that “least cost” does not mandate a particular procurement strategy in light of OCA’s suggestion that a portfolio approach will allow a DSP to “capture the comprehensive benefits of Act 129”, including benefits associated with smart meter and energy efficiency programs. *See* OCA Comments, p. 7. Nothing in Act 129 requires a DSP to undertake portfolio management or supports a conclusion that energy efficiency, time-of-use rates, and smart meter benefits cannot be realized through a variety of procurement strategies, including full requirements contracts where suppliers are able to consider a DSP’s energy efficiency, time-of-use, and smart meter programs and accordingly compete to provide supply products at the lowest price.

characteristic of the “prudent mix” of default service supply contracts. *See* 66 Pa. C.S. § 2807(e)(3.4).

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

PECO proposed that the Commission should evaluate procurement plans based upon the proposed length of the procurement plan, with consideration of laddered contracts or other contracts extending beyond the term of a plan to the extent such contracts may affect future default service plans. Plans should be evaluated when submitted on an "ex ante" basis, and Act 129 clearly does not envision an ex-post, "after the fact" review. *See* PECO Comments, p. 7.

Other parties generally agree with this approach, or suggest that the only proper consideration is whether the procurement plan will obtain competitively-priced supply, but some parties recommend a fixed, long-term period ranging from five to twenty years.⁵ PECO disagrees with the recommendations for a fixed long-term evaluation period, as such a requirement will unduly constrict the Commission's review of procurement plans and potentially result in erroneous results given the unavailability of long-term reliable pricing information to accurately determine whether a particular contract will be "least cost over time."

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?

Consistent with its Initial Comments, PECO maintains that no provisions in the Default Service Regulations are necessary to ensure the construction of needed generation capacity in Pennsylvania, either directly by EDCs or DSPs or indirectly through mandating procurement of *long-term contracts*.

This basic position is supported by the overwhelming majority of parties to this

⁵ *See* Citizen Power Comments, p. 2 (recommending evaluation period of 20 years); Citizens/Wellsboro Comments, p. 5 (recommending evaluation period of no less than five years).

proceeding, and only the OCA, the Industrials, and Citizen Power submitted Initial Comments supporting mandating new generation (directly or indirectly) through new default service regulations.⁶ Such regulations would contravene the overriding public policy of the Competition Act, which was not altered by Act 129, in favor of using market forces to control the cost of generation and shift risks from consumers to generation owners. *See* 66 Pa.C.S. § 2802(6) (providing that “[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity”).

PECO generally agrees with the comments of Exelon Generation in response to this Question, especially with regard to the benefits of being a part of the regional transmission organization operated by PJM Interconnection, L.L.C. (“PJM”). PECO also observes that attempts to ensure the construction of new generation in Pennsylvania through long-term contracts would result in increased risks being borne by retail customers. Past experience shows that long-term contracts increase the risk that retail rates will be well above future market price levels, potentially for long periods of time.⁷ In addition, bidders for such contracts (as well as regulators approving such contracts) face significant uncertainty due to the lack of transparent market prices for longer-term generation and delivery, as well as significant collateral

⁶ *See* OCA Comments, pp. 9-10; Industrial Consumer Group Comments, p. 3; Citizen Power, p. 4.

⁷ For example, the California Department of Water Resources in early 2001 signed ten-year contracts to purchase power worth approximately \$43 billion. Futures prices hovered in the range of \$350-\$550 per MWh during the time that the contracts were negotiated, but by August 2001, futures prices had dropped below \$100 per MWh. Thus, the state has been obligated to pay rates well above market prices for a long period of time. *See* Electric Energy Market Competition Task Force, Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy (April 5, 2007), p. 90.

PECO notes that the risks associated with long-term contracts can also be seen in the market price drops that occurred in the summer of 2008. Had long-term contracts been procured in early 2008 with regulatory guarantees backed by revenues from ratepayers, the people of Pennsylvania would now be saddled with large amounts of above-market costs.

requirements necessary to protect customers from financial exposure associated with supplier default (and long-term contracts may increase the likelihood of supplier default), and such uncertainty and collateral requirements would be reflected in supplier bids. Additionally, long-term contracts that are for fixed volumes of supply or that are tied to specific generating resources magnify risks associated with above-market costs being levied on a decreasing base of retained default service customers. Finally, long-term contracts tied to specific generating resources may include additional risks associated with plant outages, specific fuel costs, certain technologies, development delays, and other risks that are unique to a particular plant.

