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June 3, 2011

Via Hand Delivery

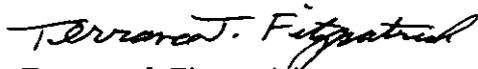
Rosemary Chiavetta, Esq.
Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta,

Enclosed for filing, please find an original and five (5) copies of the Energy Association of Pennsylvania's Comments in the above-referenced Docket Number.

Very truly yours,


Terrance J. Fitzpatrick
President & CEO

cc: Robert F. Powelson, Chairman (via hand-delivery)
John F. Coleman, Jr., Vice Chairman (via hand-delivery)
James H. Cawley, Commissioner (via hand-delivery)
Tyrone J. Christy, Commissioner (via hand-delivery)
Wayne E. Gardner, Commissioner (via hand-delivery)
Office of Competitive Market Oversight (at ra-OCMO@state.pa.us)

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's
Retail Electricity Market

I-2011-2237952

COMMENTS OF THE
ENERGY ASSOCIATION OF PENNSYLVANIA

I. INTRODUCTION

On April 29, 2011, the Commission entered an Order initiating this "Investigation of Pennsylvania's Retail Electricity Market." The Commission first announced its intention to conduct this investigation in its Final Order resolving the First Energy – Allegheny Power merger proceeding.¹ In that proceeding, the Commission rejected a proposal by an intervenor, Direct Energy, to remove the post-merger electric distribution companies (EDCs) from their roles as the default suppliers of electricity to customers who have not chosen an Electric Generation Supplier (EGS). The Energy Association of Pennsylvania (EAP) filed an *amicus curiae*² brief in that proceeding for the purpose of opposing the Direct Energy proposal on procedural and substantive grounds.

The Investigation Order stated that the investigation will consist of two phases, and that the Commission will conduct two *en banc* hearings. The Order also invited comments by June 3, 2011 on eleven questions set out in the Order. These questions focused on a number of issues in the retail electricity market, especially default service and whether EDCs should continue to provide default service.

EAP is a trade association that represents and promotes the interests of electric and natural gas distribution companies operating in the Commonwealth. EAP respectfully submits

¹ Joint Application of West Penn Power Company and FirstEnergy Corp., Docket Nos. A-2010-2176520 and A-2010-217632 (order entered March 8, 2011), p. 46.

² This term is Latin for "friend of the court." Such briefs are filed by those who have an interest in an issue in a proceeding, but who are not formal parties to the proceeding.

these comments on behalf of its EDC members³ in response to the Commission's Investigation Order.

II. GENERAL COMMENTS

A. If done properly, EDCs are not opposed to consideration of alternative models for default service.

All of the EDCs in Pennsylvania are providing default service pursuant to default service plans approved by the Commission. While each plan is different in terms of the procurement strategies being pursued, a strong majority of them follow a model in which the EDC simply passes along and reconciles the actual cost of providing the service. For EDCs following this model, continuing to provide default service is not critical to their long-term business interests. Accordingly, EDCs are not opposed to consideration of different models for default service if these changes are pursued in an open, deliberate, and lawful manner.

Under the predominant model, EDCs do not benefit from default service; however, they do have a great amount of time and resources invested in developing and implementing the current model for default service. EDCs have participated in the Commission's rulemaking and policy statement proceedings regarding default service. They have sought and obtained Commission approval of default service plans, often after administrative litigation on these plans. They have expended resources developing and implementing customer education programs, billing system changes, and purchasing strategies based upon these plans.

EAP believes the current model for providing default service is working reasonably well considering the goals established by the General Assembly for default service. It is providing customers with competitive prices while allowing them an opportunity to shop for lower prices or other features important to them. This model enjoys public acceptance and supports a stable

³ Citizens' Electric Company, Duquesne Light Company; Metropolitan Edison Company (A FirstEnergy Company); PECO Energy Company; Pennsylvania Electric Company (A FirstEnergy Company); Pennsylvania Power Company (A FirstEnergy Company); Pike County Light & Power Company; PPL Electric Utilities Corporation; UGI Utilities, Inc. – Electric Division; Wellsboro Electric Company; and, West Penn Power Company (A FirstEnergy Company).

political and regulatory environment that is conducive to attracting investment. However, EAP does not object to consideration of other default service models if the General Assembly wishes to place more emphasis on encouraging customers to shop for electricity.

B. Pennsylvania's current statutory scheme for default service does not focus exclusively on the goal of maximizing shopping.

In order to understand current public policy regarding default service in Pennsylvania, it is important to review the evolution of this policy since the passage of the Electricity Generation Customer Choice and Competition Act (Competition Act).

