

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**IMPLEMENTATION OF ACT 129 OF  
OCTOBER 15, 2008; DEFAULT  
SERVICE**

**DOCKET NO. L-2009-2095604**

**PROPOSED POLICY STATEMENT  
REGARDING DEFAULT SERVICE  
AND RETAIL ELECTRIC MARKETS**

**DOCKET NO. M-2009-2140580**

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**COMMENTS OF EXELON GENERATION COMPANY, LLC AND  
EXELON ENERGY COMPANY**

Pursuant to the Notice of Proposed Rulemaking Order (the “Rulemaking Order”) and Proposed Policy Statement entered in the above captioned dockets on January 14, 2010, Exelon Generation Company, LLC (“Exelon Generation”) and Exelon Energy Company (“Exelon Energy”) (collectively referred to as “ExGen”) hereby submit their comments to the Pennsylvania Public Utility Commission’s (“Commission”) proposed amendments to the default service regulations, 52 Pa. Code §§ 54.181 *et seq.* (“Default Service Regulations”), and the Commission’s Policy Statement Regarding Default Service and Retail Electric Markets, 52 Pa. Code §§ 69.1801 *et seq.* (“Policy Statement”) intended to address changes to the Pennsylvania Public Utility Code (the “Code”) resulting from the enactment of Act 129 of 2008 (“Act 129” or “the Act”).

**I. INTRODUCTION**

ExGen appreciates the opportunity to provide comments to the Commission’s proposed amendments and the specific questions posed in the Rulemaking Order regarding the interpretation of certain Act 129 provisions. Exelon Generation owns or controls approximately

31,000 MW of generation supply and is a leading wholesale power marketer throughout the nation, including through participation in utility load auctions. Exelon Energy is a wholly-owned subsidiary of Exelon Generation and a licensed Electric Generation Supplier in Pennsylvania.

## **II. EXECUTIVE SUMMARY**

Act 129 amended the Electricity Generation Customer Choice and Competition Act (“the Competition Act”) to, among other things, more completely define the intended objectives and procedures for default service provider (“DSP”) procurements. The original language of the Competition Act directed DSPs to procure supply at “prevailing market prices.” Some interpreted this standard narrowly, as only permitting spot or other short term purchases of energy where a visible prevailing market price exists for the energy product. In Act 129, the legislature clarified its intent to give DSPs, and ultimately the Commission, flexibility to design “competitive” procurement plans consisting of a “prudent mix” of spot market purchases, short term contracts, and long term contracts of between four and 20 years in length. While Act 129 limits the use of long term contracts to 25% or less of the DSP’s projected default service load, the legislature did not specify what constitutes a “prudent mix,” but rather, left it to the Commission and the DSPs to flexibly design individual procurement plans that “achieve the least cost over time.”

ExGen respectfully suggests that the Commission rules should follow the legislative intent and preserve much needed flexibility at a time when energy markets, load, and environmental considerations are rapidly changing. Making a determination of each DSP’s procurement plan on a case-by-case basis is the most effective way to ensure the plan meets the goals of Act 129 and the legislature’s objective that the Commission make individualized, “specific findings” that each plan “includes prudent steps necessary to obtain least cost

generation.”<sup>1</sup>

### III. COMMENTS ON PROPOSED REGULATIONS AND QUESTIONS

ExGen agrees with the changes to the Commission’s proposed regulations, and provides an answer to each of the questions posed in its Rulemaking Order. ExGen suggests in advance, however, that the intent of Act 129 can best be understood when considering the entire Act holistically. Attempting to define the specific requirements of the Act individually necessarily frustrates its overarching goals. With that in mind, ExGen has attempted to offer its experienced perspective on the specific questions posed by the Commission in its Rulemaking Order.

