

LEGAL SERVICES



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June 17, 2004

**VIA FEDERAL EXPRESS MAIL**

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

**Re: Reply Comments of Allegheny Power  
Provider of Last Resort (POLR) Roundtable;  
Docket No. M-00041792**

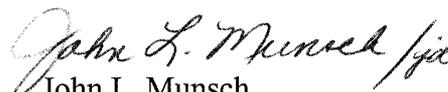
Dear Secretary McNulty:

Enclosed please find an original and three copies of the Reply Comments of Charles J. Kruft, Manager, Rates of Allegheny Power, submitted in the above-captioned proceeding on behalf of Allegheny Power.

In accord with the filing directions issued in your letter of May 28, 2004 at this docket, copies of the Reply Comments are being served via electronic mail in PDF format upon the Commission's Law Bureau and upon its Office of Communications.

Please contact me at the phone number or email above if you have questions about Allegheny Power's filing in this matter. This filing is made by Federal Express and is deemed filed today pursuant to 52 Pa Code §1.11.

Very truly yours,

  
John L. Munsch  
Senior Attorney

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**REPLY COMMENTS OF WEST PENN POWER COMPANY,  
DBA ALLEGHENY POWER, ON PROVIDER OF LAST RESORT  
BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION  
DOCKET NO. M-00041792**

West Penn Power Company, doing business as Allegheny Power (AP), appreciates this opportunity to provide Reply Comments in the Provider of Last Resort (POLR) Roundtable established by the Pennsylvania Public Utility Commission. AP continues to support its initial position that its experience in other jurisdictions, particularly in Maryland, can provide valuable information to this Commission as it addresses the future of default service in the Commonwealth of Pennsylvania. AP believes that its initial Comments filed with the Commission on April 21, 2004 provide the necessary regulatory framework for the future provision of Provider of Last Resort (POLR) Service within the Commonwealth of Pennsylvania. With the Commission adopting appropriate protections and with full cost recovery, AP is ready to continue to serve as the POLR provider in its service territory after its generation rate caps expire.

AP supports the Reply Comments filed by the Energy Association of Pennsylvania, and therefore will not reiterate those positions in our Reply Comments.

AP will however, address the issues of cost safeguards, administrative charges and reciprocal collateral requirements in the following comments.

### **COST SAFEGUARDS**

Consistent with any obligation to provide POLR service, AP believes that adequate cost protection against the risk of customer migration back to POLR service, electric supplier default, and prudency challenges to the results of the wholesale power procurement is required for the Electric Distribution Companies (EDCs) to provide this service.

The EDCs should be allowed, in return for any POLR obligation, full cost recovery for all awarded electric supply contracts associated with customer migration back to POLR service that may require the EDCs to purchase electric supply at higher costs. EDCs should be protected from any electric supplier default through full cost recovery as outlined in more detail in AP's initial comments. Finally, the EDCs should be insulated from any prudency challenges to the results of the competitive bid process used to procure electric supply to satisfy POLR load.

### **ADMINISTRATIVE CHARGE**

The establishment of POLR prices and services for customers who elect not to choose an alternative retail supplier and for customers who are unable to select an alternative retail supplier must be carefully balanced with the electric restructuring goal of developing a competitive retail electric market. A retail electric market can only function if the barriers to competition are removed. In developing a POLR option, a level playing field for both the POLR provider and the competing retail electric suppliers must be obtained, and there should be no

price advantage for customers remaining on utility-provided POLR service. The use of an appropriate administrative charge or adder is essential to the establishment of a POLR price that is comparable to competing retail electric suppliers.

An administrative charge must be included in the POLR price to allow for cost recovery of a utility's incremental costs directly related to providing POLR service, a reasonable return to shareholders in exchange for the obligation to purchase and supply power to POLR customers and an allowance intended to replicate a retail electric suppliers' costs for marketing and "back office" costs such as customer care functions. Absent the inclusion of an administrative charge in the POLR price to customers, a competing retail electric supplier would suffer a price disadvantage in comparison to the POLR provider, which would be viewed negatively by prospective customers.

The return portion of the administrative charge is necessary to compensate shareholders of the POLR provider for real and perceived risks of managing the POLR process and services. Such risks require that shareholders be compensated through a reasonable return. Under traditional rate base/rate of return ratemaking, utility shareholders are compensated for investing in a capital-intensive industry through a return on the utility's plant investment. However, the provision of POLR service will require minimal, if any, capital investment by the EDC, thereby generating no return under traditional ratemaking. Shareholders and the capital markets cannot be expected to invest in and lend funds to an EDC or any entity, regulated or unregulated, that manages the procurement of

hundreds of millions of dollars annually in electric supply contracts without adequate compensation for their investment in such a company. Potential investors and creditors can be expected to react negatively, in terms of expected return and credit costs, if they cannot be assured that the POLR provider is being granted a reasonable return for this continued POLR service obligation

Additional risk relating to the electric supply contracts arise simply due to the complexity of contract negotiations and the number of potential bidders in weakened financial condition.

Regulatory risk is another area of risk, whether perceived or real, that investors are mindful of and therefore expect a return for investing in a regulated entity. Any perception on the part of investors that full cost recovery is questionable may lead to higher return expectations by investors.

### **RECIPROCAL COLLATERAL REQUIREMENTS**

Some parties to this proceeding have proposed reciprocal collateral requirements that would require EDCs to meet the same collateral requirements as a wholesale electric supplier. AP strongly opposes this requirement, for a number of reasons. First, the EDCs are regulated entities, under the jurisdiction of the PUC, while the wholesale electric suppliers are not. This is an important distinction in that the EDC, as the POLR provider, has a revenue stream from POLR customers that is regulated by the PUC, and therefore affords the wholesale supplier security that the revenues are present for payment of electric supplier bills. Second, instead of reciprocal collateral requirements, if an EDC is

in a situation wherein payment to suppliers may be somewhat questionable in light of an EDC's financial condition, the EDC could be required to make accelerated payments (such as weekly) to the wholesale electric supplier to settle amounts due for service provided and therefore reduce the risk to the wholesale supplier.

This concludes AP's Reply Comments in this proceeding.