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June 3, 2011

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

Re: Investigation of Pennsylvania's Retail Electricity Market
Docket No. I-2011-2237952

Dear Secretary Chiavetta:

On behalf of the Retail Energy Supply Association ("RESA") enclosed please find the original of its Comments along with the electronic filing confirmation page with regard to the above-referenced matter.

Sincerely yours,

Deanne M. O'Dell

Deanne M. O'Dell, Esq.

DMO/lww
Enclosure

cc: ra-OCMO@state.pa.us w/enc.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electric Market	:	Docket No. I-2011-2237952

COMMENTS OF THE RETAIL ENERGY SUPPLY ASSOCIATION

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Date: June 3, 2011

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I. INTRODUCTION

As the Commission correctly notes in its order initiating this proceeding, "in 1996, Pennsylvania emerged as a national leader in electricity policy" with the passage of the Electricity Generation Customer Choice and Competition Act ("Choice Act").[1] The Choice Act was intended to give the Commonwealth's residents and businesses the opportunity to free themselves from their decades long need to rely exclusively on the electric distribution company ("EDC") for their electricity generation service.[2] Instead, the Choice Act envisions consumers receiving their generation from the competitive market through electric generation suppliers ("EGS") such as the members of the Retail Energy Supply Association ("RESA").[3]

The reason for transitioning away from the traditional monopoly supply approach is clear – "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."[4] The legislature implicitly recognized that a well functioning, robust competitive market is the best way to provide the most innovative products and services at the most reasonable prices. Recognizing that breaking the well established monopoly would take time, the Choice Act set forth a transition plan which the Commission has been dutifully implementing for almost a decade and a half now – first through EDC restructuring plans, then

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1 *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952, Order entered April 29, 2011 ("*Investigation Order*") at 1; 66 Pa.C.S. § 2801 et. seq.

2 66 Pa. C.S. § 2806(a).

3 RESA's members include: Champion Energy Services, LLC; ConEdison *Solutions*; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Energetix, Inc.; Energy Plus Holdings, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; MC Squared Energy Services, LLC; Mint Energy, LLC; MXenergy; NextEra Energy Services; Noble Americas Energy Solutions LLC; PPL EnergyPlus, LLC; Reliant Energy Northeast LLC and TriEagle Energy, L.P.. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

4 66 Pa. C.S. § 2802(5).

through the adoption of regulations implementing the Choice Act and, more recently, through the approval of default service plans for the EDCs as well as numerous retail market opening initiatives and rulemakings.

Pennsylvania has made a tremendous amount of progress in implementing the goals of the Choice Act. Today, EGSs including many of RESA's members, are providing service to all types of customers in Pennsylvania. However, the status of retail competitive market development is markedly different across customer classes and EDC service territories. Customer migration levels are substantially higher for the large commercial market where default service is structured as a fully market responsive hourly priced product. On the other hand, in the smaller customer market, where default service is structured as a quarterly adjusted fixed price product based largely on longer term supply contracts, customers have been much slower to switch. To date, only 20.3% of all Pennsylvania service accounts have switched to a competitive supplier and there is a significant portion of the Commonwealth (predominately in Western Pennsylvania) where only the smallest amount of customers have switched and there are very few to no competitors making offers.[5] Now that the generation rate caps – an artificial pricing of generation that bore no relationship to the market price – have been removed for all EDCs the question becomes whether additional actions are needed to realize the "end state" envisioned by the Choice Act which is a market where competitive suppliers – and not the monopoly EDCs – are providing generation service to a significant number of consumers in all customer classes. RESA's answer is unequivocally yes.

For these reasons, RESA enthusiastically supports the Commission's initiative in this proceeding to "to address the status of the current retail market and explore what changes need to

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5 *See* http://www.papowerswitch.com/

be made to allow customers to realize the benefits of competition."[6] As explained further below, there are a number of barriers that currently exist in Pennsylvania which are hampering the development of a fully robust competitive market such as the failure of the EDCs to fully unbundle, the present "default" structure wherein the EDCs automatically provide electric generation service to customers, the over reliance on longer term procurement contracts providing default service to residential and smaller commercial customers, the offering of other retail generation products by the EDCs in addition to default service, the continuation of the billing relationship with the incumbent EDC, and a wide variety of operational barriers preventing competitors from accessing needed information within the control of the EDC to price and offer competitive supply.

