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June 15, 2010

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

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

Dear Secretary Chiavetta:

Enclosed for filing are the Reply Comments of the Office of Consumer Advocate, in the above-referenced proceeding.

Should you have any questions, please contact our office at the number above.

Respectfully Submitted,

Jennedy S. Johnson

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Assistant Consumer Advocate
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Enclosure
cc: Elizabeth Barnes, Assistant Counsel (via e-mail only)

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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

REPLY COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE
REGARDING PROPOSED MODIFICATIONS
TO THE DEFAULT SERVICE REGULATIONS

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Dated: June 15, 2010

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I. INTRODUCTION

On May 1, 2010, the Commission's Proposed Rulemaking Order Regarding Implementation of Act 129: Default Service was published in the *Pennsylvania Bulletin*. 40 Pa.B. 2267. In the Rulemaking Order, the Commission proposed amendments to its default service regulations as required by the enactment of Act 129 in order to make those regulations consistent with the Act. The OCA and others submitted Comments on the Proposed Rulemaking Order on June 1, 2010. The OCA now submits these Reply Comments to the Comments filed by others in this matter.

As the OCA has set forth in its Comments on this issue, the design of default service remains one of the most critical tasks facing the Commission. Act 129 affirms and strengthens the obligation of Default Service Providers (DSPs) to bring the benefits of competitive prices in the wholesale market to all customers – including those who remain on default service. The preamble to Act 129 states that one of the main goals of the Act is to reduce the cost and price instability of electric energy:

> The General Assembly recognizes the following public policy findings and declares that the following objectives of the Commonwealth are served by this act:
>
> (1) The health, safety and prosperity of all citizens of this Commonwealth are inherently dependent upon the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, taking into account any benefits of price stability over time and the impact on the environment.

Act 129, 66 Pa.C.S. § 2806.1 *et seq*, pmbl.

As the Declaration of Policy makes clear, the Act was passed in large measure to bring down the cost of power and provide price stability to customers over time. Act 129 was passed in October 2008, in advance of the end of rate cap protections for most Pennsylvania consumers. In order to ameliorate potential rate increases, and reach the goal of reasonable rates, the Act addresses several aspects of generation procurement as well as customer usage that can impact the cost and price of service. The Act requires DSPs to implement comprehensive energy efficiency programs, develop advanced metering and rate programs, and affirmatively seek out default supplies for customers at the least cost over time. It is from a comprehensive view of the Act that the OCA submits the Commission must implement its changes to the existing default service regulations.

In these Reply Comments, the OCA will address the positions and proposals of some of the Companies and Organizations who submitted Comments in this matter. The OCA requests that these Reply Comments be read in conjunction with its Comments filed on June 1, 2010 that address these and other issues in greater detail.

II. REPLIES TO SPECIFIC ISSUES RAISED BY COMMENTERS

A. Default Service Procurement Methodology.

A number of Commenters discussed the issue of the means by which default service supply is procured (i.e. full requirements contracts versus a managed portfolio). This issue is at the heart of Act 129 itself. As the OCA discussed in is Comments, Act 129 requires DSPs to provide customers with the least cost service over time, through a mix of default supplies that best accomplishes that goal. Act 129 severs the Restructuring Act's prior requirement that default service rates must reflect "prevailing market prices," and instead empowers DSPs to actively engage the competitive wholesale market, and bring demand side and energy efficiency resources to bear, as a means of ensuring that non-shopping customers receive reliable and adequate service at stable rates designed to be least cost over time (the issue of prevailing market prices will be discussed in more detail in Section D, below).