#### 1. What is meant by “least cost to customers over time?”

The words “least cost to customers over time” refer to the competitive processes and Commission oversight described in Act 129. Procurements that meet these statutory requirements by definition will produce the least cost to consumers over time – regardless of whether the resulting energy costs are lower or higher as measured against existing market prices at any point in time. As indicated, Act 129 does not identify one “cookie cutter” approach to procurements, but rather, provides the DSP with a menu of options to competitively procure energy and provide price stability to the consumers. At the same time, Act 129 provides assurance to both generation suppliers and the DSPs that supply contracts entered into through Commission approved procurements will not be subject to hindsight review and challenge. ExGen believes that the procurement flexibility set forth in Act 129, as well as the finality of supply contracts, are essential to a well functioning procurement structure and will allow the Commission to evolve procurement practices over time and in response to changing market and load conditions.

More broadly, all of the language of Act 129 must be read in context with the entire

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<sup>1</sup> 66 Pa. C.S § 2807(e)(3.7)

Competition Act to create competition by giving every Pennsylvanian the right to choose an alternative retail supplier, and to shift the risks of generation construction and operation from consumers to generation investors. ExGen respectfully requests that when implementing the objectives of Act 129 to obtain least cost procurement the Commission should do so in a manner that supports competitive markets overall consistent with the principal intent of the Competition Act.

**2. What time frame should the Commission use when evaluating whether a DSP's procurement plan produces least cost to customers over time?**

ExGen believes that the Commission must consider whether a specific plan produces least cost to customers "over time" on a case-by-case basis. Because Act 129 was specifically designed to allow DSPs flexibility to design their procurement plans, each plan will likely contain a different mix of spot market purchases, short term contracts, and long term contracts. The Commission must consider the mix of electricity products used to meet the Act's objectives in each specific procurement plan in determining whether or not that plan produces least cost to customers over time.

The Act does limit the use of long term contracts, however, to a maximum of 25% of the DSP's projected default service load. By specifically limiting long term contracts, and not short term or spot market purchases, it is clear the legislature was inclined to have procurement plans, as a whole, cover a relatively shorter period of time. This is also consistent with the Commission's Policy Statement, which asserts that initial DSP plans should have a term of two to three years and thereafter be for two years, unless otherwise directed by the Commission.<sup>2</sup>

Additionally, Act 129 clearly prohibits an after-the-fact review of a Commission-approved procurement plan to determine if least cost over time was achieved. The Act states

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<sup>2</sup> See Policy Statement, § 69.1804.

unequivocally that “costs incurred through an approved competitive procurement plan shall be deemed to be the least cost over time....” 66 Pa. C.S. § 2807(e)(3.6). Act 129 only provides for an after-the-fact review in two narrow circumstances: where, after hearing, a DSP is found to be at fault for (1) not complying with the Commission-approved procurement plan; or (2) committing fraud, collusion, or market manipulation with regard to generation supply contracts. *See* 66 Pa. C.S. § 2807(e)(3.9).

The prohibition of after-the-fact review is grounded in the least cost requirement. The possibility that a DSP would not recover all of its default service costs creates a cost recovery risk for potential suppliers. The risk of not getting full cost recovery would cause potential suppliers to either (1) not bid, which would decrease the competitiveness of the procurement process; or (2) bid with a significantly higher risk adder that would raise the default service prices for consumers.

**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?**

No. Initially, the question presumes that there is an isolated Pennsylvania market. In actuality, Pennsylvania has the benefit of being a part of PJM Interconnection (“PJM”) and shares resources with 12 other PJM states. PJM manages this multi-state pool, on a least cost basis, to ensure that the wholesale electric power system operates reliably and at the most reasonable cost. Creating state specific regulations to address construction of new generation would frustrate the benefits of the regional nature of the RTO, is not supportive of competitive markets, and would likely lead to substantially higher electric rates for Pennsylvania customers. Moreover, even if Pennsylvania were its own market, the legislative history of Act 129 reflects that the legislature considered and rejected provisions that would require the construction of

generation in the DSP procurement process.

