

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Rulemaking Re Electric Distribution
Companies' Obligation to Serve Retail
Customers at the Conclusion of the
Transition Period Pursuant to 66 Pa. C.S.
§2807 (e)(2)** : : **Docket No. L-00040169**

Default Service and Retail Electric Markets : : **Docket No. L-00072009**

**REPLY COMMENTS ON BEHALF OF METROPOLITAN EDISON
COMPANY, PENNSYLVANIA ELECTRIC COMPANY AND
PENNSYLVANIA POWER COMPANY**

TO THE PENNSYLVANIA PUBLIC UTILITY COMMISSION:

I. INTRODUCTION

On February 9, 2007 the Pennsylvania Public Utility Commission (“Commission”) entered two orders, *Rulemaking Re Electric Distribution Companies’ Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807 (e)(2)* (“ANOFR” or “Rulemaking”) and *Default Service and Retail Electric Markets* (“Policy Statement”). Pursuant to these orders, Metropolitan Edison Company (“Met-Ed”), Pennsylvania Power Company (“Penn Power”) and Pennsylvania Electric Company (“Penelec”) (collectively “FirstEnergy” or “the Companies”) provided comments to the ANOFR and the Policy Statement on March 2, 2007 as did many other entities. Below are FirstEnergy’s Reply Comments to selected issues raised by various organizations in their comments to the ANOFR and Policy Statement.

II. COMMENTS

1. “Lowest Reasonable Long Term Costs” Standard should not be used.

In its comments, the Office of Consumer Advocate (“OCA”) and IECPA¹ endorses the use of the lowest² reasonable long-term costs standard. However, FirstEnergy agrees with PPL Electric that it would be impossible to apply this standard since the Commission has not provided a definition and this standard would subject default service providers (“DSPs”) to inappropriate after-the-fact reviews. In fact, the Commission’s pre-approval process for competitive procurement plans would no doubt be lengthy and litigious as each party advocates its view of the single “lowest” cost. The Companies also agree with the Office of Small Business Advocate (“OSBA”) and PECO Energy Company (“PECO”) that this standard conflicts with Section 2807 of the Electricity Generation Customer Choice and Competition Act (“Competition Act”)³, which requires DSPs to acquire electric energy at “prevailing market prices”. The use of this standard could lead to a significant amount of litigation as DSPs are second guessed regarding their procurement plans and could also dampen the DSPs ability to “recover fully all reasonable costs” as required by Section 2807(e)(3). As long as a DSP implements its Commission-approved plan, there should be no additional hurdle regarding “lowest reasonable long term costs” that would prohibit cost recovery.

Additionally, IECPA points to this standard as justification for its position that DSPs should be mandated to offer long-term fixed price service.⁴ IECPA contends that without

¹ IECPA represents the Industrial Energy Consumers of Pennsylvania, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Users Group, PP&L Industrial Customer Alliance and the West Penn Power Industrial Intervenors.

² OCA at 2. IECPA at 2.

³ 66 Pa. C.S.A. § 2801 et al.

⁴ IECPA at 2.

this offer, the DSP would not be a competitive alternative.⁵ The Companies disagree with requiring DSPs to make such an offering. The proposition that default service should be competitive is contrary to the Competition Act because, as evident from the name, it is meant to be a basic default service for customers who choose not to shop or whose supplier does not deliver electricity as contracted. It is clearly disingenuous to argue that the service to be available, in the event no other service is available, should itself be viewed as in competition with other types of service. DSPs should not be forced into what could potentially be long-term, below market contracts to the detriment of the development of competitive electric markets as required by the Competition Act.

2. Reconciliation does not restrict shopping and DSPs must be allowed reconciliation to fully recover all reasonable costs as required by Section 2807(e)(3) of the Electric Competition Act.

