

Hawke
 McKeon
 Sniscak &
 Kennard LLP
ATTORNEYS AT LAW

William T. Hawke
Kevin J. McKeon
Thomas J. Sniscak
Norman James Kennard
Lillian Smith Harris
Scott T. Wyland
Todd S. Stewart
Craig R. Burgraff

Steven D. Snyder
Janet L. Miller
Steven K. Haas
William E. Lehman
Rikardo J. Hull
Katherine E. Lovette
Amy A. Whitney

100 North Tenth Street, Harrisburg, PA 17101 Phone: 717.236.1300 Fax: 717.236.4841 www.hmsk-law.com

July 20, 2006

VIA HAND DELIVERY

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

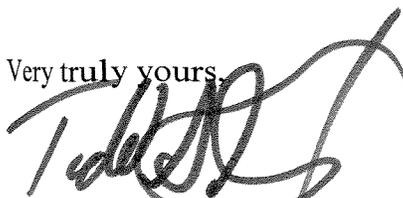
Re: Policies to Mitigate Potential Electricity Price Increases; Docket No. M-00061957; **REPLY COMMENTS OF DOMINION RETAIL INC.**

Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and fifteen (15) copies of Dominion Retail Inc.'s Reply Comments in the above-captioned matter.

If you have any questions, please do not hesitate to contact me.

Very truly yours,



Todd S. Stewart
Counsel for Dominion Retail Inc.

TSS/ajt/kml
Enclosures

cc: Shane Rooney, Esquire, Law Bureau
Gary Jeffries, Esquire, Dominion Retail, Inc.

THE COMMONWEALTH OF PENNSYLVANIA
BEFORE THE PENNSYLVANIA PUBLIC
UTILITY COMMISSION

Policies to Mitigate Potential Electricity :
Price Increases : Docket No. M-00061957
:

REPLY COMMENTS OF DOMINION RETAIL, INC.

Dominion Retail, Inc. (“Dominion” or “Dominion Retail”) wishes to thank the Commissioners and Staff for their interest and obvious concern, which reflects a tremendous understanding of the interplay between utility service and the lives of so many Pennsylvanians. The purpose of the exercise is to address ways to mitigate the impact of potential increases in wholesale electricity prices at the expiration of the currently existing rate caps in most utility service territories. Dominion Retail believes that the discussion and the questions proffered and the answers provided at the *en banc* hearing demonstrate that there is agreement on some issues and a divergence of opinion on others with regard to what actions the Commission should take. Nonetheless, the discussion was informative and well articulated and should provide the Commission with much of the information it needs to decide the appropriate course.

Dominion Retail offers these reply comments to address some of the views articulated by parties in their written comments or oral presentations before the Commissioners at the *en banc* hearing. Dominion Retail agrees with many of the parties who claim that the most effective method that many customers have of limiting the impact of price increases is through conservation and demand reduction, and Dominion Retail encourages the Commission to explore policies that would promote meaningful demand-side management programs for all customer

classes, including residential customers. Moreover, Dominion Retail urges the Commission to employ all due haste in implementing rules for the provision of provider of last resort service, and in particular, for the acquisition of energy by providers of last resort. Waiting will only encourage continual attempts by EDCs to implement “temporary” programs that are contrary to the Commission’s previously expressed views. Fairness and consistency suggest that the Commission should not consider POLR plans for utilities that have not yet emerged from capped rates until such emergence is closer at hand.

Dominion Retail offers these comments to suggest that the Commission plot a firm course that emphasizes actual competition as the best means of addressing these price issues, instead of being swayed by dire warnings and hyperbolic assertions which blame “competition” for the current state of affairs, and which seek to roll back the clock—before competition ever was given a real chance.

1. “Ugly POLR”.

A number of parties have suggested that what marketers want is for the Commission to impose rules that would require what they have been calling “ugly POLR” service. Ugly POLR service in their view is a service that would create price volatility and lack of price certainty for customers by requiring customers of POLR service to receive hourly or even monthly adjusted rates. These parties take the view that customers are unable to adjust to rates that reflect actual market prices, because customers cannot adjust consumption or otherwise manage price volatility. Those same parties suggest that marketers want the Commission to impose such service so that the marketers can take on the role of the “white knight” and offer customers fixed price services, which is what they believe customers truly want, in order to gain market share. Perhaps a more accurate way of characterizing the marketers’ intentions would be to say that

marketers are attempting to create opportunities for possible market entry which will have the benefit of initiating retail competition. Monthly variable prices are one way of allowing market entry. However, it is not possible for anyone to claim that variable pricing will cost customers more on their electricity bills. In the long run, it is possible, even likely, that variable prices may be less costly than a series of fixed price plans. It is quite possible that the fixed prices created by auctions may also be “ugly POLR.” More importantly, Dominion Retail does not believe that it is good public policy to shield customers from price volatility and promote a paternalistic view of customer’s abilities that is not accurate. Moreover, acting in response to that view will have the ultimate negative effect of shielding customers from price volatility. Exposure to price volatility is the best driver of innovation and conservation, and may be the best hope for consumers in the long run.

