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December 10, 2012

VIA ELECTRONIC FILING

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

RE: Investigation of Pennsylvania's Retail Market: End State of Default Service, Docket No. I-2011-2237952; **COMMENTS OF ELECTRIC GENERATION SUPPLIER PARTIES TO TENTATIVE ORDER**

Dear Secretary Chiavetta:

Enclosed for filing with the Commission is the original Comments of Electric Generation Supplier Parties to Tentative Order in the above-captioned docket.

Thank you for your attention to this matter. If you have any questions related to this filing, please do not hesitate to contact my office.

Very truly yours,

Todd S. Stewart
Counsel for Dominion Retail, Inc. and Interstate Gas Supply, Inc.

TSS/jld
Enclosure

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service	: : :	Docket No. I-2011-2237952

COMMENTS OF ELECTRIC GENERATION SUPPLIER PARTIES TO TENTATIVE ORDER

At its Public Meeting of November 8, 2012, the Pennsylvania Public Utility Commission ("Commission") issued a Tentative Order in which it proposed a new model for Default Service at the end of the current transitional period – June 1, 2015 – that is intended to "improve competition in the current retail electric market." The proposed model would continue the Electric Distribution Company's ("EDC") current role as the default service provider ("DSP"), but would propose changes to the existing statutory construct that requires DSPs to purchase electricity through a mixture of short, medium, and long-term contracts which are intended to result in the least cost over time. For residential and small commercial customers the Commission's new construct would: 1) require EDCs to purchase ninety (90) day full requirements contracts on a continuing quarterly basis; 2) continue the current quarterly reconciliation of default service prices to coincide with the ninety (90) day default service price; and, 3) include other consumer protections.

In its Tentative Order, the Commission advocates for its preferred end-state by arguing that the current procurement and pricing of default service is hampering competition. The Commission's syllogism is as follows:

- because the current price signal for customers is the EDC's Price to Compare ("PTC"); and,
- because the PTC is based upon a blend of contracts (long-term, short-term and spot) that don't always track current market prices; and
- because these non-market relevant energy costs are subject to a reconciliation mechanism which not only insulates EDCs from any collection risk but which also can further disassociate the PTC from wholesale energy prices; and,
- because the PTC is not correlated with wholesale energy markets, the PTC may move in ways that are inconsistent with price trends in those markets causing boom and bust cycles for EGSs.

Therefore, it has been very difficult for EGSs to compete.

The conclusion is correct, but the suggested means of ameliorating the disconnect between the PTC and market-based EGS pricing does not recognize that the fundamental problem is <u>not</u> with the PTC – but with the very continued existence of default service as a utility-based model that does not represent a fully-loaded market based price. The Commission's proposed "fix" for these problems is to require ninety day prices, suggesting that these will provide default service prices that "bear a closer resemblance to market conditions," and that "the changes also provide a regulatory framework that encourages further EGS investment in Pennsylvania's Retail Electric Market."[1] The Commission acknowledges its belief that the "market should be the primary factor driving EGS' prices" and expresses its concern that without the changes that it proposes it has "legitimate and substantial concerns that the current Retail

[1] Tentative Order, pp. 10-11.

Electricity Market will not be viewed as sustainable by EGSs." The Commission hopes that "through this proposal...[it will] create a structure where the market drives prices charged by EGSs", and where "EGSs invest in Pennsylvania due to certainty and a level playing field, and where customers enjoy competitive prices in a wide variety of innovative products and offerings."[2]

