PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held August 19, 2004

Commissioners Present:

Terrance J. Fitzpatrick, Chairman
Robert K. Bloom, Vice Chairman
Glen R. Thomas, Statement attached
Kim Pizzingrilli
Wendell F. Holland

Petition of Duquesne Light Company for Approval of Plan for Post-Transition Period Provider of Last Resort Service — P-00032071

OPINION AND ORDER

BY THE COMMISSION:

I. Introduction

Before the Commission are the Recommended Decision of Administrative Law Judge (ALJ) Michael A. Nemec issued May 26, 2004, and the separately filed Exceptions of the Office of Trial Staff (OTS), Reliant Energy, Inc. (Reliant), Direct Energy, Dominion Retail, Inc. (Dominion Retail), Citizens Power, Inc. (Citizens Power), Constellation Power Source, Inc. and Constellation Newenergy, Inc. (collectively, Constellation) and Strategic Energy, L.L.C. (Strategic Energy). The foregoing Exceptions were filed on June 9, 2004. Replies to Exceptions were filed by Strategic Energy, Reliant, the Duquesne Industrial Intervenors (DII), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), and Duquesne Light Company (Duquesne or Company). The Replies to Exceptions were filed on

June 16, 2004. Also before the Commission is a Motion to Strike the Reply Exceptions of Reliant Energy, Inc. filed by Duquesne on June 23, 2004.

II. History of the Proceeding

On December 9, 2003, Duquesne filed a Petition requesting approval of its Plan for Provider of Last Resort (POLR) service for the period of January 1, 2005 to December 31, 2010 (Plan or POLR III Plan). The Plan is Duquesne's proposal for the provision of electric generation service to customers who do not choose an electric generation supplier (EGS) or who fail to receive service from an alternative supplier.[1] The Plan also seeks approval for the sale of POLR III energy and capacity to Duquesne from its affiliate, Duquesne Power; (2) Duquesne Power's acquisition of the Sunbury Station; and, (3) membership in PJM West.

On December 23, 2003, the OCA filed an Answer to the Petition. On December 29, 2003, the OSBA filed its Answer. On December 30, 2003, the OTS filed its Notice of Appearance. On December 31, 2003, DII filed its Petition to Intervene and Answer to Duquesne's Petition.

A Prehearing Conference was held in Harrisburg on January 14, 2004, to consider Duquesne's Petition. Extensive discovery ensued amongst Duquesne and the numerous other Parties that petitioned to intervene in this proceeding. By Prehearing Order issued January 16, 2004, ALJ Nemec granted the following Parties leave to intervene: Allegheny Power; AmeriNet Central; Citizen Power; Constellation; Energy America, LLC; Exelon Corporation; PECO Energy Company; DII; Dominion Retail;

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[1] Duquesne's petition contains a history of the prior POLR I and POLR II filings. Also see *ARIPPA v. Pa. PUC*, 792 A.2d 636, 642-643 (Pa. Cmwlth. 2002), for a concise history of electric generation deregulation in Pennsylvania.

Green Mountain Energy Company; Ohio Edison Company, *et al.;* Pepco Energy Services, Inc.; PJM Interconnection, LLC (PJM); Reliant; and Strategic Energy.

Evidentiary hearings on the Petition were held in Pittsburgh on March 30, March 31, and April 1, 2004. On April 13, 2004 (revised on April 16, 2004), the OCA filed its Stipulation (OCA Stipulation). The OSBA and DII both filed their stipulations on April 16, 2004, (OSBA Stipulation and DII Stipulation, respectively). Various Parties objected to consideration of the Stipulations without an opportunity to examine the supporting witnesses. Following a telephone conference conducted on April 23, 2004, the litigation schedule was modified to provide for the serving of prepared testimony regarding the Stipulations. A hearing on the Stipulations was held on May 7, 2004. Supplemental Briefs on the issues raised by the Stipulation were filed on May 15, 2004.

Duquesne, OTS, OCA, OSBA, DII, PJM, Strategic Energy, Dominion Retail, Penn Futures, Direct Energy, Constellation, and Reliant filed Main Briefs. Citizen Power filed a Letter Brief. Duquesne, OTS, OCA, OSBA, DII, Strategic Energy, Dominion Retail, Direct Energy, Constellation, and Reliant filed Reply Briefs. Duquesne, OCA, OSBA, DII, Dominion Retail, Strategic, Direct Energy, Constellation, and Reliant filed Supplemental Briefs. The resulting record consists of 1,094 pages of testimony, as well as the numerous statements and exhibits of the Parties.

