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March 2, 2007

VIA EXPRESS MAIL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Re: 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**

Dear Secretary McNulty:

Enclosed for filing, please find an original and fifteen (15) copies of the Comments of UGI Utilities, Inc. – Electric Division (“UGI”) submitted in response to the Commission’s above-captioned Advance Notice of Final Rulemaking Order. An electronic copy of these comments has also been submitted to Shane Rooney at srooney@state.pa.us.

Should you have any questions concerning this submission, please feel free to contact me.

Very truly yours,

A handwritten signature in black ink, appearing to read "Mark C. Morrow", written over a horizontal line.

Mark C. Morrow

Counsel for UGI Utilities, Inc. –
Electric Division

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

**COMMENTS OF
UGI UTILITIES, INC. –
ELECTRIC DIVISION**

UGI Utilities, Inc. – Electric Division (“UGI”) appreciates this opportunity to submit comments in response to the Commission’s Advance Notice of Final Rulemaking Order (“ANFRO”) entered on February 9, 2007. These comments are intended to supplement those filed by the Energy Association of Pennsylvania at this docket.

INTRODUCTION

UGI commends the Commission for making significant changes to its prior proposed default service regulations to reflect changes in the Commonwealth’s energy policies since default service regulations were initially proposed, and to reflect, in part, the experience that has been gained both within and outside of Commonwealth as energy markets have evolved.

Since 2002, when UGI terminated its recovery of Competitive Transition Costs and exited out from under the statutory rate caps established under 66 Pa.C.S. §2804(4), UGI has successfully procured default service power supplies for its customers by constructing a portfolio of energy supplies in a manner that enables it to respond to changes in market conditions and to mitigate both short-term price volatility and supplier default risks. This successful approach was based, in part, on UGI’s long experience in procuring natural gas supplies through a portfolio

approach in wholesale markets for the customers of its gas division. This successful approach has enabled UGI to:

- Offer annual fixed-rate default service prices to customers so that customers have known annual default service prices to use when shopping for alternative power supplies.
- Offer multiple-year default service price options to customers seeking greater long-term price certainty.
- Offer default service prices that are not a pure pass-through of wholesale costs, thereby providing room for alternative electric generation suppliers to compete.
- Offer reasonable default service prices that are reflective of wholesale market conditions, but which are not significantly affected by short-term price volatility.
- Offer default service prices under terms that make the risks associated with non-reconcilable prices acceptable to UGI and its shareholders.

Based on its experience, UGI has long urged the Commission to avoid adopting overly prescriptive default service procurement rules that could limit the Commission's ability to respond to changing conditions and experiences, and to avoid the premature adoption of default service regulations in an environment where wholesale and retail markets are still evolving. Ideas, , such as default service procurement auctions, that might initially seem appealing, may not produce optimal results in real world conditions and reflect the circumstances of every electric distribution company ("EDC").

UGI believes that the Commission's decision to look to the natural gas industry for guidance, its acceptance of a portfolio approach for procuring default service supplies and its stated intention to retain some degree of flexibility by addressing some issues by way of policy statement are significant and important policy steps. UGI believes, however, that there may be

significant inconsistencies between the stated goals of the Commission, and the provisions of the proposed final default service regulations.

UGI also believes that the Commission should retain the flexibility, as it has for certain natural gas distribution companies (“NGDC”), of permitting default service providers to offer optional fixed-price default service options that are not subject to adjustment. While the Commission has apparently taken the decision on page 22 of its ANFRO, to leave such service offerings to Electric Generation Suppliers (“EGS”), it is possible that EGSs may not provide such options in all service territories, or may only do so at very high rates. For example, although UGI has been out from under its statutory rate cap for a considerable period of time, and procures all of its power supplies at market rates from unaffiliated suppliers, no EGSs currently offer service in the UGI service territory. In this environment, UGI has offered optional fixed-rate default service offerings that have met the needs of many of its default service customers.