With respect to full requirements contracts, certain Commenters generally stated two arguments: 1) the full requirements approach is a form of a portfolio approach and 2) full requirements contracts produce better price results than utility-managed portfolios. Companies such as Allegheny Power, PPL Electric, the First Energy Companies and PECO argue that full requirements contracts are a form of managed portfolio because they provide customers with long-term value and utilize the wholesale supplier's portfolio of resources. See Comments of Allegheny Power at 4-5; Comments of PJM Power Providers Group at 5-6; Comments of PPL Electric Utilities at 8-10; Comments of the First Energy Companies at 7; Comments of PECO at 12; Comments of Constellation at 22-28[1]. Additionally, many of these Commenters allege that there is no evidence to support the notion that a managed portfolio approach will, in fact, result

[1] The OCA would note Constellation's Comments, although specifically addressing the proposed Rulemaking, were filed in the M-2009-2140580 Policy Statement docket. Any references or citations in this document to Constellation's Comments are to those that were filed in Docket M-2009-2140580.

in default service costs that are the least cost to customers over time. Id. The OCA disagrees with these positions for the reasons discussed below.

As was discussed in its Comments, the OCA submits that DSPs should purchase default supplies through a portfolio approach to best meet Act 129's requirements. Under a portfolio approach, each DSP will procure power directly from the wholesale market through a variety of products tailored to the specific load. In order to balance the precise load at a given time, the DSP would be able to access the energy balancing services of PJM (or for Pike, NYISO) Regional Transmission Organization through spot market purchases and sales. A portfolio approach provides the default service provider with the latitude needed to procure the various products available to meet its least cost obligation. Indeed, these thoughts were echoed in the Comments of Citizens' Electric Company and Wellsboro Electric Company who, although smaller utilities, utilize a full managed portfolio approach. Comments of Citizens and Wellsboro at 6.

In addition, a portfolio approach will allow the DSP to lower the cost of the supply portfolio when customers participate in Act 129's energy efficiency, demand response and time of use (TOU) rate programs. To the extent that residential customers reduce usage or can be called at times of peak demand to reduce or shift load, the portfolio manager will be able to incorporate those savings into reduced spot purchases at high cost periods and into reduced block purchases, if needed. To the extent that residential customers are able to utilize smart meter technology to reduce peak demand, the portfolio manager will be able to procure less power at high cost peak periods. The end result is a reduction in the supply costs to the portfolio and a reduction in the rate levels needed to ensure that the DSP recovers all of its reasonable costs.

Although many of the Commenters criticized the managed portfolio approach, they failed to address the drawbacks of the full requirements approach. In contrast to a portfolio approach, full requirements contracts shift the obligation to meet default service load to third party suppliers. These suppliers are obligated to meet a fixed percentage of the default load at both on-peak and off-peak hours. In addition, these suppliers are required to provide service to a set percentage of default load regardless of the level of retail shopping that takes place in the service territory. The risks associated with the variation of load are assigned a risk premium cost by bidders and are priced into the winning bids and paid for by default service customers. Finally, winning suppliers must incorporate a profit margin to make their participation meaningful. These profit margins are in addition to the profit margins the generation suppliers build into their supply of the product to the full requirements middlemen. While the bidding process will identify the bidder that prices the risk premium and profit at the lowest level, it will not eliminate the need for full requirements suppliers to incorporate these additional costs into their bids.[2]

Under the Portfolio Approach, the DSP can directly access the generation products available in the wholesale market without the need to pay an extra level of profit and risk premiums to full requirements suppliers. As noted above, the OCA is unaware of any quantitative analysis showing full requirements products to be least cost products. Indeed, it

2 Commenters supporting the full requirements approach argue that it is a form of portfolio approach. The full requirements provider does not, however, reveal its procurement approach or its "portfolio" making it impossible to reach this conclusion.

should come as no surprise that the introduction of a third party middleman to take on the default supplier obligation would add, rather than subtract, costs.[3]

Further, Constellation argues that a managed portfolio approach requires the DSP to time the market. Comments of Constellation at 24-30. This criticism is incorrect. Under a managed portfolio approach, a DSP is able to diversify its risks by purchasing a variety of products over a period of time. The DSP can generally follow an approved schedule but also has the flexibility to decide to modify its purchases when market conditions clearly call for such changes. This is not trying to beat the market, as claimed by the Commenters that are critical of the managed portfolio approach. Rather, it is the exercise of sound, prudent business judgment based upon knowledge of the market conditions.[4]

With respect to the second assertion made by certain Commenters, that there is a lack of evidence supporting the use of a managed portfolio approach, the OCA submits that evidence from recent procurements demonstrates that the procurement of default supplies through a portfolio approach has been beneficial to consumers.