By Recommended Decision issued May 26, 2004, ALJ Nemec, *inter alia*, approved Duquesne's POLR III Plan, as modified by the DII Stipulation, the revised OCA Stipulation and the OSBA Stipulation. The Recommended Decision also granted the Calpine Corporation leave to intervene. We now consider the Exceptions and Reply Exceptions filed to the Recommended Decision. As noted above, on June 23, 2004, Duquesne filed a Motion to Strike Reliant's Reply Exceptions.

III. Overview & Legal Principles

A. Overview

On November 30, 2000, the Commission approved a settlement that provided for POLR service in Duquesne's service territory until December 31, 2004. *Public Utility Commission v. Duquesne Light Company*, Docket No. R-00974104 (Order entered November 30, 2000) (POLR II). The POLR II Plan spanned Duquesne's transition period and was designed to address Duquesne's POLR service while Duquesne continued to collect competitive transition costs (CTC) from a majority of its customers. In view of the fact that the terms and conditions of Duquesne's POLR II Plan expire on December 31, 2004, it is time to determine the parameters of Duquesne's POLR service post-December 31, 2004. To that end, Duquesne filed its Petition for Approval of the POLR III Plan.

B. Applicable Legal Principles

Before proceeding to a discussion of Duquesne's Plan, we will review the statutory considerations that will guide us as we review the Parties arguments in this proceeding. The primary section involved is Section 2807(e) of the Public Utility Code (Code), 66 Pa. C.S. § 2807(e). That Section relates to the obligation of an electric distribution company (EDC) to provide electric service as a result of the implementation of competition in the retail electric market in Pennsylvania. That Section provides:

> **66 Pa. C.S. §2807(e) -** An electric distribution company's obligation to provide electric service following implementation of restructuring and the choice of alternative generation by a customer is revised as follows:
>
> (1) While an electric distribution company collects either a competitive transition charge or an intangible transition charge or until 100% of its customers have choice,

> whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric service and the production or acquisition of electric energy for customers.
>
> (2) At the end of the transition period, the Commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period.
>
> (3) If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or Commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.
>
> (4) If a customer that chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy service.

On March 4, 2004, the Commission convened a POLR Roundtable at M-00041792 as a forum for the discussion of POLR issues. The Commission is now reviewing the results of that Roundtable with a view to crafting proposed regulations in accordance with Section 2807(e)(2). Until those regulations are promulgated, we must be guided by the more general pronouncements of policy in the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801, *et seq*. (the Act). The following policy declarations of the Act will be particularly helpful in reviewing Duquesne's Petition.

> **Section 2802(3)** - Because of advances in electric generation technology and Federal initiatives to encourage greater competition in the whole-sale electric market, it is now in the public interest to permit retail customers to obtain direct access to a competitive generation market as long as safe and affordable transmission and distribution service is available at

levels of reliability that are currently enjoyed by the citizens and businesses of this Commonwealth.

Section 2802(5) - Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity.

Section 2802(9) - Electric service is essential to the health and well-being of residents, to public safety and to orderly economic development, and electric service should be available to all customers on reasonable terms and conditions.

Section 2802(16) - It is in the public interest for the transmission and distribution of electricity to continue to be regulated as a natural monopoly subject to the jurisdiction and active supervision of the Commission. Electric distribution companies should continue to be the provider of last resort to ensure the availability of universal electric service in this Commonwealth unless another provider of last resort is approved by the Commission.

Section 2807(c) - Subject to the right of an end-use customer to choose to receive separate bills from its electric generation supplier, the electric distribution company may be responsible for billing customers for all electric services, consistent with the regulations of the Commission, regardless of the provider of those services.

A primary innovation mandated by the Act was to provide customers with direct access to a competitive generation market. 66 Pa. C.S. § 2802(3). The reason for this change is the legislative finding that "competitive market forces are more effective than economic regulation in controlling the costs of generating electricity." 66 Pa. C.S. § 2802(5); *See*, *Green Mountain Energy Company, et al. v. Pa. PUC*, 812 A.2d 740, 742 (Pa. Cmwlth. 2002). Accordingly, a fundamental policy underlying the Act is that competition is more effective than economic regulation in controlling the costs of generating electricity. 66 Pa. C.S. § 2802(5).

