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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of Act 129 of	:	
October 15, 2008; Default Service	:	Docket No. L-2009-2095604

COMMENTS OF THE

ENERGY ASSOCIATION OF PENNSYLVANIA

I. Introduction

At its Public Meeting of January 14, 2010, the Commission adopted a Proposed Rulemaking Order regarding the implementation of the default service procurement provisions of Act 129. The Proposed Rulemaking Order was published in the *Pennsylvania Bulletin* on May 1, 2010 and interested parties were given 30 days to file comments. The Energy Association of Pennsylvania ("EAP" or "Association") files these comments on behalf of its Electric Distribution Company ("EDC") members.[1]

Act 129 modified the language of the Electricity Generation Customer Choice and Competition Act ("Competition Act") governing the procurement of electricity by EDCs (or alternative default service providers) to serve non-shopping customers. Under the Competition Act, EDCs were required to purchase electricity for default service "at prevailing market prices." Act 129 repealed this language and instead required that EDCs purchase power in a manner designed to ensure adequate and reliable service at the least cost to customers over time. 66 Pa. C.S. §2807(e)(3.4). Act 129 also explicitly required EDCs to use competitive processes to acquire power for

[1] Allegheny Power, Citizens' Electric Company, Metropolitan Edison Company, PECO Energy Company, Pennsylvania Electric Company, Pennsylvania Power Company, Pike County Light & Power Company, PPL Electric Utilities Corporation, UGI Utilities, Inc. (Electric and Gas), and Wellsboro Electric Company.

default service, including auctions, requests for proposals, and bilateral contracts. 66 Pa. C.S. §2807(e)(3.1). Further, the Act required EDCs to procure a "prudent mix" of spot market purchases, short-term contracts, and long-term contracts. 66 Pa. C.S. §2807(e)(3.2).

II. General Comments

In general, the proposed regulations incorporate the language of Act 129 verbatim. The Commission acknowledged this in its Proposed Rulemaking Order (p. 15). EAP agrees with this approach because it provides the maximum amount of flexibility for the Commission to consider different procurement strategies for different EDCs and at different points in time.

Since the Commission's default service regulations went into effect, the Commission has approved default service plans that include a variety of approaches that appear to satisfy the basic criteria set out in the procurement provisions of Act 129. These plans included competitive procurement processes, different types and lengths of contracts, and were designed to provide the lowest price for customers. Despite some differences in these plans, they have accomplished the goals of providing reliable generation service at the least cost to customers, and they have also allowed for the development of retail competition. It is important for EDCs and the Commission to retain flexibility to develop default service plans that reflect both changing circumstances and the accumulated experience gained under previous plans. Attempting to establish prescriptive requirements for default service would stunt this natural growth and evolution, and would be contrary to the public interest.

While it is proposing to adopt the procurement provisions of Act 129 verbatim, the Commission's Proposed Rulemaking Order states that there is ambiguity in the statutory interpretation of Act 129's procurement language. As a result, the Commission seeks additional comment on sixteen questions. Before answering these questions specifically, it is useful to state some overarching principles that answer many of these questions.

First, it is neither necessary nor wise to attempt to resolve all the ambiguities in Act 129's procurement language in regulations adopted a relatively short time after that

law was passed. Pennsylvania is just now beginning to emerge from the transition period to competition. Currently, a majority of customers in Pennsylvania still pay capped generation rates and, as a result, do not have electricity generation suppliers offering to serve them.

The Commission, consumers, and EDCs all have more to learn about which procurement approaches may best accomplish the goals for default service in different circumstances and at different times. It is important for the Commission to retain flexibility to allow its default service policies to evolve. The Commission recognized the need for flexibility when it adopted its default service regulations and policy statement. For example, the Commission was aware that the best approach to default service at the time rate caps expire, when there was the biggest risk of substantial price increases for customers, would not necessarily be the best approach for future default service plans.

There is no reason for the Commission to depart from its current approach of developing default service policies on a case-by-case basis. To the contrary, this approach has worked well and should be retained.