Citizens and Wellsboro utilize the portfolio approach to procure all of the power needed to provide default service. Utilizing the portfolio approach, the Companies have realized the following default service prices:

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3 In its Comments, P3 references the "Monte Carlo" study published by the NorthBridge Group for a proceeding before the Rhode Island Public Utilities Commission. Comments of P3 at 6. While the Northbridge study points out what it claims are the disadvantages of block and spot default service supply, their study also concedes that block and spot are actually less expensive than full requirements. (See page 20 of the Northbridge report).

4 The OCA would also note that Constellation references the unique situation that arose in the Wellsboro service territory in 2008 as a reason not to use a managed portfolio approach. Comments of Constellation at 22-23. In the case of Wellsboro, the utility had contracted for power supplies delivered at the PJM Western Hub. Due to a transmission problems Wellsboro experienced a temporary spike in congestion for the path between the Western Hub and its service area. Under both a managed portfolio and a full requirements approach, this problem can be avoided by contracting for energy to be delivered directly to the DSP's zone. As shown below, even with the extraordinary price spike, customers of Wellsboro and Citizens have fared quite well under the Companies' managed portfolio approach. It is telling the Wellsboro and Citizens, which have no unregulated generation affiliates, continue to support a portfolio approach. See Comments of Citizens and Wellsboro at 6.

	JAN-08	APR-08	JUL-08	OCT-08	JAN-09	APR-09	JUL-09	OCT-09	JAN-10	APR-10
CITIZENS ¢/kwh	7.9028	8.6162	9.9792	10.081	9.6705	8.8099	7.423	9.5399	8.2687	9.055
WELLS. ¢/kwh	8.5561	10.673	10.672	10.405	11.706	7.6571	7.7516	8.5294	7.3017	8.6542

Sources: PUC tariff filings for Citizens and Wellsboro.

During this same time frame, both PPL and Penn Power were procuring supplies through a full requirements approach for default service customers. For PPL, its default service price in 2010 is 10.448 cents/kwh for residential customers. Penn Power's residential customers saw default service prices that were higher in each quarter of 2008-2010 than the Citizens and Wellsboro prices and ranged from 9.44 cents/kwh to 12.8 cents/kwh.

As noted above, Wellsboro was subjected to a significant spike in the level of Congestion charges in the PJM market in late 2007 through early 2008. The Congestion charges were hundreds of times greater than what Wellsboro would typically have experienced at the Wellsboro Aggregate Bus. The Commission approved recovery of those congestion charges over a twelve month period, and opened an investigation into the price spike that was resolved through the approval of a Settlement (P-2008-2020257). The OCA notes that the April 2008 through January 2009 Wellsboro rates reflect this pricing anomaly. Wellsboro's all-in generation prices between April 2009 and April 2010 ranged from 7.3 cents/kwh to 8.65 cents/kwh.

There have also been several procurements made by DSPs for future default service where block products were purchased along with full requirements products. The OCA recognizes that block purchases do not include all of the product attributes and costs that are included in full requirement purchases and must be incorporated in a comprehensive portfolio (including capacity, ancillary services and load shaping costs) in order to determine the total cost to customers. In addition, prices will vary based on the timing of purchases, location, RTO, and ratemaking differences. Even when taking into account these variations, however, the OCA submits that the use of a broader portfolio of products has had a positive impact on the procurements done to date in Pennsylvania.

