BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Default Service and Retail Electric Markets) Docket No. M-00072009

COMMENTS OF THE
NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM)[1] hereby submits Comments on the Commission's Proposed Policy Statement on a default service regulatory framework pursuant to the Order adopted February 8, 2007, in the above-referenced proceeding. NEM commends the Commission for its comprehensive strategy embodied in the Proposed Policy Statement, the Advanced Notice of Formal Rulemaking on default service regulations and the Order on electricity price mitigation. Taken in combination, these measures will advance the development of the competitive retail electric market and provide needed regulatory certainty to the stakeholders.

In 2004, the New York Public Service Commission (NYPSC) issued a Statement of Policy on Further Steps Toward Competition in Retail Energy Markets.[2] The NYPSC's Policy Statement set forth a number of accelerated migration strategies that the state's electric and natural gas utilities subsequently implemented. The results have been

[1] NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, advanced metering, demand and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include inventors, patent holders, systems integrators, and developers of advanced power line surveillance and grid reliability technology with advanced uses in Power Line Communications (PLC) technologies as well as new and innovative electrical applications known as Smart Electricity.™

[2] New York Public Service Commission, Case 00-M-0504, Retail Competitive Opportunities, Statement of Policy on Further Steps Toward Competition in Retail Energy Markets, issued August 25, 2004 [hereinafter Retail Policy Statement].

dramatic. The number of competitive suppliers competing to serve consumers in the State of New York has increased to over one hundred, and consumer migration, particularly amongst the residential customer class, has been remarkable.[3] In tandem with its issuance of the Policy Statement, the NYPSC instituted an Office of Retail Market Development (ORMD). THE ORMD was charged with facilitating the implementation of the Policy Statement, and it has gained national and international recognition for its significant achievements in this regard.

NEM is pleased that this Commission appears poised to follow a similar path to that of the NYPSC. Many of the recommendations set forth in the Proposed Policy Statement closely mirror the Policy Statement from New York. And, importantly, this Commission has also proposed to institute choice ombudsmen at both the Commission and utility-level. NEM's supports this Commission's efforts to ensure the further development of the competitive retail electric market as embodied in the Proposed Policy Statement. NEM's comments on the Proposed Policy Statement are intended to support and strengthen the Commission's vision based on NEM's experience in this and other jurisdictions.

I. Default Service Procurement Model

The Commission has proposed that default service providers (DSPs) utilize a portfolio approach to energy procurement accompanied with regular price adjustments. The Commission rejected the wholesale auction method utilized by New Jersey because, "we are not convinced that the New Jersey procurement approach for residential customers has allowed meaningful retail competition to develop for these customers at this time."

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[3] In New York, over 1.25 million customers have migrated to competitive suppliers. Of that 500,000 customers migrated just since the time the NYPSC's Retail Policy Statement was issued in August 2004.

(Order at 4). In the alternative the Commission is encouraging DSPs to ladder contracts, make multiple procurements over the course of a year, and utilize spot market purchases.

The Commission proposes that for residential customers and non-residential customers with less than 25kw in maximum registered peak load, procurement practices should feature, "procuring most fixed-term supply through full requirements contracts of one to three years in duration. Contracts should be laddered to minimize risk, with a minimum of two competitive bid solicitations a year to further reduce the risk of acquisition at a time of peak prices." (Proposed Section 69.1805(1)). For non-residential customers with 25-500kw in maximum registered peak load, "Fixed term contracts should be one year in length and may be laddered to minimize risk, with a minimum of two competitive bid solicitations a year to further reduce the risk of acquisition at a time of peak prices." (Proposed Section 69.1805(2)). For non-residential customers with greater than 500kw in maximum registered peak load, "Hourly priced or monthly-priced service should be available to these customers. The DSP may propose a fixed-price option for the Commission's consideration." (Proposed Section 69.1805(3)).

NEM has a number of concerns with the proposed default service approach. NEM understands that the proposed regular adjustments to the price to compare (PTC) are intended to keep the default service price closer to actual market conditions. Drawing from experience in the natural gas industry, the Commission has proposed quarterly adjustments for residential customers and monthly adjustments for large business customers. (Proposed Section 69.1809). Given the underlying portfolio that would determine the size of those adjustments (based largely on long term contracts), NEM questions whether the price derived under the laddered, portfolio approach will bear enough resemblance to actual market conditions and may have an unintended stifling effect on competition akin to the wholesale auction method for residential customers in New Jersey. NEM submits that no cost, no risk utility hedging places all other market participants at a competitive disadvantage. NEM recommends that utility hedges, if prudent, be of limited duration and be shareholder-funded. Month-ahead hedging until the utility exits commodity functions minimizes the anti-competitive impact of the status quo.