Second, the procurement language of Act 129 is broad enough to allow the Commission to exercise its discretion to balance a number of policy goals for default service. Act 129 states some of these goals – adequate and reliable service, and least cost to customers over time. But it is also important to remember that while Act 129 modified the procurement language of the Competition Act, it left the fundamental purpose of the latter Act in place – to create a competitive market and provide customers with a choice of electricity suppliers. It is still the public policy of the Commonwealth that "competitive market forces are more effective than economic regulation in controlling the cost of generating electricity." 66 Pa. C.S. Sec 2802(5). Experience in Pennsylvania and throughout the country has shown that the policies governing default service by EDCs are critical to the development of competition. Where default service rates are capped or heavily regulated to isolate them from market forces, retail competition has not developed. Accordingly, the Commission must also consider the impact on competition when it develops policies governing procurement for default service.

Before addressing the specific questions posed by the Commission, there is one proposed change to the default service regulations that is not consistent with Act 129. The Act states clearly that the default service provider "shall" have the right to recover costs pursuant to a reconcilable automatic adjustment clause. 66 Pa. C.S. §2807(e)(3.9). Despite this, the Commission proposes changing 52 Pa. Code §54.187 to state that costs "may" be recovered through those mechanisms. To be consistent with Act 129, the word "may" must be changed to "shall".

III. Responses to Questions Posed by the Commission

1. *What is meant by "least cost to customers over time"?*

Response: This term is ambiguous because it is not clear what period of time is being contemplated. This provides the Commission with discretion to look ahead, but in doing so the Commission should recognize that the further ahead one looks, the less certain one can be about the conditions that will prevail. Moreover, it is impossible to know with certainty what particular strategy will result in the least cost over time, and the longer the period of time, the less certain one can be of the results.

As stated in the general comments above, the Commission has discretion to determine what "least cost to customers over time" means. In doing so, the Commission should consider its goals in establishing default service procurement policies. After the Commission has done so, the results of the procurement should be deemed to satisfy the least cost over time standard.

2. *What time frame should the Commission consider?*

Response: See the response to question 1. In addition, the most obvious time frame would be the period covered by the default service plan – 2 to 3 years for an initial default service plan. See, 52 Pa. Code §54.185(c). However, consideration may also be given to longer time periods in connection with long-term contracts, subject to the caveat stated above that the longer the time frame, the greater the uncertainty.

3. *In order to comply with the requirement that the Commission ensure that default service is adequate and reliable, should the Commission's default service regulations incorporate provisions to ensure the construction of needed generation capacity in Pennsylvania?*

Response: The available evidence indicates that market forces are providing sufficient incentives to maintain adequate generation capacity to meet the needs of

customers. For example, PJM's presentation at the Commission's Summer Reliability Forum predicted a 28% reserve margin for the summer of 2010, well beyond the 15.5% reserve margin required for reliability purposes.[2] Even accounting for the effects of the recession, this suggests that market forces and policies governing wholesale electricity markets are attracting resources needed to maintain reserve margins.

4. *If the Commission should adopt a provision to ensure the construction of needed generation capacity, how should the default service regulations be revised?*

Response: As stated in response to the previous question, it is unnecessary to adjust default service procurement policies in order to encourage construction of generation capacity.

However, if some form of long-term procurement for the construction of generation is mandated by the Commission, the procurement must be competitive and market based. The process should also be open to capacity additions at new or existing plants, and be non-discriminatory to all generation fuel types. As previously discussed, the Commission must also be cognizant of the uncertainties inherent in long-term contracts.

5. *Which approach to supply procurement – a managed portfolio approach or a full requirements approach – is more likely to produce the least cost to customers over time?*

Response: There is not a clear answer to this question because it depends on future events which cannot be known at the time that decisions must be made. Moreover, as stated previously, the Commission should balance a number of goals in setting default service procurement policy.