The difference in the full requirements and managed portfolio approaches can be seen in recent procurements by other Pennsylvania EDCs. For example, on April 22, 2010, PPL Electric Utilities released the results of procurements made earlier that month. For residential customers, PPL procured both full requirements contracts and 25 MW round-the-clock blocks of power for delivery from January 2011 through February 2012. The price of the block purchases for that delivery period averaged $46.59 per MWh. The winning bid price for the full requirements tranches during that same period was $74.82 per MWh.

PECO also procured both block energy products and full requirement products in order to serve its post-rate cap default service load. PECO's publicly released information shows that the average winning bid price for its residential full requirements tranches in its Spring 2009 solicitation was $88.61 per MWh and the average winning bid in its Fall 2009 solicitation for its residential full requirements tranches was $79.96 per MWh. PECO also released the aggregate results of its residential block energy purchases from the Spring 2009 and Fall 2009 solicitations, and the average winning bid price was $61.74 per MWh. PECO's publicly available rate information can be found on its website, http://pecoprocurement.com/index.cfm ?s=background&p=previousResults.

In addition, Met-Ed and Penelec procured both full requirements contracts and block products for residential customers in early 2010. For full requirements tranches to meet January through May 2011 residential load, the average price result was $77.76 per MWh for

Met-Ed, and \$64.34 per MWh for Penelec. For the 50 MW, round-the-clock block of power procured to serve residential load for the 48 month period beginning June 2011 and ending in May 2015, the Met-Ed and Penelec block prices were \$59.77 per MWh and \$54.38 per MWh, respectively. Importantly, these block purchases are for round-the-clock service <u>for a four-year period</u>.[5]

While comparisons of block and full requirements products cannot be made on an "apples to apples" basis, the OCA submits that Pennsylvania DSPs have been able to purchase a variety of block power products at reasonable prices. At the very least, this evidence suggests that block and spot purchases should be a part of the prudent mix of products required in order to ensure that default service is "least cost to customers over time."[6]

The OCA further submits that a portfolio approach is most consistent with both the supply and the demand aspects of Act 129. Act 129 requires that each DSP shall include a prudent mix of resources. 66 Pa.C.S. § 2807(e)(3.2). A portfolio approach allows the discretion to include a variety of resources and products and affords the flexibility to incorporate new products into the supply mix when available. Through the incorporation of a portfolio approach, each EDC will be able to bring the full benefits of Act 129's energy efficiency, demand response, smart meter, and time of use rate requirements to retail customers. To the extent residential customers reduce usage and peak load, for example, the DSP will be able to

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5 In addition to the specific Pennsylvania procurements addressed above, in its Comments the OCA also addressed other states' results under the full requirements approach. <u>See</u> Comments of the OCA at 15-17. In New Jersey, for example, where generation is procured under a series of three year full requirements contracts, the resulting prices for New Jersey utilities ranged from 10.35 cents/kwh to 11.27 cents/kwh in 2009 and from 9.51 cents/kwh to 10.33 cents/kwh in 2010, even as overall PJM energy prices fell dramatically. <u>See</u> <u>http://www.bgs-auction.com/bgs.auction.prev.asp</u>.

6 The OCA also submits that a portfolio approach is more appropriate to meet the Commission's obligation to ensure adequacy of supply. As noted in the OCA's response to Questions 3 and 4 in its Comments, the OCA supports the use of long term contracts to facilitate new generation construction. Under a portfolio approach, the Commission could integrate these types of long term contracts into a DSP's procurement plan. It is unclear that such contracts could be included under a full requirements approach.

incorporate those savings into reduced spot purchases during high cost periods, and into reduced block purchases if needed. To the extent residential customers are able to utilize smart meter technology to reduce demand, the DSP will be able to procure less power at high cost peak periods. The end result is a reduction in the supply costs to the portfolio, and a reduction in the rate levels needed to ensure that the DSP recovers all of its reasonable costs.