The Act provides that electric service is an essential service and should be available to all customers "on reasonable terms and conditions." 66 Pa. C.S. § 2802(9). This is one of the fundamental goals of the Act. However, the means to accomplish that goal is competition, not regulation. It is against this statutory back drop that we examine Duquesne's Petition.

IV. Duquesne's POLR III Plan

A. Overview

There are three facets to Duquesne's Petition. The first facet is Duquesne's Petition as it relates to residential, small business and small commercial customers. The ALJ and the Parties have referred to this part of the Petition as the Small Customer Plan. The second part of Duquesne's Petition differs in many significant respects from the Small Customer Plan and is designed for Duquesne's large industrial and large commercial customers. This is the Large Customer Plan. Finally, Duquesne has requested approval from the Commission to join the regional transmission organization (RTO) operated by PJM Interconnection, LLC (PJM). We will discuss each of these facets of the Petition in turn. As we begin our discussion of the Petition, we recognize that Duquesne' membership in PJM is a crucial facet for the entire proposal before us. It will be helpful to note here that we will approve Duquesne's request to join PJM. That issue is discussed more fully below.

B. The Small Customer Plan[2]

1. Positions of the Parties

a. Duquesne's Proposal

Duquesne's Small Customer Plan provides for two consecutive three-year fixed rate periods. The first period runs from January 1, 2005, through December 31, 2007. The second period runs from January 1, 2008, through December 31, 2010. Duquesne proposed an average generation rate increase of 11.5% over current rates to commence in January 2005. As originally proposed, Duquesne proposed a second generation rate increase of 9.5% to commence in January of 2008. (R.D. at 9).

Duquesne will enter into a contract with an affiliate, Duquesne Power, for its POLR service power supply. Duquesne Power will obtain power to supply the POLR load through a combination of the proposed purchase of a generation asset, the Sunbury coal-fired electric generation station, and wholesale market purchases. Duquesne Power will provide all the capacity, energy and ancillary services necessary to serve Duquesne's POLR load. (*Id.*). The purchase of the Sunbury generating station was recently approved by the Federal Energy Regulatory Commission (FERC) at *Joint Application of Sunbury Generation, LLC and Duquesne Power, L.P., for Authorization to Transfer Facilities Under Section 203 of the Federal Power Act*, FERC Docket No. EC04-36 (Order issued August 6, 2004).

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[2] The Small Customer Plan applies to Rate Schedules RS, RH, RA, GS/GM, GMH, AL, SE, SM, SH, MTS and PAL.

b. Duquesne/OCA Stipulation

Duquesne's Small Customer Plan was modified by Partial Stipulations reached by Duquesne, the OCA, and the OSBA. The primary modifications to the original Plan as it affects residential customers on the RS, RH and RA rate schedules are as follows:

- POLR Service will be provided during the initial three-year term at the rates originally proposed, but with the addition of a PJM surcharge to defray the costs of Duquesne's membership in PJM.

- For the second three-year term (2008-2010), the rates shall be bounded by both a floor and a ceiling. The floor will be the rates in effect on December 31, 2007. The ceiling will be the rates as originally proposed by Duquesne in the Petition. If Duquesne wishes to set rates above the floor, it must file a request to do so on or before March 1, 2007, and support its request with market evidence or propose a market-based process to establish the necessary increase. If Duquesne does not elect to make such a filing, the rates in effect on December 31, 2007, shall remain in effect for the second three-year period.

- Duquesne will not seek a generation rate increase above the levels agreed upon unless (i) Duquesne Power defaults on its power contract with Duquesne, and (ii) Duquesne Holdings[3] defaults on its power contract with Duquesne, and (iii) these defaults threaten the

[3] Duquesne Holdings is the parent of Duquesne. (Duquesne St. No. 2 at 16).

financial stability of Duquesne to continue providing reliable service to its customers.

- Duquesne will not seek a distribution rate increase that would become effective prior to January 1, 2008, provided that there are no governmental or RTO directions for system upgrades, the cost of which would prevent Duquesne from earning a fair rate of return.