RESA urges the Commission to find during Phase I of this investigation that several elements of the current default service structure and retail market design in Pennsylvania are not fulfilling the objectives of the Choice Act for all consumers and must be improved. As discussed in detail below, there are a number of ways to address the current deficiencies to ignite participation by a much more significant number of Pennsylvanians in the retail market. Thus, as part of Phase II of this proceeding, RESA supports a detailed examination of all the changes most likely to effectuate the goals of the Choice Act, including a full analysis of how each of the changes may be implemented.

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6 *Investigation Order* at 2.

II. RESPONSES TO QUESTIONS SET FORTH BY COMMISSION

A. Question No. 1: What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?

The Choice Act permitted EDCs to recover their "stranded costs," i.e. investments in infrastructure made before the law was passed that may have become uneconomic and unrecoverable in a competitive environment. To do this, generation, transmission and distribution rates were capped at 1996 levels. In subsequent years, the market price of energy increased but EDCs were still charging consumers pursuant to the rate cap levels. This stalled the ability of competitors to enter the market because they could not compete with the artificially lower price of generation being assessed by the EDCs.

Prior to January 1, 2010, rate caps were lifted for approximately 15% of Pennsylvania ratepayers (living in the service territories of Citizens, Pike County Power & Light, Wellsboro, UGI, Penn Power, and Duquesne). On January 1, 2010, rate caps were lifted for 25% of all Pennsylvania ratepayers living in the service territory of PPL. On January 1, 2011, the remaining 60% of Pennsylvanians subject to generation rate caps expired (those consumers living in the service territories of PECO, Allegheny, Met-Ed, and Penelec).

Since PPL's generation rate cap expired on January 1, 2010 and with the assistance of various market opening policies adopted by the Commission, the competitive retail market in Pennsylvania has started to develop with more competitors entering the market and more Pennsylvanians receiving their supply from an EGS. Today, all types of customers are enjoying the benefits of competition. In areas where competition has developed the most significantly (mainly the PECO, PPL, and Duquesne service territories) customers have a variety of new product and service offerings available. While the level of savings will vary as the default rate changes, currently, residential customers can save up to 20% off their EDC's default service rate.

Customers have green energy options and at least one supplier is offering a competitive dynamic pricing option to residential customers.

In the commercial and industrial market, customers have a plethora of commodity and energy service products to choose from, including fixed and variable price options, renewable energy options, demand response products and other innovative energy solutions. This Commission, the legislature, consumer advocates, and market participants (including retail and wholesale suppliers and the EDCs) deserve significant credit for working to implement foundational policies to promote the development of retail competition and for fostering greater customer awareness of retail choice. While the initial post-rate cap period has been widely viewed as a success story, the current status of retail competition in Pennsylvania is far from the desired end-state envisioned when the Choice Act was first enacted.

The current status of the retail market can be assessed and analyzed from a variety of perspectives. Two commonly used metrics include customer switching statistics and the number of competitive suppliers and offers available in the market. Below are the Commission's latest statics regarding this:

Weekly PAPowerSwitch :. Update

Pennsylvania Public Utility Commission

www.PAPowerSwitch.com

CUSTOMERS SWITCHING TO AN ELECTRIC GENERATION SUPPLIER

WEDNESDAY, JUNE 1, 2011

Electric Utility	Date Updated	Total Switching Customers			Residential Switching Customers			Commercial Switching Customers			Industrial Switching Customers		
		#	%	% of Load	#	%	% of Load	#	%	% of Load	#	%	% of Load
Duquesne	5/28/11	165,382	28.2	67.68	145,113	27.7	30.37	19,609	31.8	76.35	660	57.0	93.62
Met-Ed	6/1/11	18,088	3.3	38.9	7,293	1.5	1.1	10,069	15.6	37.5	726	49.5	83.5
PECO	5/31/11	309,530	20.0	51.0	245,682	17.0	18.0	61,278	38.0	54.0	2,570	81.0	91.0
Penelec	6/1/11	34,531	5.8	44.3	16,077	3.2	1.1	17,577	21.3	39.8	877	54.0	85.7
Penn Power	6/1/11	31,224	19.5	54.7	26,487	18.8	12.6	4,578	23.3	64.7	159	65.2	96.3
Pike County	5/24/11	3,338	72.0	63.0	2,688	74.0	71.0	647	66.0	56.0	3	43.0	63.0
PPL	5/28/11	549,831	39.1	74.8	470,337	38.3	42.4	76,797	44.2	84.0	2,697	61.2	95.7
UGI	5/28/11	467	0.73	16.02	1	0.0	0.0	404	4.87	29.43	62	32.8	76.34
West Penn Power	6/1/11	34,088	4.8	36.6	15,854	2.6	0.7	18,122	19.1	53.8	112	88.2	64.6
Statewide Total	6/1/11	1,146,479	20.3 *	49.66 **	929,532	18.7	19.69**	209,081	29.4	55.06 **	7,866	59.1	83.31 **

* Percentage based on the total number of customers of regulated electric utilities in Pennsylvania as of 12/31/10. (4,970,057 Residential + 680,045 Commercial/Industrial = 5,650,102 Total Customers).