NEM recommended to the Commission in its prior comments in this docket that residential and small commercial customers receive monthly-adjusted, market-based pricing and that large customers receive hourly pricing.[4] NEM continues to believe that price signals of this frequency are appropriate.[5] Given this Commission's emphasis on demand response as part of its comprehensive strategy, the importance of the frequency and accuracy of pricing signals cannot be understated. This is supported by the U.S. Department of Energy recent recommendations on demand response where it concluded

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[4] The New Jersey Board of Public Utilities expanded the class of customers on hourly PJM real time pricing to all customers above 1000 kW effective June 1, 2007. NJBPU Docket No. EO05040317, Decision and Order, December 8, 2005, pages 15-16. Additionally, the New York Public Service Commission (NYPSC) recently required utilities to implement hourly, real time pricing (RTP) for their large customers. ConEd and O&R implemented hourly pricing for their mandatory time of use customers, those with peak demands greater than 1.5 MW and 1 MW respectively, as of May 1, 2006. National Grid will implement hourly pricing for its SC3 customers at 500kw and above as of September 1, 2006. NYSEG and RG&E must implement mandatory hourly pricing as of January 1, 2007, for their time of use customers at 1000kw or above. NYSEG and RG&E must file plans for converting the remainder of their mandatory time of use customers to hourly pricing. Central Hudson implemented an hourly pricing program in 2005 for its customers with peak demands greater than 1 MW. See New York Public Service Commission, Case 03-E-0641, ORDER DENYING PETITIONS FOR REHEARING AND CLARIFICATION IN PART AND ADOPTING MANDATORY HOURLY PRICING REQUIREMENTS, issued April 24, 2006.

[5] The NYPSC found in its Retail Policy Statement that, "While hedging can provide useful protection against market price variation, requiring utilities to enter into ongoing, long-term, full-service contracts for its existing commodity customers may be inconsistent with the movement toward a fully competitive marketplace." Specifically, "for the largest commercial and industrial customers, their commodity rates should reflect spot markets and existing hedges should be allowed to expire without being renewed. We will continue to monitor the state of the market for other customer classes and as the markets continue to mature, we expect that the hedges providing price volatility protection for these customers will be allowed to expire as well." NYPSC Case 00-M-0504, Retail Policy Statement, pages 33-35.

that, “Default service RFP tariffs that index hourly prices to day-ahead markets support demand response and retail market development by giving customers more notice and certainty of the financial consequences of their response.”[6]

The frequency of the adjustment of the price to compare impacts the Commission’s decision to permit interim rate reconciliations. As noted in our Comments in the companion default service regulation proceeding, the rate reconciliation process for the natural gas market is itself the subject of dispute, and is one of the issues referred to the natural gas collaborative for study. The issue with the interim reconciliations is the tendency to skew rates so as not to be reflective of current market conditions. NEM submits that to the extent residential and small customers received monthly-adjusted, market-based rates and large customers received hourly-adjusted, market-based rates, the need to implement interim reconciliations would be greatly reduced, and therefore, the distortionary effect on the price to compare should be diminished.

Moreover, to whatever extent the Commission permits DSPs to engage in a portfolio approach to energy procurement, NEM urges that disclosure of the DSPs’ hedging strategy is critical. Disclosure will add transparency to marketplace transactions and aid in leveling the playing field between competitive suppliers and incumbent utility-DSPs. NEM does not believe that information of this nature constitutes trade secret data. Public utilities have an obligation to serve the public, not speculate with public funds. Consequently, commodity pricing should not be proprietary or a trade secret. An overriding principal, as the utilities transition out of competitive businesses, is that commodity pricing should be as transparent as possible. In order to make utility pricing

[6] U.S. Department of Energy, Benefits of Demand Response and Recommendations, February 2006, at 52.

transparent, all price components of utility service should be disclosed and easily read on the utility bill. Accurate consumer comparisons will be undermined by the failure to disclose how frequently the utility rate is subject to change, that the utility rate is subject to adjustment for true-ups, and what current utility rate adjustments are in effect. The benefits to be gained through disclosure by leveling the playing field amongst the market participants strongly outweighs any perceived negative consequences.