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

As PECO stated in its Initial Comments, and as set forth in its Reply Comments to Question No 3, PECO does not believe the Commission should adopt any additional provisions in the Default Service Regulations to ensure the construction of generation capacity.

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?

PECO maintains that the Commission should ensure that a full requirements product procurement approach remains an option for DSPs in designing future default service plans in order to best ensure the least cost to customers over time. As described in PECO's Initial Comments, the Commission has regularly approved the use of full requirements contracts for default service supply, and the Initial Comments of parties in this proceeding reflect support for such contracts by other DSPs, customer advocates, retail suppliers, and wholesale suppliers. Furthermore, as described in PECO's response to Question No. 1, *supra*, full requirements contracts provide price stability benefits and significant protection to default service customers

from risks that could impact the cost of generation, and full requirements suppliers can also incorporate a DSP's energy efficiency, time-of-use, and smart meter programs in bidding to provide supply products at the lowest price.

No party has introduced any compelling evidence why the Commission should change direction and limit consideration of full requirements product procurement approaches going forward. In its Initial Comments, the OCA offers information from recent default service supply procurements in Pennsylvania, Illinois, and New Jersey to support its belief that the managed portfolio approach is superior to the full requirements approach, but this information is unpersuasive for several reasons.

In Pennsylvania, the OCA points to the following results:

- A procurement of 25 MW round-the-clock blocks of power by PPL Electric for delivery between January 2011 and February 2012 averaging \$46.49 per MWh, in comparison to full requirements contracts for the same period priced at \$74.82 per MWh.
- A procurement of block energy products by PECO in Spring and Fall 2009 averaging \$61.74 per MWh, in comparison to full requirements procurements by PECO in Spring and Fall 2009 which averaged \$88.61 per MWh and \$79.96 per MWh, respectively.
- A procurement in early 2010 of a four-year block product (June 2011-May 2015) by Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec") priced at \$59.77 per MWh and \$54.38 per MWh respectively, in comparison to full requirements average price results of \$77.76 per MWh for Met-Ed and \$64.34 per MWh for Penelec for delivery between January and May 2011.

The OCA concedes that "comparisons of block and full requirements products cannot be made on an 'apples to apples' basis" due to the fact that block purchases do not include all of the product attributes required for default service supply and do not reflect all costs to consumers, and that prices will vary based upon timing of purchases, delivery locations, and ratemaking

differences. *See id.* at 15. The OCA's concession is entirely proper but is fatal to its argument: the block and full requirements procurements are for entirely different products at different times and with different characteristics,⁸ and the simple fact of a lower price for the less complex and comprehensive block product provides no basis for the OCA to conclude that "the use of a broader portfolio of products has had a positive impact on procurements done to date in Pennsylvania." *Id.* at 13.

OCA's reliance on procurement results in Illinois and New Jersey is also misplaced. In its Initial Comments, the OCA points to testimony by OCA witness Matthew I. Kahal in the recent Met-Ed/Penelec default service proceeding in which Mr. Kahal observes that residential bills for customers of Commonwealth Edison ("ComEd") (which are based on blended supply procurement costs, including the costs of full requirements contracts procured in 2006) were forecasted to be reduced by 7.5% following a 2009 block energy procurement by the Illinois Power Agency. Contrary to the OCA's claims,⁹ this information is simply a reflection of the fact that Northern Illinois wholesale energy prices declined significantly between the time that the previous supply was procured and the time of this solicitation for supply, and is not evidence that

⁸ While a block energy product involves the delivery of a constant amount of energy over a given time period, a fixed-price full requirements product is a much more complex product that covers many more costs and risks for customers. For example, a fixed-price full requirements product obligates the seller to provide capacity and ancillary services, and to satisfy AEPS requirements. It also involves the obligation to serve the hourly load shapes of customers, which are likely to involve higher demands during higher price periods (e.g., summer on-peak hours are generally associated with higher hourly market prices and loads than non-summer off-peak hours). In addition, fixed-price full requirements products obligate the seller to bear expected costs associated with customer migration, price and load uncertainty and correlations, regulatory risks, administrative and legal requirements, and other obligations. Furthermore, the OCA's quoted price for the PPL full requirements product has been adjusted upward to include line losses and gross receipt taxes, while the quoted PPL block product price does not include these cost components.

