



March 23 2007

VIA EXPRESS MAIL

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
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Harrisburg, PA 17120

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**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 Reply Comments of UGI Utilities, Inc. – Electric Division (“UGI”) in the above-captioned matter. 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 in a cursive style.

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) :

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

UGI Utilities, Inc. – Electric Division (“UGI”) appreciates this opportunity to respond to comments on the Commission’s Advance Notice of Final Rulemaking Order (“ANFRO”) entered on February 9, 2007. These reply comments are not intended to address all issues, and are instead focused on certain issues where UGI believes further comment is appropriate.

**I. UGI AGREES WITH THE OCA THAT DEFAULT SERVICE POWER
SUPPLIES SHOULD BE ACQUIRED BY CONSTRUCTING A PORTFOLIO
OF ASSETS THAT MAY INCLUDE LONG-TERM CONTRACTS**

In its comments the Office of Consumer Advocate (“OCA”) states that in order to provide reliable default service at reasonable and stable prices, a default service provider (“DSP”) should be permitted to “acquire a portfolio of generation resources that includes a variety of fuel sources and length of contract terms.”

As a long-term buyer in wholesale electric and natural gas markets, UGI strongly agrees with the OCA that default service customers would best be served by having a DSP procure a portfolio of supply assets, including longer-term contracts where appropriate. As the OCA notes, a portfolio of supply contracts that includes longer-term contracts may provide the best

opportunity to mitigate the effects of short-term wholesale price volatility, and can also provide a DSP with the flexibility to respond to opportunities in the wholesale marketplace as they arise.

UGI also believes that the portfolio of supply assets may properly include hedging and other financial instruments, and would note that such hedging and other financial instruments are used to construct natural gas supply portfolios for certain natural gas distribution companies in Pennsylvania. Use of these hedging and financial instruments are not just applicable to marketers.

Also, a flexible portfolio approach may also offer the best means of managing the costs associated with unknowable or unanticipated swings in demand caused by weather, customer migration or other factors. While load following services can be purchased to handle swings in demand, such services can be very expensive since wholesale suppliers may have to build large risk premiums into their price. As the Commission's experience in reviewing Section 1307(f) gas cost filings should indicate, there may be other lower-cost means of handling all or portions of swings in demand under a portfolio approach. In the case of DSPs, such means may include the purchase of options that provide the right, but do not require, the purchase of power at a fixed price during a future period, or agreements to purchase blocks of power at a fixed cost with a plan to resell the power, on a hedged or unhedged basis, in the event demand does not materialize.

UGI also agrees with the OCA that the obligation of the DSP to "acquire electric energy at prevailing market prices" under 66 Pa.C.S. §2807(e)(3) should not be construed to somehow limit a DSP to only making purchases in often volatile short-term or spot energy markets. As the OCA suggests in its comments, the wholesale market provides a variety of products, including longer-term power contracts, and each of those products can and does have a "prevailing market price." While some marketers argue that the DSP price should be based on short-term purchases,

this could very well result in volatile and 'ugly' default prices. UGI submits the Competition Act does not require Default Service prices to be 'ugly' in order for more customers to secure their supplies from EGSs.

While the provisions of 66 Pa.C.S. §2807(e)(3), in the view of OCA, UGI and others are consistent with a portfolio approach that would include longer-term contracts, the Commission should be aware that legislation proposed by Governor Rendell, as part of his Energy Independence Strategy, would further clarify this by amending §2807(e)(3) to a DSP should acquire a "portfolio of resources," and that such a portfolio:

shall be designed to produce the lowest reasonable rates on a long-term basis and shall reflect a diversity of supply and demand-side resources, a diversity of fuel types and a prudent mix of long-term, short-term and spot market purchases.

Finally, UGI believes the Commission should reject the notion advanced by the Retail Power Supply Association and others that permitting a DSP to purchase power through a portfolio of contracts that may include longer-term purchases is somehow harmful to competition and contrary to the public interest. UGI does not believe that EGSs will purchase power supplies only through short-term purchases, and instead believes that EGS will construct a portfolio of supplies that will include longer-term contracts and the use of hedging instruments and other financial products where appropriate. Thus EGSs will be competing against other EGSs whose power supply costs will not reflect current short-term or spot purchase prices. Just as such competition among EGSs with varying portfolios should not be viewed as harming competition, the use of a reasonable portfolio approach by a DSP should not be viewed as harmful to competition, and may further stimulate it.