Relatedly, DSPs should be discouraged from acquiring a portfolio that confers an unfair, anticompetitive advantage. On this subject, the NYPSC found that, "if it is determined that a utility has entered into a long term contract to retain market share or to otherwise impede the development of a competitive market, the costs of those contracts may not be recoverable from ratepayers."[7] NEM urges this Commission to issue a similar admonition.

II. Alternative Energy Portfolio Standard Compliance

The Commission noted a tension between the statutory requirement that default service supply be acquired at "prevailing market prices" in contrast to certain stakeholders arguments that alternative energy investments cannot be secured without the guarantee of a long term power purchase agreement. NEM submits that this issue can be overcome by shifting the perspective as to where the DSP will be procuring the alternative energy supplies. NEM recommends that the Commission should look to PJM to implement the alternative energy portfolio standard. Alternative energy suppliers should contract directly with PJM to provide the power, and DSPs can purchase the power as needed to fulfill their obligation. This system would prevent DSPs from being locked into long-

[7] NYPSC Case 00-M-0504, Retail Policy Statement, page 34.

term contracts that could become uneconomic over time. It would also prevent an impediment to transitioning from incumbent utility DSPs to competitive supplier DSPs since the issue of stranded costs associated with long-term contracts for these resources would be avoided.

III. Default Service Cost Elements

The Commission noted its "significant concern" that, "some generation costs have been improperly allocated, or 'embedded,' in EDC distribution rates." (Order at 6). The Commission proposed that all electric utilities rates be examined for this purpose in their next respective rate cases to occur no later than December 31, 2007. (Proposed Section 69.1808(b)). The Commission set forth a detailed list of cost elements that the DSPs price to compare should include:

(1) Wholesale energy, capacity, ancillary, congestion, applicable RTO or ISO administrative, and transmission costs.
(2) Supply management costs, including supply bidding, contracting, hedging, risk management costs, any scheduling and forecasting services provided exclusively for default service by the EDC, and applicable administrative and general expenses related to these activities.
(3) Administrative costs, including billing, collection, education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service.
(4) Applicable taxes, excluding sales tax.
(5) All costs for alternative energy portfolio standard compliance. Proposed Section 69.1808(a).

NEM supports the Commission's initiative to ensure that proper cost allocations occur between delivery functions and competitive (and potentially competitive) commodity-related functions. Embedded cost-based utility rate unbundling is critical to the further development of the competitive retail electric market because it provides consumers with accurate price signals with regard to the full retail cost of providing 24 hour/7day no notice service.[8] Also, in the absence of fully unbundled rates, migrating consumers unfairly and improperly bear the expense of commodity-related functions that remain hidden in delivery charges.

NEM supports unbundling of the cost items delineated by the Commission. NEM recommends that further commodity-related costs be unbundled as well. These additional costs include bad debt, customer care, and metering. All of these are commodity-related costs that the DSP will incur on behalf of default service customers in the provision of electricity supply and should be reflected in the price to compare.

IV. Rate Change Mitigation

Based on the concern that consumers in some utility service territories may experience sizable rate increases at the conclusion of the generation rate caps, the Commission convened a proceeding and hearing to study possible solutions. In the proposed policy statement, the Commission recommends that default service customers be provided with the ability to defer a portion of rate increases, on an opt-in basis, with repayment subject to "interest." NEM agrees that if such programs are implemented they should be on a voluntary opt-in basis. Importantly, NEM also urges that such programs be implemented in a competitively neutral manner, through a nonbypassable wires charge.[9] This will ensure that consumers receive the benefit of such programs whether they remain on

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[8] The NYPSC has determined that, "one prerequisite to fostering market development is the conduct of cost studies, the ensuing assignment of costs to the utilities' various functions and services, and the establishment of fully unbundled, cost-based rates for electric and gas service." Case 00-M-0504, Order Directing Expedited Consideration of Rate Unbundling, issued March 20, 2001, page 1. The NYPSC described the process as follows, "The purpose of the Unbundling Track is to study and allocate utility costs between competitive and non-competitive functions and to establish cost-based competitive rates that would afford customers accurate price signals as they choose among the providers of services in the competitive market." Case 00-M-0504, Statement of Policy on Unbundling and Order Directing Tariff Filings, issued August 25, 2004, page 2.