- Duquesne agrees to meet or exceed the reliability requirements for distribution service during the term of the distribution rate cap.

- Duquesne agrees to a specified PJM Surcharge without reconciliation during the six-year POLR term. The PJM Surcharge will be included in Small Customer generation rates to facilitate Small Customer shopping decisions.

- Duquesne agrees to provide renewable and environmentally beneficial energy resources as part of its Small Customer POLR supply portfolio consistent with any enacted law. If no such law is enacted, Duquesne will utilize renewable and environmentally beneficial resources for at least 2% of its small customer supply portfolio during the years 2005-2007, and for at least 4% of that portfolio during the years 2008-2010.

- Duquesne agrees to pursue cost-effective demand response programs for its Small Customers and agrees to meet with interested parties when developing and designing demand side response programs.

(OCA Stipulation).

The average residential generation rate, including the PJM Surcharge, for the initial three-year term under the proposal as revised is 6.24 cents/kWh. The average residential rate ceiling for the second three-year term is 6.86 cents/kWh. (*Id.*, Attachment A). Residential customers are subject to a twelve-month stay-out provision whereby customers returning to POLR service must remain on POLR service for twelve consecutive months. (*Id.*, at ¶ 4.a.).

c. Duquesne/OSBA Stipulation

The Stipulation between Duquesne and the OSBA also modified Duquesne's proposal as it relates to Rate Schedules GS/GM and GMH. The principal modifications are as follows:

- Small Commercial & Industrial (C&I) Customers will receive fixed rates as set forth in the OSBA Stipulation for the first three years of the POLR service term. Duquesne and the OSBA agree to modify the rate design for Small C&I Customers as set forth in the OSBA's direct testimony. There will be a reduction in demand charges by 10%, and a recovery of associated revenues in the tail block charge of each rate class. Duquesne and the OSBA agree that the rate redesigns are to be revenue neutral.

- For the second three years of the POLR service term, Duquesne agrees that the rates will be subject to a floor and ceiling as set forth in the Stipulation. If Duquesne wishes to raise rates above the floor, it must file on or before March 1, 2007 and support its request with market evidence, or propose a market-based process to establish the necessary increase.

- Duquesne and the OSBA have agreed to a fixed PJM Surcharge, not subject to reconciliation, which will be in place for the entire six-year POLR service term.

- Duquesne agrees not to seek generation increases other than as set forth in the Stipulation unless (i) Duquesne Power defaults on its power contract with Duquesne, and (ii) Duquesne Holdings defaults on its power contract with Duquesne, and (iii) those defaults threaten the financial ability of Duquesne to continue providing reliable service.

- Duquesne agrees to pursue cost-effective demand response programs for its Small C&I Customers and will meet with the OSBA when it develops or designs such programs.

(OSBA Stipulation).

Small C&I Customers are subject to a twelve-month stay-out provision if the customer returns to POLR service. However, the customer may exercise the option to move back into the market upon the payment of a Generation Rate Adjustment (GRA). (*Id.* at ¶ 4.a.).

2. ALJ's Recommendation

The ALJ recommended approval of the Small Customer Plan, as modified by the OSBA and OCA Stipulations. He did so for three primary reasons. First, he suggests that the Duquesne proposal was "the only comprehensible and complete plan presented in this record." (R.D. at 18). Second, the ALJ observed that the Plan will

provide for POLR service while the Commission completes the general POLR regulations that will further define POLR service. Finally, the Duquesne proposal provides for the recovery of Duquesne's costs associated with "joining and meshing its operations with PJM." (*Id.*).

The ALJ also discussed the pricing aspect of Duquesne's Plan as follows:

> The question of just what are prevailing market prices is an interesting one. It will be answered presumably by this Commission's regulations. In the meantime, Duquesne has set its small POLR prices based on the wholesale cost of power plus a margin to cover its costs, risks and provide a profit similar to what it was experiencing under the POLR II rates. It sounds to me like Duquesne has established a price at which it is willing to provide its services to the public. That those rates are set higher than the POLR II rates would seem to provide an opportunity to the suppliers/marketers to continue to persuade customers in the Duquesne service territory to shop. The switching rules under POLR II, that are proposed to be carried over to POLR III, do not seem to have hindered shopping.