Requiring DSPs to build generation also is inconsistent with the underlying principles of the Competition Act. The Competition Act recognizes that “competitive market forces are more effective than economic regulation in controlling the cost of generating electricity.” 66 Pa. C.S. § 2802(6). In the face of a history of construction cost overruns and poor operational performance, the Competition Act reflected a policy to shift the costs and risks of generation construction and operation from consumers to investors. The Commission should not put these risks on DSPs’ customers.

Moreover, as a practical matter, requiring DSPs to build generation is ultimately inconsistent with customer choice itself. A utility that builds generation to support its DSP obligation faces substantial economic risks if customers migrate to competitive suppliers during the construction of the new plant. This migration risk would be magnified in the (likely) event that construction costs exceeded budget and, in turn, made the default service rate substantially higher than market. The unfortunate solution to this problem – advocated by some – is to eliminate the customers’ right to choose alternative electric suppliers, effectively recapturing the customers in a monopoly. The Commonwealth has consistently rejected these proposals.

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

As explained in the response to Question No. 3, ExGen believes strongly that the Commission should not amend the Default Service Regulations to address construction of generation capacity. If the Commission nonetheless moves forward on this issue, it should do so through a separate rulemaking proceeding allowing all stakeholders the opportunity to fully examine the complex issues and consequences of addressing capacity needs on a one-off basis. At the very least, the regulations must maintain the foundation for obtaining least cost capacity,

that is, competitive procurement.

At a high level, the regulations should (1) require DSP shareholders to assume all construction and operations risks and should (2) not permit DSPs to enter into any contract for new generation unless the price is less than the existing market price for power. The regulations should also specify a competitive process based on lowest cost to the customers, regardless of fuel type, location, technology, or vintage. Additionally, it is important that the new resource be integrated in such a way as to not frustrate existing wholesale market rules. Thus, the Commission should make clear that the economic justification for new capacity cannot include the effect of price suppression on existing markets.

ExGen reiterates that the issues and consequences of an individual state addressing a reliability need outside of the well functioning regional wholesale market rules is complex and requires its own rulemaking proceeding to ensure the final regulations ensure the most cost effective solution to meeting reliability.

**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?**

Managed portfolio and full requirements products are two approaches that are difficult to compare. The fundamental difference between a managed portfolio approach and full requirements approach is allocation of risk. A managed portfolio approach may produce lower prices with great volatility risks while full requirements products minimize risk by forcing generation suppliers to assume the volatility associated with changes in load. As discussed above, the intent of Act 129 is to achieve least cost procurement while also considering price stability, using a prudent mix of products. Some economists would argue that riding the spot market produces the best long term results at the least cost. However, the intent of Act 129 is not just least cost but also “price stability” and a prudent mix of standard and full requirements

products achieves both goals.<sup>3</sup>

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

Consistent with the discussion above, ExGen believes that the Commission must make a determination on a case-by-case basis if each DSP’s procurement plan proposes a prudent mix of competitively procured products that achieves least cost and stability over time. Other than limiting the long term purchases to no more than 25% of the DSP’s projected default service load, there is no bright line test for what amount of which product meets the Act’s goals. As stated above, there is no “cookie cutter” approach. Maintaining procurement flexibility is necessary for the Commission to evolve procurement practices over time and in response to changing market and load conditions.

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

ExGen believes that a procurement plan could potentially achieve the Act’s goals by containing diversified contracts accumulated over time. It does not believe, however, that is the only way to attain the Act’s goals. Accordingly, ExGen respectfully maintains that one of the key elements of a well functioning procurement structure is allowing the DSPs and Commission flexibility in structuring and approving plans that meet the Act’s objectives.

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

No, for all the reasons discussed in ExGen’s answer to Question Nos. 1, and 5-7.

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

No, for all the reasons discussed in ExGen’s answer to Question Nos. 1, and 5-7.

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<sup>3</sup> In adopting the Act, the General Assembly recognized that determination of least cost must also consider “any benefits of price stability over time.” *See* Act 129 of 2008 (Preamble).