[9] This is manner in which the Maryland Public Service Commission chose to mitigate electric price increases. Consumer migration, including amongst residential customers, has been steadily progressing in the state. Arguably, the competitive neutrality of the mitigation mechanism contributes to this success.

default service or choose a competitive supplier, with possible additional price minimizing benefits.

The Commission also suggests that other rate mitigation strategies can be proposed by the DSP. For example, "a DSP might offer customers the option to pre-pay some portion of an anticipated rate increase." (Order at 9). The prepayment option could extend for as long as three years. (Proposed Section 69.1811). NEM is similarly concerned that this option must be implemented in a competitively neutral manner, i.e., the consumer benefit would have to be repaid (flowed through) the delivery charge. Otherwise, consumers that elect a prepayment charge could effectively be trapped in utility default service. If a consumer prepays a significant sum to avoid a potential rate increase, but the benefit is repaid through the commodity charge, consumers will be disincented to consider switching to a competitive supplier. In effect, the commodity price for these customers will be held artificially low, again forestalling the development of the competitive retail electric market for them.

V. Retail Market Initiatives

The Commission has identified a number of initiatives that would facilitate the development of the competitive retail market, and as a result, contribute to the Commission's "post rate cap price mitigation strategy." (Order at 9-10). NEM strongly supports the implementation of these rules and standards throughout the Pennsylvania utilities. The Commission recommends that a Retail Markets Working Group be formed for study and policy recommendations on the initiatives. NEM suggests that the Commission clarify that the working group is not charged with engaging in the policy debate of whether these suggestions are in the public interest and whether they should be implemented. The Policy Statement's identification and approval of these initiatives should definitively decide that question. Rather, the working group should be focused on the details of expeditious utility implementation.

A. Business Rule and Process Standardization

The Commission has correctly identified business rule and process standardization as a key element to the retail market success. Toward that end, NEM supports the Commission's proposal to develop common standards and processes for access to retail electric customer information and data, availability of rate ready billing in each service territory, and the adoption of uniform supplier tariffs. To facilitate a restructured energy market, effectuation of marketer participation and customer switching should be simplified, and in the process, made less expensive. Customer information should be available to appropriate parties in a timely, accurate, low-cost and easily usable format. Utilities, suppliers, vendors and consumers should be able to exchange vital information in the lowest-cost, most efficient manner possible.

If market participants are forced to divert scarce resources to customize billing, back-office, and customer care facilities, and to develop specialized knowledge of different information systems and business rules in each service territory and jurisdiction, it drives energy prices higher. Uniformity of these business rules and processes will permit competitive marketers to enter more utility service territories on a cost effective basis, achieve economies of scale in their operations, reduce their operating costs, and ultimately, focus more resources on better serving current and future customers.

B. Utility Purchase of Receivables

NEM also supports the Commission's proposal that utilities implement purchase of receivables programs. Utilities and Public Service Commissions in many jurisdictions have implemented utility purchase of receivables (POR) programs to facilitate the development of competitive retail energy markets.[10] For instance, the NYPSC identified utility purchase of receivables as a "best practice" in its Retail Policy Statement. The NYPSC found that, "A major success in the residential market . . . is the utility purchase of accounts receivable to simplify ESCO operations and reduce ESCO overheads." All but one of the New York utilities have adopted this best practice. When utilities offer to purchase receivables at a discount rate equal to their bad debt allowance, this one small tariff provision has a significant impact on the cost to serve consumers that may otherwise be uneconomic to serve in a competitive marketplace. Yet, the implementation of a POR program should have virtually no additional cost to the utility or the consumer and could save consumers significant duplication costs thereby lowering the cost of energy.

POR programs facilitate market development because they limit the competitive disadvantages that result from guaranteed utility bad debt cost recoveries and the ability, often the exclusive ability, to collect bad debts by shutting off a captive ratepayers' energy supply. Importantly, allowing a utility to maximize the use of its legacy billing system avoids significant duplication of infrastructure costs. POR also equalizes the costs of bad debt among all market participants and ameliorates the inequities of the current payment processing order (utility arrears, supplier arrears, utility current charges, and supplier

[10] The best practice of utility purchase of receivables is in use in other jurisdictions including Consumers Energy and Detroit Edison in Michigan, PECO and Columbia Gas in Pennsylvania, PSEG, SJG and NJNG in New Jersey and NIPSCO in Indiana.

current charges). It is rarely noted that a marketer cannot reclaim its commodity in the event of a payment default. Utility assets are always there to use another day.