(R.D. at 19).

3. Exceptions and Replies to the Approval of the Small Customer Plan, as Modified by the OCA and OSBA Stipulations

a. Overview

We note that any issue or Exception that we do not specifically address herein has been duly considered and will be denied without further discussion. It is well established that we are not required to consider expressly or at length each contention or argument raised by the parties. *Consolidated Rail Corporation v. Pennsylvania Public Utility Commission*, 625 A.2d 741 (Pa. Cmwlth. 1993); *also see, generally*, *University of*

Pennsylvania v. Pennsylvania Public Utility Commission, 485 A.2d 1217 (Pa. Cmwlth. 1984).

For purposes of organization, it can be fairly stated that the majority of the Exceptions to the approval of the Small Customer Plan fall into three broad areas. First, most of the Parties filing Exceptions cited error in the ALJ's discussion regarding market price. Constellation, Strategic Energy, Dominion Retail, Direct Energy, Reliant, the OTS and Citizens Power all raised this specific issue in their Exceptions. An issue closely related to market price is the six-year term established by the Small Customer Plan. Constellation, Reliant and the OTS discuss this issue and we will resolve those Exceptions in our discussion of market price. Also, Dominion Retail and Direct Energy raised the issue of Duquesne's cost recovery. The factors relating to cost recovery by Duquesne are related to our discussion of the market price issues and we will resolve those Exceptions in that context as well.

Second, Strategic Energy, Dominion Retail and Direct Energy raised the issue of switching restrictions. Third, Constellation, Strategic Energy and the OTS except to the ALJ's statement that Duquesne offered the only comprehensible and complete plan on the record and his use of that as a basis for his recommendation. We will address each of these three categories in turn, then we will consider the Exception relating to the proposed rate redesign for Small C&I Customers.

b. Six-Year Term, Cost Recovery, Market Price

The center piece of these issues is the Code's requirement that the POLR provider acquire energy to provide POLR supply at "prevailing market prices" and recover all "reasonable costs" in doing so. 66 Pa. C.S. § 2807(e)(3).

i. Six-year term

The OTS argues that the six-year term proposed by the Petition only serves to fix rates at higher than market levels for that time period. (OTS Exc. at 9). Also, the OTS argues that the basic concept of a fixed rate for a six-year period is anti-competitive and would discourage the development of a competitive market in Duquesne's service territory during that six year period. The OTS argues that the true issue here is "how long of a period is appropriate for these rates to be *fixed*." (*Id.*). The OTS states that the proper time period for fixed rates is one year, not six. According to the OTS, a one-year time period would enable POLR customers to experience price decreases during the time period of the POLR III Plan. Also, the OTS argues that an annual price term will permit the price to more closely track prevailing market prices, either up or down. (*Id.* at 9, 10).

Reliant argues that "the long-term capped POLR prices are a barrier to competitors' entry and will inhibit the development of the competitive market." (Reliant Exc. at 10). For Small C&I Customers, Reliant proposes to link POLR prices to market prices by permitting an adjustment to the POLR rate (up or down) twice each year based on changes in the average twelve-month NYMEX PJM forward price for energy. For residential customers, Reliant suggests that Duquesne's fixed rate be permitted for a three-year period, from 2005 to 2008. At the end of that period, Reliant states that the Commission can review the competitive landscape and determine if a fixed rate should continue or if some other mechanism should be employed for residential customers at that time. (*Id.* at 9-10).

Constellation argues that a six-year fixed price "cannot possibly reflect the prevailing market price intended by the legislation." (Constellation Exc. at 11). Constellation also argues that Duquesne's proposed membership in PJM will bring it into "the most competitive wholesale market in the country." (*Id.* at 9). Therefore, to the extent that the ALJ approved the six-year term out of concern that competitive electric

markets were in their infancy, that concern is not born out by the record. (*Id*. at 8-9). Dominion Retail argues similarly that a six-year term cannot reflect prevailing market prices. (Dominion Retail Exc. at 3-4).