II. THE PROVISIONS OF THE ALTERNATIVE ENERGY PORTFOLIO STANDARDS ACT DO NOT REQUIRE DEFAULT SERVICE COSTS TO BE RECOVERED THROUGH A RECONCILABLE MECHANISM

In its comments the OCA states that since costs associated with procuring supplies to meet the mandates of the Alternative Energy Portfolio Standards Act (the "AEPS Act") are to be recovered on a reconcilable basis, all default service costs must be recovered on a fully reconcilable basis since permitting two different cost recovery mechanisms would be "not fully consistent with a portfolio approach" and would result in the benefits of portfolio management being "lost". OCA Comments, pp. 11. UGI respectfully disagrees with this position.

A DSP can construct a portfolio of supplies, including supplies to meet the requirements of the AEPS Act, regardless of the cost recovery mechanism or mechanisms employed to recover the associated costs, and the associated benefits of the portfolio approach, including the mitigation of short term price volatility and the minimization of costs, would not be necessarily be "lost."

As UGI explained in its main comments, if a DSP is willing to accept the risks associated with non-reconcilable default service rates acceptable to the Commission, it should be encouraged to do so since non-reconcilable rates can provide clearer price signals to consumers by permitting them to compare known default service rates to the non-reconcilable service offerings of other Electric Generation Suppliers ("EGSs"). For this reason it is not surprising that many of the comments of EGSs or their representatives, including the Retail Supply Association, Strategic Energy, and Dominion Retail generally opposed reconcilable default service rates.

If agreement is reached on a mutually acceptable non-reconcilable default service rates, such rates can be implemented without violating the provisions of the AEPS Act. For example, the DSP could waive its right to recover AEPS Act costs through a reconcilable mechanism.

Alternatively, the DSP could agree to vary its recovery of the non-reconcilable portion of default service rates to reflect variations in the reconcilable AEPS component.

Moreover, even if these solutions were not accepted, nothing would prevent default service rates from having more than one component with one portion being reconcilable and another portion not. Many such rates already exist, including base rates that include adjustable or reconcilable riders or surcharges. While such compound rates would not provide the price certainty of totally non-reconcilable default service rates, they would provide more price certainty than totally reconcilable default service rates.

III. PROPOSALS FOR THE APPOINTMENT OF A COMPETITOR OMBUDSMAN OR FOR STRICTER STANDARDS OF CONDUCT SHOULD BE REJECTED

While some marketers may be frustrated by limited customer acceptance of their retail service products in Pennsylvania, there is absolutely no evidence that this is the result of any favoritism being displayed by EDCs towards their marketing affiliates or any other improper behavior. Nor is there any evidence that Pennsylvania EDCs do not have the systems and clear rules in place to facilitate retail competition. Instead, it is widely accepted that the conditions for retail competition are not yet ripe in Pennsylvania since most areas of the state are still subject to below-market price caps.

In Pennsylvania, unlike certain other jurisdictions, the General Assembly has established the framework for retail choice, and EDCs have already restructured their rates and have established systems and supplier tariffs to facilitate retail choice. Interim and permanent standards of conduct have also been adopted with input from all stakeholders. Under those standards of conduct and other Commission rules there are both informal and formal mechanisms for bringing any alleged problems or violations to the attention of EDCs and the

Commission. Despite these many mechanisms, however, there has been no evidence of any problems or abuses.

There is no doubt that many EGSs want to limit or eliminate the role of the DSP since doing so might artificially increase the demand for their product offerings. By raising the spector of EDC misdeeds or administrative problems certain EGSs may feel they are advancing that agenda. It is also easy for EGSs to argue for increased administrative efforts and expenses since they currently bear none of the costs of the Commission. However, given the complete absence over many years of any real instance of favoritism or of any real administrative difficulties, the Commission should view such proposals with a great deal of skepticism.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Mark C. Morrow', with a long horizontal flourish extending to the right.

Mark C. Morrow

Counsel for UGI Utilities, Inc. –
Electric Division

Dated: March 23, 2007