For these reasons, and those detailed throughout its Comments, the OCA submits that a portfolio approach is more likely to result in the least cost to customer over time than is the full requirements approach.

B. Long Term Contracts.

Some Commenters stated that consumers will be harmed by the inclusion of long term contracts in the mix of products procured for Default Service. See Comments of the National Energy Marketers Association at 3-4; Comments of the Pennsylvania Energy Marketers Coalition (PEMC) at 3. This argument stems from the notion that the pricing of long term contracts is inconsistent with current market conditions. These Commenters allege that the "least cost" aspect of Act 129 should be considered in relation to current markets. Comments of the National Energy Marketers Association at 4; Comments of PEMC at 3.

This argument is directly contrary to the plain language of Act 129 which states that electric power procured to serve default service customers "shall include a prudent mix of the following: (1) spot market purchases, (2) short-term contracts, (3) long term purchase contracts…." 66 Pa.C.S. § 2807(e)(3.2) (emphasis added). While what constitutes a prudent mix will vary from Company to Company and from class to class, any suggestion that long term contracts should not be considered as part of this mix is clearly contrary to the language of Act 129.[7]

For these reasons, the OCA submits that the Comments recommending that long term contracts not be used in the provision of default service must be rejected.

C. Prudent Mix.

Many Commenters discussed what constitutes a prudent mix of contracts in their Comments. For example, both the Industrial Customer Groups and Citizens and Wellsboro state that for a there to be a prudent mix, at least two of the three types of purchases (i.e., spot market purchases, short term contracts and long term contracts) must be used. Comments of the Industrial Customer Groups at 4; Comments of Citizens and Wellsboro at 7. Some utilities, such as Allegheny Power, commented that only spot market purchases are appropriate for the Industrial Class. Comments of Allegheny Power at 6.

The OCA submits that that statutory language indicates a preference for a mix of all categories of supply (long term, short term and spot). The OCA further submits that the Act requires that the supply mix be prudent. In reconciling these provisions, the OCA submits that the ultimate purpose of the Act is to achieve "least cost to customers over time." In this regard, the appropriate mix may vary by customer class, particularly given differing expected retail shopping levels. For residential customers, the OCA generally supports the inclusion of all categories of products unless such procurements will clearly result in higher costs.

Accordingly, the OCA submits that what constitutes a prudent mix of contracts would vary from DSP to DSP, and vary depending on market conditions. A prudent mix of contracts may also vary from one class of customers to another. What constitutes a prudent mix

[7] The OCA would note that the issue of what constitutes a prudent mix is addressed in more detail in Section C, below.

of supply for residential customers could be substantially different than what would be a prudent mix of supply for industrial customers where most customers are expected to shop.

D. What Constitutes The "Least Cost to Customers Over Time".

In its Comments, the National Energy Marketers Association (NEM) states that the concept of "least cost to customers over time" should be "consistent with the competitive electric market principles adopted for the Commonwealth in the Electric Generation Customer Choice and Competition Act." Comments of NEM at 1-2. NEM specifically discusses competitive market forces in relation to least cost procurement and states that "consumers can be significantly harmed by utility long-term pricing that bears little resemblance to market conditions." Id. at 2-3. The OCA reads these Comments (along with NEM's citation of 1 Pa. C.S.A § 1932(b), relating to construing multiple statutes as one) to suggest that the previous prevailing market prices standard should, in some way, be read in conjunction with the least cost to customers over time standard. Such a statutory construction cannot be supported.

Act 129 specifically repealed the requirement that DSPs procure power to serve default customers at "prevailing market prices" and replaced that requirement with the obligation of DSPs to procure power at "least cost to customers over time." The OCA submits that understanding what the repealed language required helps to provide an understanding of the current legal requirement, and why the two standards are not equivalent. While the prevailing market prices standard provided the DSP with some latitude in what was to be procured, it did not explicitly require the DSP to develop a plan with the paramount goal of keeping costs down over time for its customers. There were a number of different market products and prices available for DSPs to meet their default service obligation. The prior language allowed each DSP to procure default supplies in the market, regardless of the type, and allowed for the recovery of those costs as long as they matched the "prevailing market price" of the relevant product at that time.