6. *What is a prudent mix of spot, long-term and short-term contracts?*

Response: This question cannot be answered in a vacuum – without considering all of the circumstances in effect at the time that a decision is made. Moreover, the Commission has discretion to consider a number of goals in setting default service policy, and should continue to develop this policy on a case-by-case basis.

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[2] *Summer 2010 PJM Reliability Assessment*, presentation to Pennsylvania Public Utility Commission, May 20, 2010.

7. *Does a "prudent mix" mean that the contracts are diversified and accumulated over time?*

Response: See the response to question 6.

8. *Should there be qualified parameters on the prudent mix? For instance, should the regulations preclude a DSP (default service provider) from entering into all of its long-term contracts in one year?*

Response: See the response to question 6.

9. *Should the DSP be restricted to entering into a certain percentage of contracts per year?*

Response: See the response to question 6. In addition, it would be unwise to establish such prescriptive standards in regulations.

10. *Should there be a requirement that on a total-DSP basis, the "prudent mix" means that some quantity of the total-DSP default service load must be served through spot market purchases, some quantity must be served through short-term contracts and some quantity must be served through long-term contracts?*

Response: See the response to question 6. In addition, it would be unwise to establish such prescriptive standards in regulations.

11. *Should there be a requirement that some quantity of each rate class procurement group's load be served by spot market purchases, some quantity through short-term contracts, and some quantity through long-term contracts? In contrast, should a DSP be permitted to rely only one or two of those product categories with the choice depending on what would be the prudent mix and would yield the least cost to customers over time for that specific DSP?*

Response: See the response to question 6. In addition, it would be unwise to establish such prescriptive standards in regulations.

12. *Should the DSP be required to hedge its positions with futures, including natural gas futures, because of the link between prices of natural gas and the prices of electricity?*

Response: This is one option that may be worthy of consideration in individual default service filings, but it should not be mandated in regulations.

13. *Is the "prudent mix" standard a different standard for each different customer class?*

Response: The standard may lead to a variety of approaches because of legitimate differences in the characteristics of the different rate classes. However, what this means specifically is best addressed on a case-by-case basis.

14. *What will be the effects of bankruptcies of wholesale* suppliers to default service suppliers on the short and long term contracts?

Response: This depends on a number of factors, including the amount of security requirements associated with the contracts.

15. *Does Act 129 allow for an after-the-fact review of the "cost reasonableness standard" in those cases where the approved default service plan gives the EDC substantial discretion regarding when to make purchases and how much electricity to buy in each purchase?*

Response: No. 66 Pa. C.S. §2807(e)(3.8) only allows the Commission to disallow costs for non-compliance with the approved plan, fraud, collusion, or market manipulation with regard to these contracts.

16. *How should the requirement that "this section shall apply" to the purchase of AECs be implemented? Section 2807(e)(3.5) states that "....the provisions of this section shall apply to any type of energy purchased by a default service provider to provide electric generation supply service, including energy or alternative energy portfolio standards credits required to be purchased, etc."*

Response: This language means that the purchase of AECs must comply with the same procedures and policies that govern the purchase of energy for default service. For example, EDCs must use competitive procurement procedures designed to provide the least cost to customers.

IV. Conclusion

The default service procurement language of Act 129 is broad enough to provide the Commission with discretion to consider a number of policy goals when ruling upon default service plans. The commission has wisely taken a case-by-case approach to developing default service procurement policies, which gives the Commission flexibility to allow its policies to evolve with changing circumstances. It would serve the public interest for the Commission to continue this approach in applying the default service procurement language of Act 129.

Respectfully Submitted,

Terrance J. Fitzpatrick
President & CEO
Energy Association of Pennsylvania
800 North Third Street, Suite 301
Harrisburg, PA 17102
(717) 901-3912
tfitzpatrick@energypa.org

Donna M. J. Clark
Vice President & General Counsel
Energy Association of Pennsylvania
800 North Third Street, Suite 301
Harrisburg, PA 17102
(717) 901-0631
dclark@energypa.org

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