It was recognized from the beginning of implementation of the Competition Act⁴ that the terms under which default service are provided are important to the development of retail competition. As originally enacted, the Competition Act provided that if a customer does not choose an EGS, then the EDC or commission-approved alternative supplier "shall acquire electric energy at prevailing market prices to serve that customer."⁵ The Act also provided that the Commission shall adopt regulations at the end of the transition period (the multi-year period during which EDCs were recovering stranded generation costs and during which EDC generation rates were capped) to define the EDC's obligation to acquire electricity for non-shopping customers at the end of the period.⁶

The Commission adopted both regulations and a policy statement governing default service in 2007.⁷ Perhaps the most important issue addressed in these documents was what type of procurement strategy EDCs should pursue in the wholesale electricity market pursuant to the "prevailing market price" standard of the Act. At that time, there was concern that customers might experience large increases in their electricity bills when the generation rate caps expired for most EDCs at the beginning of 2010 and 2011. This was so because of the

⁴ Act 138 of 1996, 66 Pa.C.S. Section 2801 et seq.

⁵ 66 Pa.C.S. Section 2807 (e) (3) (repealed).

⁶ 66 Pa.C.S. Section 2807 (e) (2) (repealed).

⁷ Final Rulemaking Order In Re: Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa.C.S. §2807(e)(2), Commission Docket No. L-00040169 (entered May 10, 2007); and Final Policy Statement Order Re: Default Service and Retail Electric Markets, Docket M-00072009 (entered May 10, 2007).

higher level of wholesale electricity prices at that time, and the experiences of EDCs in other states whose customers experienced significantly higher bills when their rate caps expired.⁸ The Commission addressed many of the procurement strategy issues in the policy statement because a policy statement is a more flexible document, and the Commission recognized that procurement strategies might change over time. Specifically, procurement strategies at the time that rate caps expired should focus more on price stability, while procurement strategies for future default service plans should focus more on development of an active retail market, with default service prices tied more closely to changes in wholesale prices.

The General Assembly amended the default service provisions of the Competition Act in Act 129 of 2008. These amendments reflected concerns about the potential for higher electricity bills when rate caps expired, and made clear that the General Assembly envisioned a regulated model for default service. Procedurally, Act 129 required filing and advance Commission approval of default service plans, and required the Commission to make specific findings in granting such approval.⁹ Substantively, Act 129 repealed the “prevailing market price” standard and required default service providers to purchase a “prudent mix” of spot market purchases, short-term contracts, and long-term contracts to achieve the goals of “adequate and reliable service” and “least cost to customers over time.”¹⁰

While the Commission retains flexibility in determining what constitutes a prudent mix of purchases in light of market conditions, and may consider the impact of a purchasing strategy on the development of retail competition, it is clear from the Act 129 amendments that the General Assembly envisions default service as a regulated service that is designed to do more than just maximize shopping. Also, Act 129 applies to any default supplier, whether an EDC or a Commission-approved alternative default supplier.

⁸ Final Order Re: Policies to Mitigate Potential Electricity Price Increases, Commission Docket No. M-00061957 (entered May 17, 2007).

⁹ 66 Pa.C.S. Section 2807 (e) (3.6), (3.7).

¹⁰ 66 Pa.C.S. Section 2807 (e) (3.2).

In summary, the question of what purposes default service is designed to achieve must be examined before considering who should provide default service. Under current law, default service is a regulated service and the default service provider, whether an EDC or a Commission-approved alternative supplier, must submit plans that reflect consideration of different purchasing strategies designed to balance a number of goals. Default service is more than just a stopgap service designed to encourage customers to shop. Accordingly, changes to the default service model intended primarily to stimulate shopping will likely require legislative changes.

III. RESPONSES TO QUESTIONS IN THE INVESTIGATION ORDER

The primary points EAP wishes to emphasize at this stage of the investigation are listed above in the General Comments section. EAP will also respond to certain of the eleven questions listed in the Investigation Order, and encourages the Commission to consider the separate comments of its EDC members on the questions.

1. *What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?*

The quarterly shopping statistics published on the website of the Office of Consumer Advocate (OCA)¹¹ provide the information necessary to answer this question. Not surprisingly, more industrial customers are shopping than commercial or residential, because they are the most sophisticated and sensitive to price differences due to competitive pressures. Overall shopping levels have increased since the expiration of rate caps at the beginning of 2010 and 2011. To cite one example, 2% of PECO Energy Company's customer load was shopping in April 2009, but by April 2011, four months after the expiration of PECO's rate cap, the percentage of load shopping had increased to 50%.

The widest variation of results are in the residential class, with 42% of PPL's residential load shopping as of April 2011, and very small shopping levels in some other service territories.

¹¹ www.oca.state.pa.us

A major contributor to this variation is likely to be differences in when the EDCs procured power in the wholesale market. If an EDC procured more energy at a time that wholesale prices were high, its price to compare will reflect those higher costs, and it is more likely that EGSs will be able to offer savings compared to that price. Under Act 129, all EDCs have a duty to use competitive procurement processes designed to minimize the cost of default service, so it is not surprising that in some cases default service prices may be at a level that EGSs have difficulty offering savings to customers.