Several commentators, Retail Energy Supply Association (“RESA”), Strategic Energy, LLC, Direct Energy Services, LLC, Dominion Retail, Inc. and IECPA suggest that the Commission should reverse its position and not allow reconciliation. At the core of their arguments is the belief that reconciliation will have a chilling affect on competition. Based on the arguments put forth by these parties, it is not clear that there is a common understanding of the purpose and effect of reconciliation. The Companies agree with Constellation Energy Group Companies who recommend the Commission should clarify “interim price adjustments to the PTC... will be made only for reconciliation purposes – i.e., to account for new supply mix blended into a DSP’s default service load and in order to reconcile default service costs and revenues – and not for changes in published and/or estimated market prices for energy.” (Pg. 10.)

⁵ Id at 8.

The Companies believe that reconciliation is a critical component to competition; not a barrier as portrayed by some commentators. The purpose of reconciliation is to ensure that DSPs do not lose money nor profit from providing this essential service. It effectively neutralizes any explicit or implicit incentives the DSP may have to compete with competitive service providers. Customers need to know that there will be a financially stable DSP to provide the essential service they require. Yet, customer shopping patterns can and do shift with changes in market prices. Reconciliation protects the customer from the DSP profiting from such shifts and at the same time protects the DSP from the financially adverse effects of a shortfall arising from what it is paying for default supply and what it is collecting from customers. As the Commission states “reconciliation would ensure that DSPs fully recover their actual, incurred costs without requiring customers to pay more than is required.” Competition cannot be promoted to the detriment of DSPs. In fact, Section 2807(e)(3) of the Competition Act mandates that DSPs fully recover all reasonable costs. Reconciliation via an automatic adjustment clause is the appropriate mechanism to provide DSPs with full cost recovery.

IECPA attempts to limit the types of costs that are subject to reconciliation, by asking the Commission to confirm that congestion is to be included in the wholesale suppliers’ bids and will not be subject to reconciliation in the Price-to-Compare (“PTC”). As stated above, this limitation would be contrary to Section 2808(e)(3) of the Competition Act which mandates that DSPs fully recover all reasonable costs. Second, FirstEnergy believes that the Commission correctly allowed flexibility in the rules for the DSP to develop a supply plan that could utilize a variety of wholesale market products, including spot purchases. The use of spot market purchases of generation and transmission as part of a supply plan by definition would be variable

and unpredictable in nature, and reconciliation of the generation costs and all transmission costs, including transmission congestion costs, will be needed to allow spot purchases to be viable. Reconciliation of all transmission costs associated with POLR service is needed to allow the DSP the ability to recover all costs.

Additionally, FirstEnergy agrees with the OSBA that not having reconciliation can actually undercut competition.⁶ Without reconciliation, there can be an under-collection resulting in default service customers paying below market rates. This more than anything will dampen electric generation suppliers' ability to compete. Contrary to the arguments of the opposing commentators, reconciliation is the only means of sending accurate price signals. The Companies also agree with the OCA that since cost recovery for compliance with the Alternative Portfolio Standards Act is reconcilable, all default service cost should receive the same treatment.⁷

In their comments the OCA states that reconciliation should occur annually and not quarterly.⁸ The Companies believe DSPs should have the flexibility to propose a monthly, quarterly or annual reconciliation process. Only permitting an annual reconciliation could cause large deviations year to year in the default service rate whereas more frequent adjustment will minimize retail price volatility and will minimize differences between the actual retail price paid by customers of the DSP and DSP's underlying supply cost which will have been incurred in accordance with an approved plan.

⁶ OSBA at 11.

⁷ OCA at 21.

⁸ Id.

As stated earlier, DSPs must be assured that they fully recover all reasonable costs and reconciliation is the most effective means to accomplish full recovery.

3. Customer Class Groupings as well as the need for Joint Procurement should be left to the determination of each DSP.

The OCA advocates a separate class for small commercial groups with less than 25 kW peak load.⁹ FirstEnergy believes that customer class groupings should remain flexible and be left to each DSP to propose and justify as part of their DSP procurement plan. The DSPs can submit the customer class grouping that they feel are appropriate, based on the DSPs knowledge of load and rate schedules, when the DSPs submit their plans for approval. All parties to the proceeding will have the full opportunity to support or challenge these DSP-specific customer groupings with the Commission when making the final decision on the appropriateness.