While UGI applauds the Commission for revising its regulations to provide for the procurement of default service power supplies on a staggered basis, UGI believes the Commission should remain vigilant, in both revising its proposed final default service regulations and in making decisions in future default service proceedings, to avoid causing a run-up in market prices on certain procurement dates by requiring or permitting large portions of default service supplies to be procured at the same time or in an overly restricted fashion. Calls for uniformity in approach and dates for procuring default service supplies should not be accepted if such uniformity creates the potential for the exercise of temporal market power by certain participants in wholesale energy markets.

Accordingly, UGI urges the Commission to consider the potential improvements or clarifications to its proposed final default service regulations set forth below.

COMMENTS

I. **THE PROPOSED PROCUREMENT RULES SHOULD NOT BE OVERLY PERSCRPTIVE AND SHOULD PRESERVE THE COMMISSION'S ABILITY TO CONSIDER ALL SUPPLY OPTIONS AND ARRANGEMENTS.**

Under the provisions of §54.186(a), a default service provider ("DSP") shall be required to submit a procurement and implementation plan with the Commission that will be subject to full review before it is implemented. Thereafter, electric generation supply will be procured pursuant to the plan (§54.188(c)), and the procurement decisions will be subject to Commission review (§54.188(d)). To the extent that an affiliated supplier participates in the process, protocols must be proposed, reviewed and implemented to ensure that the affiliate does not receive an advantage (§54.186(5)).

Despite providing for prior and subsequent review, and providing that protocols must be established to ensure that affiliates do not obtain an advantage, the proposed regulations also attempt to establish certain parameters and limitations for potential default service supply plans. For example, the provisions of §54.186(4) specify that all "electric generation supply" should "be acquired through a competitive bid solicitation process, spot market purchases, or a combination of both." The provisions of §54.186(c), in turn, establish certain standards for a "competitive bid solicitation process." These include:

- (i) A bidding schedule.
- (ii) A definition and description of the power supply products on which potential suppliers shall bid.
- (iii) Bid price formats.
- (iv) The time period during which the power will need to be supplied for each power supply product.
- (v) Bid submission instructions and format.

- (vi) Price-determinative bid evaluation criteria.
- (vii) Relevant load data, including the following:
 - (A) Aggregated customer hourly usage data for all retail customers.
 - (B) Number of retail customers.
 - (C) Capacity peak load contribution figures by rate schedule.
 - (D) Historical monthly retention figures by rate schedule.
 - (E) Customer size distribution by rate schedule.

The provisions of §54.186(c)(2), in turn, provide that the “default service implementation plan” shall “include fair and non-discriminatory bidder qualification requirements, including financial and operational qualifications, or other reasonable assurances of any supplier or electric generation services’ ability to perform.”

To date almost all the interim default service plans the Commission has reviewed have involved proposals to implement auction processes to procure full requirements load-following service, and have not involved the acquisition of default service supplies through a portfolio approach. The proposed regulations, to a significant degree, reflect such a Pike County - style auction process for all default service requirements, including load following service requirements (albeit with multiple procurements), rather than a more balanced portfolio approach to supply. UGI believes the Commission should not now limit its discretion in reviewing future supply plans by adopting such unnecessarily restrictive auction-style rules.

In constructing a portfolio of supplies under a portfolio approach a DSP may elect to purchase blocks of power to meet loads that are certain, and may consider a number of different options to meet potential loads that are not known in advance and may depend on customer switching rates, weather or other factors. Alternatives may include purchasing blocks of power with the expectation of selling into the wholesale market during low-load periods, purchasing

options (thereby minimizing the risk of market losses if power is not needed and wholesale prices are low), other financial products that may minimize the price risk of spot market purchases or the purchase of load following services.

The provisions of §54.186(c)(vii), however, would require the submission of detailed customer load data that would only have applicability in the event a DSP elected the option of purchasing a load following service. While load following services may have been part of the design of default service auction processes reviewed by the Commission to date, such services should not be preordained as the preferred method of handling variations in customer loads under a portfolio approach, and information only pertinent to soliciting a load following service should not be required to be disclosed in all bid solicitations.

The proposed regulations also reference acquisitions of “electric generation supply” (§54.186(4)), that must “be acquired through a competitive bid solicitation process, spot market purchases, or a combination of both.” The terminology used in these sections may also raise uncertainty as to whether the acquisition of options or other financial instruments, as well as demand response services, would be permissible even if such instruments or demand response resources would be a least cost solution.