- 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?**

No. Other than the existing requirement that long term purchases cannot constitute more than 25% of the DSP’s projected default service load, ExGen submits that the Commission should not put a fixed requirement on any type or length of contract for all the reasons discussed above.

- 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 on 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?**

No. Other than the existing requirement that long term purchases cannot constitute more than 25% of the DSP’s projected default service load, ExGen submits that the Commission should not put a fixed requirement on any type or length of contract for all the reasons discussed above.

- 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?**

No. ExGen believes that DSPs can effectively manage market volatility, while also achieving least cost for the default service customers, by competitively procuring a prudent mix of different electric products. However, to the extent that a DSP and/or the Commission believe that gas options can reduce risk, then they should be permitted to include these options as part of the competitive procurement strategy and plan.

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

The goal of the Act is the same for all customer classes – to achieve least cost and stability. However, different customer classes have different risk tolerances and the same procurement mix that achieves the goals for one class may not achieve the optimal results for another class. The decision of whether a specific DSP’s procurement plan for each customer class achieves the Act’s goals should be made on a case-by-case basis.

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

Credit and collateral provisions in supply agreements typically require a supplier to post collateral equal to the difference between the contract price and market price in order to protect the utilities from default. If a supplier declares bankruptcy, the utility can seize that collateral and use it for contingency procurement plans.

**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?**

No. Act 129 provides specific assurance that supply contracts entered into through Commission approved procurements will not be subject to hindsight review and challenge. Act 129 only provides for an after-the-fact review in two narrow circumstances: where, after hearing, a DSP is found to be at fault for (1) not complying with the Commission-approved procurement plan; or (2) committing fraud, collusion, or market manipulation with regard to generation supply contracts. *See* 66 Pa. C.S. § 2807(e)(3.9).

As stated above in response to Question No. 3, the prohibition against after-the-fact review was designed to ensure procurement plans are competitive, and to protect consumers from artificially high prices.

**16. How should Section 2807(e)(5)'s requirement that "this section shall apply" to the purchase of AECs be implemented?**

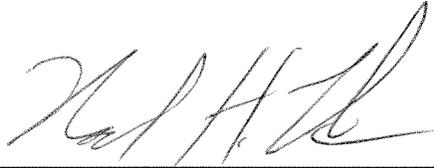
Consistent with ExGen's comments above, the key underpinning of Act 129 is flexibility for DSPs and the Commission in structuring and approving competitive default service procurement plans. Accordingly, ExGen believes a DSP should also have flexibility in how it proposes to procure required alternative energy credits ("AECs") for its default service customers. By stating explicitly, however, that ". . . the provisions of this section shall apply to any type of energy purchased by a default service provider. . . including energy or alternative energy portfolio standards credits required to be purchased. . . ." the legislature clearly intended the overarching requirement of Act 129 – that is "competitive procurements" designed to achieve "least cost overtime" – to also apply to procurements that include AECs. In other words, simply because AECs are required to be purchased pursuant to the Alternative Energy Portfolio Standards Act ("AEPS"), does not exclude those energy products from the overarching goals of Act 129 to achieve least cost and price stability for default service customers. Additionally, to the extent that AECs are procured under long term contracts, the provisions of Act 129 allowing DSPs sole discretion to determine source and fuel type to meet its AEPS requirements must also apply.

**VI. CONCLUSION**

ExGen appreciates the opportunity to provide comments to the Commission's proposed amendments and the specific questions posed in the Rulemaking Order regarding the interpretation of certain Act 129 provisions. ExGen respectfully reiterates that the Commission rules should follow the legislative intent and preserve much needed flexibility at a time when energy markets, load, and environmental considerations are rapidly changing. Making a determination of each DSP's procurement plan on a case-by-case basis is the most effective way

to ensure the plan meets the goals of Act 129 and the legislature’s objective that the Commission make individualized, “specific findings” that each plan “includes prudent steps necessary to obtain least cost generation.”

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Noel Trask', written over a horizontal line.

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Dated: June 1, 2010