The consumer parties in particular decry as “ugly POLR” any rate that might expose customers to actual market prices on a somewhat real time or completely real time basis. They attach this negative label despite the fact that the Electricity Generation Customer Choice and Competition Act (“Choice Act”), 66 Pa.C.S. § 2807(e)(3), requires that utilities acquire energy to service POLR load at prevailing market prices. Moreover, the statute requires the utility to “recover fully” those costs. The consumer parties appear to believe that even though the statute requires the acquisition of energy at prevailing market prices, that the recovery of those prevailing market prices can and should be smoothed out so that customers never know what price prevails in the market place. Imposition of such mechanisms would have the long run effect of contributing to the increase in the price for electricity because it would not give customers accurate price signals, which in turn provides the incentive to conserve.

To conclude that customers are unable to adjust their consumption and behavior in the face of volatile and rising prices is contrary to recent experience. One need look only to the

recent reaction to gasoline prices as an example of behavior adjustment in the face of volatile and rising prices. People have adjusted driving habits, sales of more fuel efficient vehicles have increased dramatically while innovation in the development of alternative fuel and more fuel efficient vehicles has been driven by customer demand for such products. Moreover, investment in new technologies for energy production, such as alternative fuels like bio-diesel and oil shale technology have been the product of higher revenues produced by the current high market prices. All of these things can happen in the electricity market if customers are exposed to real prices. Certainly, immediate exposure to changing prices can cause customers discomfort. In the long run, however, it is the only way to drive the innovation and conservation that will cause customers to consider and adjust their consumption, so that we have a chance of reducing peak demand and reducing the need for new power plants, while at the same time, driving innovation in new technology and in creating new sources of energy to meet future needs. Higher prices spur investment in new, cleaner and more efficient generation, as can be seen today in Texas. Texas, at present, may not look like a paradise for customers, but in the long run those customers will benefit from the current huge rate of investment in efficient clean coal generation facilities by alternative providers of energy. When those plants are completed, the resulting additional capacity will drive prices down to everyone's benefit.

Shielding customers from market prices creates customers who have no real information about the actual price, no basis for making intelligent decisions, and who have no incentive to conserve. Without the information or the incentive, customers will continue to make poor consumption decisions and engage in poor energy consumption behavior. If a customer knew that they would pay a higher price for electricity between the hours of 12:00 p.m. and 5:00 p.m. on a hot summer day, rather than turning down the thermostat on their air conditioner (or even keeping at the same setting) during those hottest hours of the day, they would have an incentive

to turn the thermostat up and therefore conserve energy by choosing to be a little less comfortable. And they will be “paid” for their discomfort by saving money. One simply cannot rely on the outdated assumption that customer demand is inelastic. In Pennsylvania, customers have never seen real market prices for electricity and lack the basic tools necessary even to begin to make intelligent decisions—real-time meters and real-time prices.

When one looks to other energy markets, it is clear that customers can and do adjust behavior in the face of volatile prices. Customers can respond to market signals and that response will be to force conservation, drive innovation, reduce consumption and increase resource availability. In a world in which prices are smoothed out and homogenized, customers will have no ability or desire to make intelligent consumption decisions and demand growth will continue unabated, while the possibility of short-term price fluctuations in a world of reconciled or flattened wholesale prices will add risk for generators and keep new plants from being constructed. Prices will continue to rise gradually, but customers will have no control. That world appears to be much less desirable than what the consumer parties call “ugly” POLR.

The law in Pennsylvania is clear on how and when the transition is to be completed, and what prices customers should see and the clear path is to follow the law. Competition was supposed to be the unfettered norm long ago, and the rate caps were not supposed to last ten or twelve years. This super-long transition has prevented the type of investment and competition that would have made this current discussion unnecessary. A longer transition is not the answer, and any program that further insulates customers from the market (deferrals, laddered contracts, reconciled rates, etc.) will cause more harm than good and should be disregarded. Dominion Retail urges the Commission to finish what has been started and to not give up on competition before it has really begun.