The EGS Parties (Interstate Gas Supply, Inc. d/b/a IGS Energy, or "IGS"; and Dominion Retail, Inc. d/b/a Dominion Energy Solutions, or "DES") do not agree with the Commission's approach, nor do they entirely agree with the Commission's characterization of the perceived "problem". While it is true that the current procurement/pricing/reconciliation paradigm does indeed cause EDC's PTCs to vary from the wholesale market in anomalous and significant ways, fundamental to the issue is that the "PTC" is not a comparable product in any sense if it does not contain all of the characteristics and associated costs of providing a product at retail to consumers. From a broader perspective, and as a general matter in competitive markets, if a consumer wants to consume or a seller wants to sell, the consumer and the seller must engage in the market to consummate a transaction. If the seller does not engage, then it sells no products. If the consumer does not engage, no purchase is made and the buyer leaves the market without the product or service the consumer was seeking. It is axiomatic that a proper functioning competitive market relies upon fully engaged buyers and sellers for the market to function fully and properly. If a default service exists, allowing customer to have service without engagement, it must not be subsidized in order to ensure that competitive market products continue to be available in a vibrant market long-term.

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[2] Tentative Oder, pp. 10-12.

Allowing a default service to exist in what is otherwise supposed to be a competitive market is antithetical to the existence and full development of a competitive market. If a transactional paradigm exists in which sellers are enabled to sell, yet buyers purchase such service without any direct or affirmative engagement, then, at a minimum, that paradigm must not include a subsidization and must contain all the costs (actual and avoided) of providing and receiving the service, particularly if the price associated with the service is considered a benchmark against which the rest of the truly competitive market is measured.

This cannot be over-emphasized: Retail competition will struggle to develop as long as there is an option labeled "default service" pursuant to which customers who do nothing to engage in the market receive the benefits of the service without paying the full cost of doing so. This inherent transactional dysfunction will ultimately result in a disservice to the public because improper pricing signals will be sent from the subsidized default service to recipients of that service, and consumers taking competitive service will subsidize the "do-nothing" option of default service. When default service is provided by the utility or a surrogate, there will always be services provided and costs incurred that, if they were provided by a retail provider in a truly competitive environment, would be built into the retail commodity rate. However, when the same service is provided by the default utility, the costs or services are paid for through rates (base rates or administrative costs) and recovered from all ratepayers, both those receiving default service as well as those receiving service from competitive suppliers. Further, some of the costs of providing retail service, including administrative costs associated with regulatory compliance in regard to marketing, enrollment, and contract renewals for example, are either avoided or assumed by the default provider. Consequently, a default rate is a subsidized rate.

The disparities of the PTC and wholesale markets would be far less problematic if all customers did not initiate service from the EDC. Stated differently, the level of any EDC's PTC would be far less significant as a barrier to entry if EGSs were not required to gain market share by migrating customers away from automatic default service provided at the PTC. The default service provider is simply handed the same customers without incurring any of the costs of finding, soliciting, enticing, enrolling, verifying, and maintaining the relationship. This includes that rather significant expense of developing and maintaining the utility brand identity, which in itself is a substantial barrier to competition.

To be successful, any end state proposal must address the reality of the subsidies first, or simply eliminate the single default service benchmark. Otherwise, the changes are superficial, non-substantive, and cosmetic; and, are more likely to set competition back than to move it forward because of the intrinsic inequity of providing consumers with the advantages of what is a wholesale competitive price without also bringing into the equation all of the costs (actual and avoided) in both providing and utilizing that service. Summarily, default service is too easily provided and maintained when it is subsidized by shopping customers.

The end state model must reverse the inequities in the market that enable or encourage customers to remain on default service in perpetuity. And, the PTC is only the tip of the proverbial iceberg. Ideally, the solution would be to eliminate default service as an option. The EGS Parties believe that experience in other markets has shown that the competitive market can provide service to all customers and that a utility-provided "default" option is not necessary. However, the EGS Parties also are aware of the political reality that the Commission sees as "the" obstacle to what most parties consider to be the ideal end-state.

The alternative solutions to the default concept are to: (1) eliminate the default service and require consumers to engage in the competitive market in order to obtain generation services; (2) eliminate default service in its current form but allow consumers to continue to derive service without engagement in the market but from certified competitive suppliers at each supplier's monthly variable rate; or, (3) continue to have a default service in its current form and provided by a single provider, but include a default service fee to ensure that the subsidies that are inherent in such a default product do not distort the market price signals and artificially punish shopping customers while unduly enriching default customers and their suppliers.