The provisions of §54.186(c)(2) and §54.186(c) addressing, in part, financial security requirements may also have more applicability to a once and done auction process, and not the portfolio approach advocated by the Commission. These provisions require “financial and operational qualifications, or other reasonable assurances of any supplier of electric generation services’ ability to perform” to be established at the time a default service implementation plan is filed, and then require competitive solicitations to contain “Price determinative bid criteria.” However, under the portfolio procurement process envisioned in the Commission’s proposed regulations a DSP may be making purchases over a multi-year period. Over that period of time

the financial circumstances of suppliers may change, and such changes should be considered in evaluating bids so long as such criteria are applied in a uniform manner. Again, a once and done determination of financial qualifications may be more suited to a once and done auction process rather than a portfolio approach.

II. THE COMMISSION SHOULD NOT STRONGLY ENCOURAGE RECONCILABLE DEFAULT SERVICE RATES, NOR LIMIT ITS ABILITY TO APPROVE MORE THAN ONE DEFAULT SERVICE RATE.

The Commission states that “[r]econciliation is strongly encouraged, though not mandated, in order to ensure the full recovery of the DSP’s reasonable costs,” ANFRO at page 4, and the proposed regulations at §54.187(h)-(j) specify quarterly or monthly reconciliation, depending on customer peak load, to “ensure the recovery of costs reasonably incurred in acquiring electricity at prevailing market prices and to reflect the seasonal cost of electricity.” The provisions of §54.187(b) would also restricts DSPs to a “single rate option, which shall be identified as the PTC.”

UGI believes the Commission should consider removing any preference for reconcilable default service rates, and should not restrict its ability to approve multiple default service rate options where appropriate.

First, while the proposed regulations cite the need to reflect seasonal changes in wholesale rates in retail rates as a primary reason for encouraging reconciliation, reconciliation, in and of itself, will not cause seasonal changes in wholesale rates to be reflected significantly in default service rates as the Commission proposed default service policy statement at Docket No. M-00072009 (“Policy Statement”) recognizes. Policy Statement, page 7. Presumably, default service rates will be designed to reflect the recovery on an annual basis of anticipated annual supply costs, including seasonal variations, and reconciliations will only reflect significant variations from those projected costs, whether caused by significant price movements or by other

factors such as weather variations or customer migration. It is also not clear, under a portfolio approach involving the use of long-term contracts, that there will even be significant seasonal variations in cost. While default service rates can certainly be designed to change on a seasonal basis, such changes would be a function of rate design rather than reconciliation.

Second, reconciliation has been cited by some as a potential barrier to retail competition. Specifically, natural gas suppliers and others have argued in the Commission's SEARCH gas competition process that reconcilable rates do not foster retail competition since customers are not able to easily compare default service prices to annual competitive service offerings. Reconcilable default service rates must be an option to meet the statutory standard of full cost recovery if a DSP is not able to reach agreement on default service rates having a sufficient risk premium to cover the risks of non-reconcilable rates. However, such reconcilable rates should not necessarily be encouraged or discouraged by regulation.

Alternatively, should the Commission require reconcilable default service rates, it should not preclude the possibility of optional annual or even multiple year non-reconcilable default service rates. While the Commission may believe it will foster retail competition by limiting to EGSs the ability to offer such non-reconcilable generation rate options, there is no guarantee that EGSs will offer such rate options in all service territories or do so at reasonable rates. If the Commission believes that limiting DSP product offerings will foster retail competition, it may reach that decision in reviewing individual default service procurement and implementation plans, and need not do so by regulation before it has had the opportunity to observe the development of retail service offerings in the post-rate cap environment.

The Commission should also not reject non-reconcilable default service rates on the grounds that statutory rate caps have allegedly harmed retail competition in Pennsylvania. Such statutory rate caps were based on prior cost-of-service rate structures, and remained in place for

many years. By contrast, a non-reconcilable default service rate would reflect current wholesale market conditions and would be subject to more frequent adjustment. The Commission should also recall that it has authorized natural gas default service providers to offer annual non-reconcilable optional natural gas supply service rate options.