2. Marketing Provider of Last Resort Service.

Provider of last resort service is exactly as it sounds, the last resort for customers who choose not to choose or for those who for whatever reason find themselves taking service from the electric distribution company or alternative provider of last resort. It has never been intended to be a competitive service that seeks to win customers away from EGSs or to convince customers not to take service from competitive suppliers in the first place. The intention of the Choice Act clearly was that customers would enter the competitive market in order to save money or obtain other benefits. The fact that more customers have not engaged in the competitive market is largely a result of the artificial rate caps, and the fact that marketers have been unable to offer market prices that compete with POLR rates.¹

Because of the last resort nature of provider of last resort service, it should not be and cannot be a competitive alternative if competition is going to take hold. Because EDCs are the gatekeeper and customer information clearinghouse for all suppliers on their systems, the EDCs possess too much market sensitive information to allow them to compete fairly. It is without question that an EDC always will have an advantage. Accordingly, the Commission should ensure that EDCs do not promote, advantage, advertise, market or otherwise suggest that POLR service is better than, or even equal to service from a marketer. In short, EDCs must remain silent about POLR service except to advise customers of its availability as a last resort type service. If utilities wish to compete for customer load, they should be required to do so the same way as everybody else, through an affiliated marketer subject to all code of conduct rules. The

¹ As discussed above, Competition cannot be blamed for this state of affairs. Rather, the extended and artificial rate caps are the major culprit. While some would argue that those rate caps are the only benefits customers received from the Competition Act, Dominion Retail asserts that those rate caps have successfully dampened competition and ensured that competition would never happen in the first place. Duquesne Light Company's service territory is an example of how customers statewide could have saved money, even without rate caps. Retail prices there did not skyrocket when customers were exposed to uncapped rates. Rather, marketers were able to compete and continue to compete. In short, rate caps were not the answer. Duquesne Light customers today enjoy rates that remain lower than those they paid prior to deregulation.

utilities should not be able to enhance in any way the existing inertial advantage they have in retaining customers at the cost of the competitive market.

3. The Statute Requires Energy to be Acquired at Prevailing Market Prices.

The Choice Act requires that POLR providers acquire energy for default or POLR load “at prevailing market prices” and that the POLR providers “recover fully all reasonable costs.” 66 Pa.C.S. § 2807(e)(3). The Commission’s proposed rulemaking order concluded that the likely best method of ensuring that energy was acquired at prevailing market prices was to engage in some sort of RFP or auction process. Moreover, the Commission concluded that the best way to ensure that the rates reflected those same prevailing market prices was to prohibit utilities from reconciling rates or otherwise creating a lag or mismatch between the retail rate and the wholesale price. Dominion Retail understands all too well that requiring a utility to submit 100% of its load to the market on a particular day in hopes that the market will be favorable on that day can create significant timing risk, and if the bid is to acquire long term fixed price energy, that will increase the risk as well. It is clear that such risk will be “priced”, that is, included in bid prices. But if customers truly want long term fixed prices, they must pay the risk premium that the market assigns to that type of a rate. Dominion Retail continues to believe that more timely prices, hourly or even monthly, are mandated by the Choice Act and provide more accurate price signals for customers. Dominion Retail submits that while short-term prices may appear to be volatile, they do not include the premiums associated with long term fixed rates. However, Dominion Retail urges caution—even when they included the risks, the longer the term of the contract, the more likely it will diverge from market prices.

Dominion Retail does not agree that any reconciliation or leveling (such as laddered contracts) is appropriate. Some parties have suggested that levelized or reconciled rates might be

a way to eliminate the volatility of the wholesale market. It is this volatility that in fact is most instructive to customers to make correct choices. Artificially removing that volatility via reconciliation or laddered contracts makes it difficult if not impossible for suppliers to make competitive or even relevant offers that reflect the actual market prices that they must pay in the wholesale marketplace. Reconciled or manipulated rates produce artificial results that suppliers cannot replicate in the real world. While a short-term variable price presents its own pricing difficulties for suppliers, it is nonetheless a real price against which suppliers should be able to compete in the marketplace. But laddered contracts or artificially adjusted or manipulated rates are neither fixed long term contracts or variable short-term contracts. Rather, whether by design or intent, such contracts have proven to be the most effective means of eliminating the ability of suppliers to initially enter the market and compete.

As part of its consideration of how to proceed, and the future of competition generally, the Commission must decide whether its role is to create competition at the wholesale level or the retail level. Dominion Retail believes that the Commission's only statutory mandate in this regard is to create retail competition. Dominion Retail believes that BGS style auctions would mean that there would only be competition for customers at a wholesale level, and that there would be no competition at retail because the continuing laddered contracts and the continually lagging prices they produce, would ensure that marketers could never gain any entry into retail markets. Eventually, all retail load would be served by the providers of last resort subject only to wholesale competition by utility affiliates. BGS-style auctions produce artificially flattened price curves that can never reflect actual market prices. When customers see flattened and artificially modified retail prices, those prices are no fair basis for comparison against actual market prices offered by suppliers. Customers choose to stay with the utility, since no supplier can possibly match the utility's price unless it purchased energy at the same prices and the same

proportions as the utility through the BGS auction. Retail competition cannot exist with such a skewed acquisition regimen.