Duquesne responds and argues that a six-year fixed rate term for residential and Small C&I Customers is appropriate given the fact that such a term aligns Duquesne's customers with other customers throughout the Commonwealth who remain on fixed rates for that period of time. Duquesne also states that it is not yet in a RTO and that the proposed Plan "comes on the heels of unprecedented change in retail and wholesale power markets. (Duquesne R.Exc. at 6-7). Duquesne argues further that Reliant's proposal for a three-year term is merely aimed at Duquesne's proposed purchase of the Sunbury generating station. Duquesne states that the Sunbury plant acquisition "is the 'lynchpin' of Duquesne's supply strategy to provide service for *six years*, not three. Duquesne is not offering fixed rate protection service under the terms proposed by Reliant." (*Id.* at 7).

The OSBA responds to the six-year term issue in a general fashion. According to the OSBA, nothing in the Act prohibits a fixed-rate term of six years. Also, the OSBA argues that none of the Parties filing Exceptions have guaranteed rates for the next six years that would be lower than those proposed by Duquesne. (OSBA R.Exc. at 13). The OCA does not specifically address the six-year term. It does agree with Duquesne's arguments that Duquesne customers should be aligned with other EDC customers who remain on fixed-rate POLR service for the next six years. (OCA R.Exc. at 3).

A six-year term is too long a period of time for the proposed POLR III Plan. The Excepting Parties are correct that one cannot establish a fixed price for a six-year term and comply with the Act's mandate that POLR supply must be acquired at *prevailing* market prices. Even with the proposed rate adjustment at the end of the first

three years, the adjustment mechanism provides for a floor and a ceiling, tied to the fixed-rate established in this proceeding.

For this proceeding, the appropriate time frame is a three-year period, at the end of which the Commission can review the POLR Plan in the context of the competitive market and regulatory landscape at that time. The three-year term for the Small Customer Plan is supported by testimony from several Parties. For example, Reliant states that for residential customers, a three-year plan avoids "unreasonable allocation of risk and reward…." (Reliant St. 1 at 11). Strategic Energy also suggests that a three-year planning horizon is an appropriate time frame. (Strategic Energy St. 2 at 5-6). In addition, Duquesne and the OCA each supported the concept that a prevailing market price can be determined for a three-year period. (Duquesne St. 2-S at 11; OCA St. 1-S at 2-3). As we have indicated, a six-year time frame is too long. However, the foregoing supports the determination that a three-year term is an appropriate period.

It is possible that a second three-year term with a price adjustment as proposed will be adopted. Conversely, Commission regulations may provide a different directive. As Reliant suggests, the competitive landscape at that time may provide new pricing tools better suited to POLR service. Given the state of the market and our intent to promulgate regulations in this area, any foundation for a six-year term is too speculative. We also note that a similar term was recently approved for a POLR Plan in another EDC's service territory, although the initial price terms were set for two years, not three. *Public Utility Commission, et al. v. UGI Utilities, Inc. – Electric Division*, R-00017033 (Tentative Order entered May 28, 2004).

In making this disposition, we are cognizant of Duquesne's and the OCA's arguments which seek to align Duquesne's customers with those customers of EDCs that remain in transition. However, Duquesne will have completed its CTC collection by early 2005, on a system-wide basis. (R.D. at 4, Duquesne M.B. at 1). For purposes of

reviewing the proposed POLR III Plan, Duquesne is no longer in transition and all aspects of Section 2807(e)(3) of the Act apply. Accordingly, while the Commission is cognizant of the industry as a whole and will review the POLR III Plan in the context of the state of the industry, the fact that other EDC's remain in transition does not mandate extension of Duquesne's transition period concomitant with that of the other EDCs.

We are also aware of Duquesne's statements that the fixed price stated in the POLR III Plan is based upon a six-year term. Duquesne and the OCA have gone to great lengths to establish that the proposed rate for the first three years is properly justified as the prevailing market rate over the initial three-year term. In addition, the OCA has forcefully argued that the market remains in a developmental state, subject to significant price fluctuations. (*See*, OCA M.B. at 39). Given that record, we reject Duquesne's position that the stated price must be fixed for a six-year term. The OCA, the OSBA and Duquesne have all agreed that there should be some form of pricing review at the end of three years. We agree, but given the record before us, there is no support for the proposition that a specific rate band will reflect the prevailing market price at that time.

ii. Reasonable Costs

Dominion Retail and Direct Energy filed Exceptions citing error in the determination that Duquesne's proposal will permit it to recover reasonable costs in providing POLR service. Dominion Retail argues that an additional .5 cents/kWh must be added to the proposed rates. Dominion Retail asserts that Duquesne failed to account for "costs that suppliers are likely to face in the Duquesne market." (Dominion Retail Exc. at 7). Dominion Retail also states that a substantial portion of POLR related costs, bad debt, is currently embedded in Duquesne's distribution rates and must be transferred to the POLR Plan. (*Id.*). Direct Energy argues that Duquesne has failed to "quantify" all the risk premiums associated with providing POLR service. (Direct Energy Exc. at 5).