Even though customers have had the legal right to shop for electricity for over a decade, the retail market is relatively new. This is so because the competitive market could not begin to develop fully while rate caps remained in place, and those caps have only expired for the majority of customers in Pennsylvania in the past year and a half. It may take time for more residential electricity shopping to develop, as it took time for shopping to develop when other utility services, such as long-distance telephone service, were first opened to competition. In the meantime, customers who are purchasing default service are receiving a fair, competitive price, as stated above.

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?

As the shopping statistics alluded to above show, customers generally do have competitive options in this relatively new retail electricity market. To the extent that shopping has been slow to develop, it must be considered that under current legal requirements default service prices reflect competitive procurement processes designed to minimize prices to customers.

The term "fully workable and competitive retail market" as used in this question is not defined. It is possible that other approaches to default service might render higher shopping numbers than under the current law. As stated above, the current default service paradigm in

Pennsylvania is not designed with the exclusive goal of maximizing shopping statistics. EAP does not express a position as to whether other paradigms should be adopted except to note that this is a question for the General Assembly.

- 3. *What are the economic and managerial costs associated with electric distribution companies (EDCs) fulfilling the default service role? Are the EDCs accurately passing those costs along to default service customers? Do default service rates include any elements that are not cost-based? Is an examination of distribution rates needed to ensure proper cost allocation? Are there barriers to competition as a result of having EDCs provide default service?***

The costs of providing default service are examined in the context of Commission review of the default service plans filed by EDCs, and EAP submits that the default service prices approved by the Commission are cost-based. EAP is not aware of information indicating that an examination of distribution rates is necessary. As to whether EDCs providing default service results in barriers to competition, see the response to the previous question.

- 4. *Are there unintended consequences associated with EDCs providing default service, and related products, such as time-of-use rates?***

EAP does not have any comments in response to this question

- 5. *Should default service continue in its current form? Does default service impede competition or otherwise prevent customers from choosing electricity products and services tailored to their individual needs? Does default service provide an advantage to the incumbent EDC and/or its generation affiliate(s)?***

As stated above, EAP submits that whether having EDCs continue as default service providers impedes competition presents a legislative question, because EDCs are providing default service in a manner consistent with the Public Utility Code. Current law provides for a regulated form of default service that is not focused exclusively on the goal of maximizing the number of customers who are shopping.

Since the predominant model for default service is that EDCs do not benefit from default service, providing this service does not provide an advantage to EDCs. In addition, having EDCs provide default service does not provide advantages to generation affiliates because the

Commission ensures that any transactions between EDCs and such affiliates are arms-length transactions.

- 6. Can/should the default service role be fulfilled by an entity, or group of entities, other than the EDC? If the default service role should be filled by an entity other than an EDC, what mechanisms could be employed to transition the default service role away from the EDC and onto competitive electric generation suppliers (EGSs)? Are different approaches appropriate for different customer classes? What criteria should be used to ensure that EGSs are qualified to assume the default service role and maintain reliable service?**

EAP does not have an opinion on these questions at this time, other than to say that they present questions for the General Assembly to examine, because current law requires a regulated form of default service that does not focus exclusively on the goal of maximizing the number of customers who are shopping.

- 7. How can Pennsylvania's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electricity market? Are there additional market design changes that should be implemented to eliminate the status quo bias benefit for default service?**

See the response to the previous question.

- 8. What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?**

At this time, EAP is not aware of any procurement or cost advantages for a utility in providing default service.

- 9. What changes, to Regulations or otherwise, can the Commission implement on its own under the existing default service paradigm to improve the current state of competition in Pennsylvania?**

The procurement strategies of EDCs to obtain supplies for default service can be an important factor that affects the ability of EGSs to attract customers. The Commission has some flexibility under the statutory scheme to balance the competing goals of default service – complying with the “least cost over time” standard, while still allowing an opportunity for a

competitive market to develop. The Commission could examine its Policy Statement on Default Service and Retail Electric Markets¹² to address this question.

10. What legislative changes, including changes to the current default service model, should be made that would better support a fully workable and competitive retail market?

EAP does not take a position on whether legislative changes should be made to enhance the current retail market.

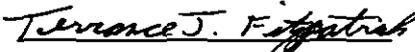
11. Are there, or could there be, potential barriers being created by the implementation of the EDC Smart Meter plans?

EDCs are implementing smart meter plans pursuant to the requirements of Act 129, and EAP does not take a position on whether these plans constitute barriers to competition.

IV. CONCLUSION

EAP respectfully requests that the Commission consider the above comments in this proceeding.

Respectfully submitted,


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Date: June 3, 2011

¹² Final Policy Statement Order Re: Default Service and Retail Electric Markets, Docket M-00072009 (entered May 9, 2007).

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