In addition, if default service is to continue, then we strongly believe that the Commission must also address the issue of how Pennsylvania consumers initiate new electric service as customers. That is, the EGS Parties propose that the best first step in resolving the current "problem" of lower than optimal levels of customer shopping, is to require customers to choose an electricity provider in the first instance when establishing service. As an initial step, all new or moving customers should be required to affirmatively choose an electricity supplier from a list of supply options, which could include default service. The process cannot, however, suggest any superior status to the default service option. Customers who, for whatever reason, do not choose would be assigned to the suppliers on the list. This process would constitute a significant remedial step by eliminating the advantage currently enjoyed by the utility through the monopolistic provision of default service, and the benefit that default service customers enjoy by having the EDC provide what is essentially a premium energy product to them at no additional cost to them.

Recognizing that the final transitional phase in which all customers must elect among competitive suppliers may take longer to implement, the EGS Parties suggest as an interim measure that any default service PTC must include all costs associated with the provision of the default service, and in so doing acknowledge the historic advantage enjoyed by the default service provider where all customers are assigned at no cost. The value of automatic no-cost customer assignment is indisputable when juxtaposed against the significant marketing costs incurred by competitive suppliers in their attempts to migrate ratepayers from default service. A significant cost component of the PTC must reflect and recover the value the customers receive from being assigned to default service. It is this benefit that customers should be required to pay for in the form of a retail adjustment factor.

The Commission obviously recognizes that ninety (90) day, full-requirements procurements implemented on a quarterly basis will drive the PTC closer to the wholesale market price. However, as this results in more market responsive prices for customers over time, it will also cause greater amounts of volatility. It may also be the case that this construct will cause customers to pay a rate that is closer to the "least cost over time" than the current multi-layer contract approach. If the Commission desires a robust and sustainable competitive market, one that includes large and small EGSs, it must understand that its proposed ninety (90) day procurement construct will do nothing to lower barriers to market entry for an EGS. A ninety (90) day procurement model fails to remedy the inequities of current default service and the resulting anti-competitive effect.

A modification to the ninety (90) day approach, however, that will, in general, produce better results for EGSs would be to eliminate the quarterly procurement process and adopt an annual procurement model with annual price changes. A model that employs annual procurement of fixed price products will eliminate the odd variability of quarterly prices and reconciliation. This model would provide default service customers with greater price stability, which would be more comparable to the offers typically provided by EGSs in the market place and would match market prices more closely than under the current model while avoiding unnecessary volatility.

The EGS Parties are extremely skeptical that moving to a ninety (90) day procurement cycle under today's market conditions will allow for the development of a robust competitive market. It will more likely lead to a scenario in which only those entities that own or control significant generation assets will be able to manage the risks of offering longer-term fixed prices to customers, which are the types of products that most customers seem to want. Rather, it is more likely that most EGSs will only be able to offer customers shorter term, e.g., ninety (90) day, prices which may or may not compete with the PTC. A market where the "competitors" are only able to offer short term prices increases the cadence of the boom or bust cycle, which the Commission wants to avoid. Customers will not respond well to a quicker cadence and are likely to return to default service on a more frequent basis, if not permanently. Contrary to creating a competitive market, we will simply enshrine default service as the pre-eminent "competitive" alternative to actual competition and the market will fail.

If the Commission seeks to promote a sustainable and robust competitive market, the pre-eminence of default service must be mitigated or eliminated. The only way to do so is to take away its inherent advantages. Default service providers should not be prioritized to receive all customers first. Default service customers should not be the beneficiaries of a premier shopping service at no charge. Lastly, default service providers should not be insulated against the risk to which competitive suppliers will be exposed in the ninety (90) day market when volatility is introduced.

Respectfully submitted,

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DATED: December 10, 2012

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