The OCA responds that Dominion Retail is actually seeking an analysis based upon a hypothetical EGS's costs. However, the OCA states that the test is that a POLR provider must recover all reasonable costs, not a hypothetical cost build-up for an electric generation supplier. (OCA R.Exc. at 9). The OCA also argues that Direct Energy's argument is unsupported in the record and is an issue "best left to the POLR Roundtable discussions." (*Id.* at 17).

We will deny these Exceptions. This record does not support a finding that substantial POLR costs are currently embedded in distribution rates. Given the state of the record, we agree with the OCA that the issue is better left to other proceedings. Similarly, we agree with the OCA that on this record, we will not engage in a hypothetical build up of an EGS's costs and require Duquesne to match those costs in its rate development.

iii. Market based price

In our review of the proposed POLR III Plan, we have rejected the six-year fixed rate term in favor of a three-year term. Thus, to the extent that Parties have excepted to the proposed Small Customer Plan rates on the basis that they have been set over too great a period of time, those Exception have been granted. Most of the Parties excepting to the proposed Small Customer Plan rates have also argued that the development of the rates is flawed and the rates cannot properly be deemed "prevailing market prices" for purposes of Section 2807(e)(3) of the Act.

Constellation argues that Duquesne's proposed rates are not "reflective of any particular analysis of market prices," but were designed to recover the costs of acquisition of the Sunbury generating station and the costs associated with the risks of a proposed fixed price subject to regulatory approval. (Constellation Exc. at 10).

Constellation asserts that Duquesne never submitted information which would support the argument that the proposed rates are based on costs, rather the rates were set with the objective of producing savings. (*Id.* at 11). Constellation also argues that the proposed rates are actually too high based upon a comparison of rates in other jurisdictions. (*Id.* at 12). Direct Energy makes similar arguments. (Direct Energy Exc. at 3-5).

Strategic Energy states that Duquesne's Small Customer Plan rates have as their main goals long-term fixed rate protection and producing rate cuts below pre-Act levels. (Strategic Energy Exc. at 13). Strategic also argues that there is a profit built into the proposed rates. Strategic Energy states that Section 2807(e)(3) of the Act provides for the recovery of reasonable costs, which may include risk premiums, but not profit. According to Strategic Energy, inclusion of profit in such rates is anti-competitive since that provides incentive to the POLR provider to keep customers on POLR service to the detriment of the market. (*Id.* at 13-15).

Dominion Retail argues that the record establishes that the proposed rates have no relationship to actual market prices. According to Dominion, the record establishes that long before the proposed rates are to go into effect, the rates are over 1 cent/kWh below market rates. Further, to the extent that Duquesne and the OCA argue that other jurisdictions reveal pricing similarities, the rates in those jurisdictions reflect time periods and points in time that are substantially different from the relevant data here. (Dominion Retail Exc. at 3-7).

The OTS argues that "only an annual wholesale auction will produce the market rates envisioned by the Competition Act." (OTS Exc. at 5). The OTS states that an annual auction will allow customers to experience higher or lower rates based upon the condition of the supply market at that time. (*Id.* at 7). Citizen Power asserts that the record reveals that there is no viable wholesale market for POLR supply. Citizen Power also argues that the record contains no evidence regarding costs of supply sufficient to

enable the Commission to determine the appropriate prevailing market price. On those bases, Citizen Power argues that the Commission should condition approval of the Plan on Federal Energy Regulatory Commission (FERC) approval of a wholesale rate, after which this Commission could establish a retail rate. (Citizen Power Exc. at 4-8).

We will deny these Exceptions. To a large extent, the objections to the proposed rates are intertwined with the proposed six-year term which we have rejected in favor of a three-year term. To the extent that arguments focus on what an appropriate market based price is, some of the excepting Parties argue that the proposed rates are too low and some Parties argue that they are too high.