Wholesale competition will happen if retail competition is allowed to thrive, but the converse is not true. Wholesale competition already exists and does not need any further assistance from this Commission, but retail competition (where this Commission's concern should lie) needs encouragement and may be the best means for mitigating electric price volatility over the long term. Laddered prices may remove volatility but do more harm in the long run because customers do not receive appropriate signals to conserve. Without conservation and meaningful demand response opportunity, uncontrolled energy demand will drive volatility in energy prices that may produce the negative situation already looming on the horizon.

4. A Return to Cost Based Rates is Not the Answer.

A few parties assert that a return to the "good old days" of cost based rates is the only solution for today's perceived higher energy prices. This view mis-assigns blame for perceived higher prices on retail competition, and ignores the fact that in real terms, prices for energy have not increased dramatically. It is not appropriate to consider today's price levels as a sudden price spike, rather they are the cumulative effect of customers having being shielded from a wholesale market which has been steadily increasing in price and volume since the imposition of capped rates as part of the restructuring process in Pennsylvania. When one considers that retail rates have been capped for nearly ten years, the current wholesale market prices do not seem disproportionate.

Dominion Retail recognizes that the wholesale market has its share of difficulties, and those wholesale market difficulties appear to be a large part of the current concern over price

setting within RTO's. Wholesale market issues are complex and have undeniable impact on every market participant's operations, but the solution is beyond the singular authority of this Commission. The Commission can, however, take on a role in pressing for the answers and the solutions at FERC.

Nonetheless, when it comes to cost based rates, one must remember the bad along with the good. In particular, one need only recall the negative effects of administrative projections of future demand that dramatically increased rates for consumers of at least two Pennsylvania utilities because they were required prematurely to build enormous levels of capacity that caused rates for those two utilities to skyrocket relative to other Pennsylvania utilities. Such forms of regulation have the potential to force customers to pay for excess capacity that may or may not be needed to serve them and which may or may not prove to be economical. In the long run, market based prices should be equivalent to or better than a regulated cost based price regime, especially if the market is allowed to develop fairly and freely and with adequate competition. The legislature appropriately made the determination when enacting the Choice Act that the market is better. Until we actually allow the market to work, it would appear at best premature to give up on that notion now.

5. The process used for approving market-based rates should be transparent and swift.

As has been seen in other states and in Pennsylvania, litigated proceedings that set actual rates for POLR service may take up to nine months and that amount of time can, standing alone, serve to exclude competitors from the market. Litigation of such rates creates an uncertainty as to duration and result and effectively bars competitors from entering the market to procure resources to serve in that territory until very close to the last minute. Dominion Retail believes that the Commission's view that the wholesale acquisition and rate setting methodologies be

decided, and then the wholesale prices should be mechanistically translated, is a better solution. Any price setting proceedings must be conducted on a short and known timetable so that all parties have access to the information at specific and known points, in time so that no party is advantaged or disadvantaged by the release of such information.

6. Retail Auctions.

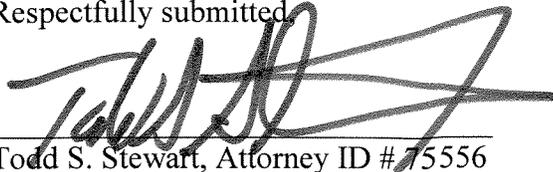
Dominion Retail believes that the Commission should consider requiring pilot retail auctions similar to those held in Pike County, now, in order to stimulate market activity and promote participation in the competitive market in advance of the lifting of the rate caps. Such programs may serve a role in initiating interest in competition as a means of mitigating high prices and would allow participants to gain experience in the competitive market now before the true price pressure is likely to arrive.

7. Conclusion.

Dominion Retail urges the Commission to stay on the course that was plotted many years ago, and to take the steps discussed herein, that will allow customers more control, not less, over the way they consume electricity. Properly prepared customers, with the right tools, are far more capable of addressing their own energy requirements than any aggregate plan. The goal of competition indeed may be lower prices, but the legislature recognized that lower prices would result only if customers had the power to make choices—that is the essence of a market. Allowing paternalistic and unnecessary price controls to persist only increases the duration of the dislocation caused by the transition and will ultimately increase the pain. We need to work harder to get competition started and work on initiatives that support competition, not those that seek to tear it down. Competition can only serve its purpose of providing true market prices

when it is left to consumers to make informed decisions. Hard experience has shown that any regulation in the form of price caps, is too much. If the Commission endeavors to fulfill its mandate to promote competition, it will surely see the benefits.

Respectfully submitted,



Todd S. Stewart, Attorney ID # 75556
Hawke McKeon Sniscak & Kennard LLP
100 North Tenth Street
Harrisburg, PA 17101
717-236-1300
717-236-4841 (fax)
tsstewart@hmsk-law.com

Counsel for Dominion Retail, Inc.

Dated: July 20, 2006