The language "least cost over time" changes the role of the DSP from that of a passive acquirer of default supplies at prevailing market prices and places on the DSP an affirmative obligation to assess which products will produce the lowest costs to customers. The key element of this language change is the shift of the DSP from simply matching its purchases to market prices at a particular point in time to seeking a prudent mix of resources at the least cost to customers over time. The OCA submits that the new standard requires that a DSP develop a procurement plan that will capture the benefits of the competitive wholesale markets and bring power to its default customers at rates that reflect the lowest costs to customers over the term of the plan and beyond. Such prices may be higher or lower than the prevailing market prices at any given point in time. But the overarching goal is to provide service to customers at the least cost over the course of time. When developing its procurement plan—in order to develop continuity in rates over the years—each DSP should avoid sole reliance on short term purchases. As explicitly noted in the Preamble to Act 129, while the DSP must focus on least cost, it should also consider the benefits of rate stability.

Accordingly, to the extent that the Commenters suggest that the prevailing market prices standard is essentially the same as the Act 129 mandate of least cost to customers over time, the Comments must be rejected.

E. What Time Frame Should Be Used To Measure "Least Cost Over Time".

A number of Commenters addressed the time period over which the "least cost over time" mandates of Act 129 should be measured. 66 Pa.C.S. § 2807(e)(3.4). For example, Citizens/ Wellsboro proposed a five-year time period and First Energy, Duquesne and PECO proposed the duration of each approved Plan (i.e. 2 years). Comments of Citizens and Wellsboro at 5; Comments of First Energy at 4; Comments of PECO at 6-8; Comments of Duquesne at 6.

The OCA submits that the "least cost over time" standard should not be constrained to the period of each approved plan. Such a restriction might preclude the consideration of long-term contracts that typically extend beyond the period of the approved plan. The OCA submits that the key inquiry should be whether each DSP has established a procurement plan by which it will actively engage the wholesale market to procure the best mix of products to benefit its particular default service customers, both during the term of the plan and beyond. For example, for a larger DSP with an anticipated large default service load, a mix of products that includes a substantial purchase of longer term resources may be appropriate. A large DSP may have access to a wider pool of suppliers and to suppliers that have an interest in locking up substantial power commitments over a longer time horizon. In all cases, the key element for review must be whether the DSP has taken an active role in evaluating all available market alternatives and will pursue a reasonable approach designed to bring its default customer the benefits of its procurement plan over time.

F. Adjustment of Prices.

In its Comments, the Pennsylvania Energy Markets Coalition (PEMC) states that utility default service pricing for residential and small commercial customers should be adjusted monthly. Comments of PEMC at 3. This recommendation is directly contrary to the statutory language of Act 129 which provides that the DSP shall offer residential customers a generation rate that "shall change no more frequently than on a quarterly basis." 66 Pa.C.S. §2807(e)(7) (emphasis added). This provision specifically modified existing regulations that required to DSPs to change default service rates for all customer classes with a maximum peak load of under

25 kW (such as residential customers) on a quarterly, or more frequent, basis. PEMC's proposed monthly adjustments are clearly prohibited by Act 129.

Therefore, the OCA submits that the portion of PEMC's comments addressing the adjustment of prices must be rejected.

III. CONCLUSION

The OCA appreciates this opportunity to submit Reply Comments on these proposed regulations. The OCA looks forward to working with the Commission to develop default service provisions that benefit Pennsylvania consumers and that are consistent with the principles of the Public Utility Code, as amended by Act 129 of 2008.

Respectfully Submitted,

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