⁹ On page 15 of its Comments, the OCA states, "*As a result of the Illinois Power Agency block purchasing strategy, rates have been reduced for residential customers.*" (emphasis added)

a managed portfolio approach is lower cost than a full requirements product approach. This fact is made plainly clear in the press release that is the source of the 7.5% estimated residential bill reduction to which the OCA's witness refers,¹⁰ and available information regarding Northern Illinois wholesale energy prices also indicates this.¹¹

Similarly, OCA provides no basis for the relevance of the lack of reduction in residential bills in New Jersey following a recent statewide full requirements procurement when compared to the results of the Illinois block energy procurement, and there are at least three reasons why such a comparison is irrelevant. First, supply procurements in the two regions occurred at different times and covered different delivery periods. Second, there are significant differences in the market conditions in the two regions, for example with respect to wholesale market price changes over time, the fuel types of generating units that set the market clearing prices, transmission constraints, etc. Third, the implementation of PJM's Reliability Pricing Model resulted in higher capacity prices in New Jersey than in Illinois.

In sum, PECO maintains that the Commission should ensure that a full requirements product procurement approach remains an option for DSPs in designing in future default service

¹⁰ See https://www.comed.com/sites/newsroom/News%20Room/newsroomreleases_05012009.aspx.

¹¹ On the date of the ComEd block energy supply solicitation referenced by Mr. Kahal, April 29, 2009, the NYMEX futures price for 2010 delivery to Northern Illinois was about \$32/MWH. Yet, on the date of the solicitation of the previous full requirements supply, September 8, 2006, the NYMEX futures price for 2009 delivery to Northern Illinois was about \$49/MWH. (Sufficient futures price information was not available for 2010 delivery on September 8, 2006.) Furthermore, it should be noted that the April 29, 2009, solicitation for block energy supply was not a simple example of supply rates changing when block energy supply replaced full requirements supply, because some of the supply that was replaced was other block energy supply that was previously procured. Specifically, the replaced supply included block energy supply procured on March 5, 2008, when the NYMEX futures prices for annual delivery to Northern Illinois were well over \$50/MWH.

plans, in order to best ensure the least cost to customers over time.¹²

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

Consistent with PECO’s Initial Comments, most parties agree that a “prudent mix” of spot market pricing, short-term contracts, and long-term contracts is appropriately addressed on a case-by-case basis and evaluated through consideration of a DSP’s service territory and customer class characteristics, including preferences for price stability.¹³ RESA agrees that a “prudent mix” of contracts will look different for each service territory and customer class but must be designed to achieve an “end state” where all customers are receiving generation service from the competitive market which, as discussed previously, is not mandated by Act 129. See Response to Question No. 1, *supra*.¹⁴

¹² While the OSBA suggests that the Commission will have sufficient data from current procurement plans to “help determine whether one procurement methodology consistently outperforms the other,” the OSBA also acknowledges that it is “perilous” to assume that there will be no major changes in market prices during the term of a default service plan and the portfolio approach does not avoid these risks but shifts those risks from suppliers to customers. OSBA Comments, pp. 20 & 23. Given this basic difference between the full requirements and managed portfolio approaches and the wide variety of possible market outcomes that may or may not occur during the terms of existing plans, PECO does not believe that an after-the-fact look at the results of current procurement plans should form a basis for determining whether either approach “consistently outperforms.”

¹³ See, e.g., OCA Comments, p. 20 (stating that “prudent mix of contracts would vary from DSP to DSP and vary depending on market conditions”); PPL Electric Comments, p. 10 (stating that there are “an infinite number of procurement plans that can be considered a ‘prudent mix’” and a DSP should have discretion to propose a mix of contracts that it believes is appropriate based on the characteristics of all default service customers); Constellation Comments, p. 31 (stating that “Act 129 appropriately provides discretion to the Commission, EDCs, and interested parties to review characteristics of each individual customer class of each separate EDC” to determine a “prudent mix”); FirstEnergy Utilities Comments, pp. 7-8 (suggesting that it may not be prudent to enter into a long-term product to serve any customer classes).

¹⁴ On page 32 (n.66) of its Comments, RESA references a report commissioned by Direct Energy Services, LLC (“Direct Energy”), which attempted to compare spot market pricing to Duquesne Light tariff prices over a specified historical period. (See Intelometry Inc., Power Price Report, Pittsburgh Market (Duquesne Light) 1/1/05 through 11/30/06, December 2006.) With respect to

Some parties suggest that a “prudent mix” must include some minimum combination of spot market pricing or short- or long-term contracts.¹⁵ PECO disagrees with these suggestions, and does not believe the Commission should adopt a restrictive understanding of “prudent mix.” Such an interpretation would reduce the flexibility of both DSPs and the Commission to be able to implement procurement plans that not only take into account different DSP and customer characteristics but are also able to change as wholesale and retail markets evolve. *See* PECO Comments, pp. 13-14. Proposals for “minimum” combinations of contracts are best considered as part of the evaluation of each DSP plan instead of mandated through statutory interpretation.