As long as a utility remains in the competitive commodity market and recovers all of the costs of bad debt in its rate structure, the efficient use of its legacy POR infrastructure to the benefit all consumers is and should be considered a best practice. The opportunity to offer a consolidated billing product and to purchase receivables should also be available to any other market participant as well. Ultimately, this competitive function will migrate to the competitive market. Until utilities exit competitive markets, POR should be considered a best practice wherever and whenever a consumer wishes to have a single consolidated bill.

Any consumer should be able to elect to receive a single bill from the supplier of its choice. And, if a utility remains in the commodity market, it should be required to both offer a consolidated bill and purchase the receivables at its bad debt rate, adjusted annually.

C. Marketer Referral Programs

The Commission's proposal to implement marketer referral programs will also contribute to market development. The prototypical model for such programs was first implemented in New York by Orange and Rockland, and it is now required for other utilities in the state.[11] It is noteworthy that the NYPSC directed that, "purchase of ESCO [marketer] accounts receivable, especially when used with a Switch and Save approach,

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[11] New York Public Service Commission, Case 05-M-0858, Order Adopting ESCO Referral Program Guidelines and Approving an ESCO Referral Program Subject to Modifications, issued December 22, 2005; Order Adopting Orange and Rockland Utilities, Inc.'s Plan for an ESCO Referral Program, issued April 19, 2006; Order Adopting Consolidated Edison Company of New York, Inc.'s Plan for an ESCO Referral Program, issued April 19, 2006; Order Adopting Niagara Mohawk Power Corporation's Plan for an ESCO Referral Program, issued April 19, 2006.

be considered in upcoming rates cases and during the course of current rate plans for utilities that agree to do so, because it has proven to be a model that works extremely well in jump-starting the energy market for residential and small commercial customers."[12]

Marketers participating in the O&R program offer enrolling customers a seven percent introductory discount from the utility commodity rate for a period of two billing cycles. Customers are enrolled in the program when they contact Orange and Rockland directly about it or they can be referred to the program after the having been informed about it by the utility's customer representative from an inbound call transaction (i.e., new service call, bill inquiry, etc.). O&R has promoted the program through advertising, bill inserts, and special events. Customers can request a specific marketer or be assigned to marketers on a random basis. The customer also has the option to return to utility service at any time. Orange and Rockland purchases the receivables of marketers participating in this program. The residential migration rate in O&R exceeds thirty percent. The program provides benefits for all involved – consumers benefit from an introductory discount and risk free introduction to choice; marketers benefit from reduced customer acquisition costs and reduced bad debt exposure; and the utility benefits from a streamlined program that is inexpensive to implement and facilitates the migration process.

D. Commission and Utility Retail Choice Ombudsmen

Finally, the Commission has also proposed the designation of a retail choice ombudsman at each utility and at the Commission. As noted in the introduction of these comments, the NYPSC's institution of an Office of Retail Market Development has been pivotal in

[12] NYPSC Case 00-M-0505, Retail Policy Statement, page 17.

that jurisdiction's recent success in market development. NEM suggests that the Commission ombudsman should be charged with implementing the policy statement that results from this docket in addition to the functions discussed in the Order.

In essence, the Commission ombudsman should be a competitive market advocate. As such the Commission should be a main interface for competitive suppliers' inquiries regarding retail choice and should field concerns about choice program policies. The Commission ombudsman may also be responsible for monitoring the status of competition and providing periodic reports to the Commission about what had been achieved and offering recommendations for next steps as may be warranted. Overall, the Commission ombudsman should be a consistent presence sending a clear signal to competitive suppliers, and the consumers they serve, of the Commission's commitment to competitive markets. Likewise, the designation of utility ombudsmen should facilitate a more expedient resolution to supplier inquiries, questions and concerns, and hopefully, therefore improve the quality of interactions between these stakeholders.

VI. Conclusion

Pennsylvania is at a critical juncture in the development of the competitive retail electric market. This Commission's comprehensive examination of all facets that impact retail market development – supply side, demand side, retail choice initiatives – should lead to significant positive improvements that encourage marketer entry and facilitate consumer choice. NEM offers its full resources to the Commission as may be needed to accomplish this goal.

Sincerely,

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