III. THE DEFAULT SERVICE REGULATIONS SHOULD STATE THEY WILL NOT BE APPLIED UNTIL AFTER THE EXPIRATION OF EXISTING COMMISSION-APPROVED DEFAULT SERVICE SETTLEMENTS AND ORDERS.

The proposed default service regulations state they implement “§2897(e) of the Electric Generation and Competition Act, 66 Pa.C.S. §§2801-2812, pertaining to an EDC’s obligation to serve retail customers at the conclusion of the restructuring transition period.” However, a number of EDCs, including UGI, have already completed their transition periods and are currently providing default service pursuant to default service settlements or orders. In the case of UGI, its current default service settlement will expire in 2009, although Commission-authorized optional fixed rate default service offering may extend beyond 2009.

UGI believes the Commission’s default service regulations should clearly state they will not be applied until the conclusion of existing Commission-approved default service settlements and orders. This is particularly true where, as in the case of UGI, non-reconcilable default service rates have been implemented and wholesale power purchase decisions have been made based on the default service settlement rules established pursuant to the Commission-approved default service settlement or order.

IV. PURCHASES MADE PURSUANT TO A COMMISSION-APPROVED DEFAULT SERVICE PROCUREMENT PLAN SHOULD NOT BE SUBJECT TO FURTHER REVIEW EXCEPT TO DETERMINE IF VIOLATIONS OF THE PLAN OR THE COMMISSION’S RULES OR REGULATIONS HAVE OCCURRED.

In the ANFRO the Commission states:

We have clarified Section 54.188(d) to state that while the result of a solicitation may be deemed approved if not formally rejected within one business day, this does not represent the end of the Commission's oversight. Should information subsequently come to the attention that the DSP failed to adhere to the approved plan, that the DSP disclosed confidential information to an affiliate, or that one or more bidders engaged in fraud, collusion, bid rigging, price fixing or other unlawful acts the Commission would investigate and seek appropriate remedies.

ANFRO, page 23.

While UGI believes the Commission's should appropriately retain its right to investigate violations or laws or regulations, it should clarify that it will not re-review the reasonableness of purchases accurately disclosed to and approved by the Commission. This will ensure power purchases can be made with reasonable confidence that cost recovery will not be subsequently denied. Accordingly, UGI believes that the final two sentences of §54.188(d) should be replaced with the following language:

The Commission shall not deny cost recovery for purchases made pursuant to the results of a competitive procurement process approved pursuant to this subsection unless the Commission learns that the DSP concealed or misled the Commission concerning its adherence to the default service procure plan, or otherwise violated applicable laws or regulations. Nothing in this subsection shall prevent the Commission from investigating the possible violations of law by bidders in the competitive procurement process.

V. THE DEFAULT SERVICE REGULATIONS SHOULD ENABLE A DEFAULT SERVICE PROVIDER TO DIRECT ASSIGN SUPPLY CONTRACTS TO EGSs IF A SIGNIFICANT PORTION OF ITS ANTICIPATED LOAD SHIFTS TO OTHER SUPPLIERS.

If the proposed regulations establish reconcilable default service rates, as well as prohibiting or limiting shopping restrictions, DSPs must be given the option to direct assign supply contracts to EGSs if a significant portion of customer loads switch to EGS service offerings. Otherwise a "death spiral" could develop where supply costs are being recovered from an ever smaller base of default service customers.

Under the comparable natural gas model, NGDCs have the right to direct assign supply contracts to NGSs if customers loads shift to NGSs before the supply contract expire. The

Commission's regulations should similarly state that supply contract assignments may be required. Alternatively, the regulations should state that the DSP shall be permitted to recover stranded costs through a distribution rate surcharge or rider.²

Respectfully submitted,



Mark C. Morrow

Counsel for UGI Utilities, Inc. –
Electric Division

Dated: March 2, 2007

² Of course, this problem could be avoided if the default service provider is willing to accept the risk of customer load shifts by establishing non-reconcilable default service rates in return for recovery of an appropriate risk premium.