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

In its Initial Comments, PECO emphasized that diversity and accumulation of contracts alone does not ensure that a particular set of contracts will constitute a “prudent mix.” Some parties, however, advocated particular diversification and accumulation strategies.¹⁶ PECO does

this report, PECO reiterates points that it made on pages 7-8 of its Comments in this proceeding. Specifically, supply products that provide price stability, such as full requirements contracts, are often designed to protect customers from risks that could increase price levels; these price stability benefits are not captured in an after-the-fact analysis like the report commissioned by Direct Energy, which focuses on the actual market outcome instead of all of the market scenarios that could have occurred. On page 33 of its Comments, RESA affirms the uncertainty of future market prices when it states, “Predicting whether any particular procurement design will produce higher or lower rates compared to another is impossible because one cannot predict future market prices and conditions.”

¹⁵ *See* Industrial Consumers Group Comments, p. 4 (requiring minimum of two types of products); Citizen Power, p. 5 (responding to Question No. 10, suggesting a statutory implication that all three types of product lengths should be employed by DSPs); Citizens/Wellsboro Comments, p. 7 (responding to Question No. 10, suggesting a minimum of two types of product lengths should be employed). PPL EnergyPlus and Allegheny Power recommend particular mixes of contracts but do not propose that those recommendations be required. *See* Allegheny Power Comments, p. 6; PPL EnergyPlus Comments, p. 6.

¹⁶ *See, e.g.*, OSBA Comments, p. 25 (advocating continuing requirement that DSPs conduct multiple procurements to procure supply for the same delivery period); OCA Comments, p. 21 (strongly supporting diversification of products as part of portfolio approach to default service

not believe that the Commission should mandate any general contract diversification or accumulation strategy as part of a “prudent mix” but consider the degree of diversity and accumulation of contracts as part of its overall evaluation of a procurement plan.¹⁷

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?

Most parties opposed any specific qualified parameters on the “prudent mix.”¹⁸ PECO agrees that no qualified parameters should be imposed, and that the details and parameters of a procurement plan should be addressed and evaluated on a case-by-case basis. *See* PECO Initial Comments, p. 16.

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

No. *See* PECO’s Initial Comments and responses to Questions No. 6 and 7, *supra*.

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?

No. *See* PECO’s Initial Comments and responses to Questions No. 6 and 7, *supra*.

supply); Citizen Power Comments, p. 5 (stating that contracts should be diversified and accumulated over time, but DSPs should be able to lock in low rates in periods of over-capacity); PPL EnergyPlus, p. 7 (advocating laddering); RESA Comments, p. 34 (supporting diversification and accumulation only of short-term contracts and commenting on potential adverse effects of laddering).

¹⁷ In addition, consistent with PECO’s Reply Comment to Question No. 6, PECO does not believe that an after-the-fact look at the results of current procurement plans should form a basis for determining whether one degree of contract diversification or accumulation consistently outperforms another. *See supra* p. 17 n. 14.

¹⁸ PPL EnergyPlus suggested a limitation on procurements in a single year, but stated that some situations may exist where it would still be prudent to enter into all of one contract type in that period. *See* PPL EnergyPlus, p. 7.

- 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?**

No. *See* PECO's Initial Comments and responses to Questions No. 6 and 7, *supra*.

- 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?**

No party supported a requirement that DSPs hedge positions with futures contracts.

Consistent with PECO's Initial Comments and the comments of other parties, the Commission should permit, but not require, the use of futures contracts.

- 13. Is the "prudent mix" standard a different standard for each different customer class?**

As stated in PECO's Initial Comments, the "prudent mix" requirement applies to all customer groups but the appropriate default service product mix for one customer group will likely differ from that of another customer group. *See* PECO's Initial Comments and responses to Questions No. 6 and 7, *supra*.