** Percentage represents megawatt hours currently delivered by alternative suppliers.

From these statistics, there are a few key observations that are important:

- The number of customers receiving service from competitive suppliers is significantly higher in the larger customer market across all jurisdictions.
- The majority of residential customers are remaining on EDC-provided default service in all jurisdictions.
- The number of active suppliers serving the smaller customer market is significantly higher in some areas of the state, and residential customers in some territories have few or no alternatives (MetEd, Penelec, Citizens Electric, Wellsboro, and UGI).

These are indicators that retail competition has not yet reached its full potential in Pennsylvania. As discussed further in subsequent questions, these indicators are also evidence of underlying structural problems inherent with Pennsylvania's current retail market design which assigns the default service role to the incumbent EDC.

According to generally accepted economic theory, effective competition can be measured according to the following basic principles: (1) the presence of many buyers and many sellers; (2) the lack of barriers to entry; (3) free and non-discriminatory access to information, technology and facilities necessary to participate in the market; (4) lack of horizontal and vertical market power or a means to mitigate market power; and, (5) the substitutability of products (i.e. the product is homogenous). While no market can meet the definition of perfect competition, these concepts can be used to evaluate the relative competitiveness of markets, including the market for retail electricity. The Commission has also used these general concepts to measure the competitiveness of the natural gas market in Pennsylvania.

Utilizing these criteria, there are several areas in which the Pennsylvania market cannot be considered fully competitive:

- *Many buyers and* many *sellers:* In some areas of the Commonwealth there are no alternatives to default service in the residential market. In others, there are only a few.
- *Barriers to entry:* Substantial barriers to entry remain as discussed more fully below. These barriers include a strong status quo bias in favor of the incumbent EDC, as well as cost, operational and technical barriers.
- *Information and technology access:* Information access continues to be a challenge because suppliers are dependent on the EDC, which is effectively a competitor in the market, for access to essential data and information, including customer historic and interval usage data, Regional Transmission Organization ("RTO") settlement data, and default service procurement cost information. Additionally most residential suppliers must use utility consolidated billing in order to overcome the natural cost advantages related to billing, collection and customer care infrastructure enjoyed by default service. This also restricts information to market participants because suppliers are unable to build and foster an ongoing, direct customer relationship.

While the progress in Pennsylvania to date is commendable, other states with fully functional competitive retail markets have designed market structures that encourage the development of competition while also ensuring that the default service provider meets requisite standards to serve that function. In Illinois, for example, a "glide path" approach has been used where classes of customers have been declared competitive based on various benchmarks. Upon this declaration, the mandatory fixed-price EDC option for such customer class is terminated. In Texas, the regulated distribution company is no longer a commodity supplier and competitive retail suppliers fulfill the default service role. By further analyzing experiences such as this in Phase II, the Commission can develop an appropriate market structure for Pennsylvania.

B. Question No. 2: Does the existing retail market design in Pennsylvania present barriers that prevent customers from obtaining and suppliers from offering the benefits of a fully workable and competitive retail market? To the extent barriers exist, do they vary by customer class?

Yes as to both questions. As discussed below, the retention of the incumbent EDC as the provider of default service presents structural barriers that impede competitive market development, to varying degrees based on customer class, ultimately preventing customers from achieving the benefits of a fully workable and competitive market. The extent to which barriers exist may vary by customer class. However, the opportunity for additional improvements and ultimately increased customer choice and the associated benefits remains a laudable goal for all consumers in the Commonwealth.