Section 54.186(b)(2) of the ANOFR allows larger DSPs the flexibility to engage in joint procurement. The Companies agree with this approach and advocate a simultaneous process in which all DSPs in the state procure their default supplies for their separate needs at the same time. If the Commission stops short of requiring a statewide, simultaneous procurement process, the Commission should also stop short of prohibiting it. However, the OSBA advocates that Penn Power should be required to evaluate a joint procurement option.¹⁰ Penn Power's load of 950 mw (approximate summer peak demand) is more than nine times the size of the other DSPs listed in this section. Additionally, Penn Power is the only DSP operating in the Midwest

⁹ OCA at 62.

¹⁰ OSBA at 7.

Independent System Operator (“MISO”) and its procurement plan has been designed to accommodate MISO planning requirements. FirstEnergy does not believe that Penn Power should be *required* to evaluate and engage in joint procurement any differently from the other larger utilities.

4. Switching Rules are necessary.

IECPA has implied that customers should be able to switch from shopping to default service with a minimum amount of rules.¹¹ Yet IECPA also advocates that the DSP be mandated to offer long-term, fixed price service without any reconciliation. These positions are entirely contradictory and subject the DSP to substantial financial risk. Simply put, the DSP should not have to commit to a long-term price for customers who may come and go at will without the DSP having assurance of full recovery of the supply costs it is incurring on behalf of those customers. FirstEnergy agrees with PECO that switching rules also are necessary to protect against seasonal gaming.¹² Furthermore, when a customer shops and returns to default service, the DSP should be able to evaluate the customer’s creditworthiness since the DSP will be holding the credit and collection risks. Customers who pose credit risks normally are assessed a deposit and a shopping customer who returns to DSP should be no exception.

Additionally, IEPCA’s advocacy for the DSP to be required to offer large customers a long-term, fixed price option flies in the face of real world experience. Penn Power beginning January 1, 2007 offered its large customers several pricing options in accordance with

¹¹ IECPA at 23.

¹² PECO at 16.

the Commission's orders¹³. Customers could chose a fixed price option from Penn Power where the price is a fixed rate for eighteen months, or they could chose an hourly price option or they could chose to receive generation service from an alternative supplier. Based on initial billing data, it appears customers representing 82% of the mwh's chose an alternative supplier, presumably because it was in their best self interest to do so. Of the energy being supplied by Penn Power, customers representing 78% of the mwhs chose the hourly priced option, not the fixed price option. Stated differently, only 4% of the energy being consumed by the largest customers is being supplied by the DSP and is being billed under a fixed price tariff. This actual experience, reflecting the independent decisions of customers vividly conflicts with IECPA's representations that these same types of customers must have long-term, fixed price options from the DSP.

5. Only incremental costs should be removed from an EDC's distribution rates.

OCA is properly concerned that the proposed Policy statement is overly broad in the discussion of costs which should be removed from distribution charges and included in the Price To Compare (pg. 22-24). Each cost category of an EDC should be examined carefully and only costs which are truly incremental or avoidable by an EDC should be removed from the EDC's distribution charge.

6. Regulations are controlling for DSP plans for delivery periods beginning January 1, 2011.

The Companies agree with OSBA (pg. 3) and DQE (pg. 4) the proposed regulations should be controlling for procurement plans beginning January 1, 2011. For EDCs

¹³ Docket No. P-00052188.

which have already exited their transition periods, the proposed regulations will clearly shape their DSP procurement plans and activities, but strict conformance to the regulations may not be possible in light of existing contractual commitments and prior Commission orders.

III. CONCLUSION

The Companies again commend the Commission for its generally carefully considered approach and appreciate the opportunity to provide comments on this very important subject.

Respectfully submitted,

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