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

Consistent with PECO's Initial Comments, the comments of other parties generally recognized the appropriateness of requiring DSPs to include contingency plans to address potential bankruptcies, the use of PJM markets to competitively procure necessary supplies, and the need for appropriate performance security provisions in wholesale contracts. However, the OCA also suggested that the possibility of bankruptcy supports a DSP portfolio management approach to default service supply because portfolio managers would be better able to address

defaults than DSPs who utilize only full requirements contracts. *See* OCA Comments, p. 29. The OCA offers no data or other information to support its claim, and PECO believes it is without merit in light of the Commission's review and approval of DSP contingency plans to date.

In addition, Citizen Power asserts that losses arising from a supplier default that exceed the contracted cost for supply under the defaulting contract should not be passed on to default customers. *See* Citizen Power Comments, p. 7. Citizen Power cites no authority for this proposition, and the denial of recovery for such costs would be entirely inconsistent with the provisions of Act 129 that ensure DSP recovery of the costs of an approved procurement plan. *See* 66 Pa. C.S. § 2807(e)(3.9). The Commission should therefore reject Citizen Power's proposal.

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?

In its Initial Comments, PECO explained that Act 129 does not allow for an “after-the-fact” review of procurement plan costs except in two specific circumstances: where, after hearing, a DSP is found to be at fault for (1) not complying with the Commission-approved procurement plan; or (2) committed fraud, collusion, or market manipulation with regard to generation supply contracts. *See* 66 Pa. C.S. § 2807(e)(3.8). Nearly all parties agree, but the OSBA asserts that a procurement plan that provides a DSP with substantial discretion in the nature and timing of default service purchases should be subject to an after-the-fact prudence review. OSBA Comments, p. 33; *see also* Citizen Power Comments, p. 7 (stating that Commission should not approve plans with substantial discretion without preliminary Commission approval of procurement decisions).

While the OSBA correctly notes that Section 2807(e)(3.9) provides for the recovery of “reasonable” costs, PECO does not believe that the reference to reasonable costs is intended to create an opportunity for general after-the-fact prudence review in light of the very limited exceptions to cost recovery relating to fraud and collusion that are explicitly set forth in Section 2807(e)(3.8). The Commission should determine as part of the procurement plan approval process whether the level of discretion to be vested in a DSP with respect to procurement decisions is proper. If the Commission believes that the level of discretion is proper, there should be no “second-guessing” of that discretion through additional cost recovery proceedings. Such proceedings could significantly increase the cost of default service supply by creating uncertainty regarding DSP recovery of costs associated with procurement contracts and diminished supplier competition, to the detriment and increased expense of default service customers.

16. How should Section 2807(e)(5)’s requirement that “this section shall apply” to the purchase of AECs be implemented?

In its Initial Comments, PECO explained that Section 2807(e)(5) should be interpreted flexibly to facilitate procurement of alternative energy credits (“AECs”) for compliance with the Alternative Energy Portfolio Standards Act, 73 Pa. C.S. § 1648.1 *et seq.*, through full requirements suppliers as part of default service supply as well as separate long-term, short-term, and spot AEC contracts to ensure “least cost” to customers for AECs. Those parties which addressed this question generally supported (or did not object to) such flexibility for DSPs. PECO believes that it would be appropriate, in light of the developing alternative energy market, to apply Section 2807(e)(5) on a case-by-case basis instead of creating specific requirements in the Default Service Regulations at this time.

III. CONCLUSION

PECO appreciates this opportunity to provide Reply Comments on the Commission's proposed revisions to the Default Service Regulations and Policy Statement Regarding Default Service and Retail Electric Markets and to respond further to the Commission's additional questions on the interpretation of Act 129. PECO looks forward to working with the Commission and other stakeholders as the amendment process moves forward.

Respectfully submitted,



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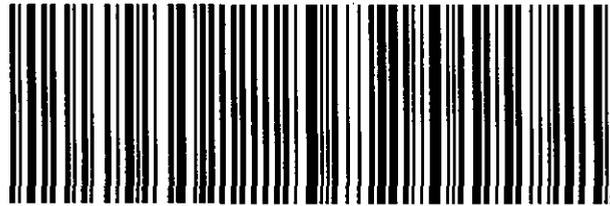
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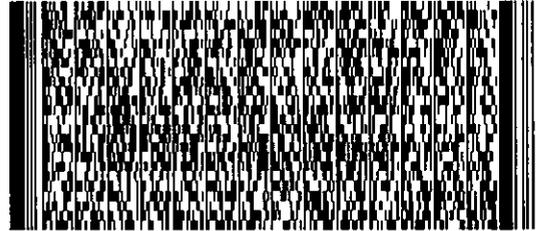
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