1. <u>Status Quo Bias</u>

The current EDC provided default service model perpetuates a strong status quo bias in favor of the incumbent EDC. Transitioning customers from their historical monopoly provider of generation service to the competitive market represents a very significant paradigm shift in the way customers think about electric generation supply. Under the historically regulated model, customers were accustomed to receiving their electric generation service from the local utility. With passage of the Choice Act and removal of the generation rate caps, now customers can choose to have their generation service provided by a competitive supplier. But despite the existence of many competitive alternative suppliers in markets like PPL and PECO, the majority of customers are remaining on default service provided by the EDC.[7] These customers are currently paying more for their electricity service than necessary and are missing out on innovative, value added products and services. For example, the current Price To Compare ("PTC") for PPL residential customers is $.0877 per kWh and ten EGSs are offering a price that is lower. Despite this, almost 61% of consumers in PPL's service territory continue to receive generation service from PPL.[8]

There are many reasons why customer migration away from EDC provided default service is not greater in these markets where significant choices do exist. These include a lack of appropriate price signals, a lack of awareness and education about electric choice, a resistance to change and fear that new suppliers would provide inferior service, among other things.. However, many of these reasons could stem from what is known as the "status quo bias."

Significant behavioral research has been conducted on the subject of status quo bias in decision making. In an article on this subject written by Professors William Samuelson (Boston University) and Richard Zeckhauser (Harvard University), they .discuss the tendency of individuals to prefer status quo options when faced with new alternatives, such as electing an incumbent, purchasing the same product or brand, staying in the same job, etc.[9] Interestingly, the status quo bias effects increase when individuals are faced with more options to choose from. This status quo bias effect presents a substantial challenge in the context of Pennsylvania's retail

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7 The level of status quo bias is much more significant in the smaller customer market.

8 Weekly PAPowerSwitch Update, June 1, 2011 available at http://www.papowerswitch.com/

9 *See* http://www.hks.harvard.edu/fs/rzeckhau/SQBDM.pdf

market design. The very existence of a "default option" is counterproductive to one of the primary goals of electric restructuring which is to encourage consumers to make an affirmative choice for their electricity supplier. Moreover, establishing the incumbent EDC as the "default service provider" further exacerbates the problem because nothing is changed from the customer's perspective in terms of who is supplying their generation service. This perspective is further reinforced by the customer's identification with the "brand" of the EDC and feelings of loyalty. These two factors further entrench customers with the incumbent perpetuating the status quo bias regardless of whether there are better options available elsewhere. As discussed in more detail below in Section II.F, RESA believes that there are a number of retail market design changes that can be implemented to mitigate or eliminate the current status quo bias, where it may exist, which favors the incumbent EDC.

2. Long Term Procurement Contracts

The current default service procurement and pricing structure for the smaller customer market wherein customers are presented with a fixed price default rate creates barriers to achieving full, sustainable competition by relying too heavily on longer term procurement contracts which can create a "boom or bust" cycle for competitive suppliers and sends incorrect price signals to customers. For the residential and small to medium commercial markets, most existing EDC default service plans rely heavily on longer term procurement contracts ranging from 12 to 29 months. Many of these contracts are entered into significantly in advance of the service period covered by the contract which effectively extends the length of the contracts further. Reliance on longer term, fixed price contracts virtually guarantees that default service rates will be divorced from prevailing market prices and conditions at the time the customers receives default service.

When current market prices are below the prices in the underlying contracts, retail suppliers have an opportunity to "beat" the EDC's default service rate. However, when prices rise above the default service rate, customers have an incentive to return to default service and retail market development is stymied. While this may appear to provide the "best of both worlds" to customers, in the long run, this market design is unsustainable and will not lead to the most economically efficient outcome. Additionally, this market design creates an incentive for EGSs to predominantly compete against the EDC's artificial default service rate rather than driving prices towards the efficient market based outcome. This tendency to offer savings compared to the default service rate limits and distorts the effects of both price and product competition among EGSs, thus preventing customers from receiving the full benefits of an efficient market.

3. Failure to Reflect All Costs in Default Service Rate

The current retail market design wherein default service is provided by the incumbent EDC also presents barriers to competition by failing to fully and accurately reflect all costs in the default service rate that suppliers must compete against, creating a significant cost advantage for default service. The EDC provides both regulated distribution service and generation supply service to customers remaining on default service. While many EDC assets, such as employees, facilities, systems and other infrastructure are used both in the provision of default service and distribution service, the EDCs have not undertaken an extensive cost unbundling review to separate these costs from regulated distribution costs and allocate these costs to default service rates. When a customer calls to inquire about his or her bill, the customer is receiving simultaneously a generation and distribution service. However, all of the costs related to the customer care function are recovered through nonbypassable distribution rates. Similarly, the