Duquesne argues that the proposed rates were set in a fashion which reflects increases in market prices as well as the costs of Duquesne joining PJM, and properly compensate for Duquesne Power's acquisition of the Sunbury plant. More significantly, Duquesne asserts that when the proposed rates are tested against recent supply auctions held in a neighboring jurisdiction within PJM, the proposed rates were "virtually identical." (Duquesne Exc. at 9).

The OCA framed this issue in an interesting fashion:

> The fact of the matter is that there are a multitude of products in the PJM markets, both short term and long term products, a multitude of market prices for these products at any given point in time, and a multitude of methods to acquire these products. All of these products and all of these prices play a role in the acquisition of energy at "prevailing market prices" by the POLR to provide reliable service on reasonable terms and conditions.

(OCA R.Exc. at 7).

According to the OCA, several market price analyses are in the record which support the proposed rates. The OCA argues that we should examine a portfolio of resources rather than focus on one particular source. (OCA R.Exc. at 21). The OCA also argues that when examined in this context, the record supports a finding that the proposed rates reflect prevailing market prices. (*Id.*).

Clearly, Duquesne is required to show that the proposed rates for the Small Customer Plan reflect prevailing market prices. 66 Pa. C.S. § 2807(e)(3). In our view, they have done so for the initial three-year term. We note Duquesne's testimony regarding the comparison to a neighboring jurisdiction within PJM. (Duquesne St. 3-R at 8-22). We also note the OCA's testimony regarding testing the proposed rates and the rate which is proposed here. (OCA St. No. 2 at 18-22 as modified by OCA St. No. 2S at 3-5). The Parties opposing these rates are far more convincing in their arguments against the second three-year period of the proposal. Accordingly, we find that based upon the record before us, Duquesne has established, by a preponderance of the evidence, that its proposed rates for the Small Customer Plan satisfy the Act's requirements that such rates reflect prevailing market prices for the three-year term period beginning January 1, 2005, through December 31, 2007.

c. Switching Restrictions

The Small Customer Plan proposes a twelve-month minimum stay requirement on residential customers, requiring customers who return to POLR service to stay with POLR service for one year before being allowed to move back into the competitive market. Customers who have never switched to an alternative supplier are permitted to leave POLR service at any time with no restriction. (Duquesne M.B. at 27).

Small C&I Customers have an annually renewing twelve-month minimum stay requirement, but with the opportunity to opt out of the minimum stay requirement

upon paying a GRA. The GRA is anniversary based, meaning that, after the first twelve months that a customer is on POLR service, the GRA renews for another twelve months. The GRA is based on the difference in supply costs between the spot prices for supply and the POLR service rate during the period when the customer starts POLR service. The customer is only assessed a GRA fee when the spot price for supply service exceeds the POLR rate. (Constellation M.B. at 5).

Constellation, Strategic Energy, Dominion Retail and Direct Energy all filed Exceptions to the proposed switching restrictions. Direct Energy argues that the twelve-month mandatory stay-out provision for residential customers and the Small C&I customer twelve-month stay-out provision with the GRA violate the Act in two ways. First, the switching restrictions violate the Act by failing to treat shopping customers returning to POLR service the same as new customers. 66 Pa. C.S. § 2807(e)(4). Second, the restrictions violate the requirement that EDCs provide comparable access to their transmission and distribution systems. 66 Pa. C.S. § 2804(6). (Direct Energy Exc. at 6). Direct Energy also argues that there is no record evidence that switching restrictions are needed in Duquesne's service territory in order to prevent "gaming" by residential customers. (*Id.*). Direct Energy asserts that if any protection is necessary, it should take the form of seasonal rates, not restrict a customer's access to the competitive market. (*Id.* at 7).

Like Direct Energy, Dominion Retail also argues that the proposed switching rules violate Sections 2807(e)(4) and 2804(6) of the Act. Dominion Retail acknowledges that elimination of switching restrictions may impose higher costs on a POLR supplier, but argues that those costs are legitimate and should be included in POLR rates. However, Dominion Retail argues that such costs may be avoided by imposing rules on suppliers that remove any profit from a supplier by not allowing a supplier to take back a customer from POLR service for a full year after the customer has

switched. The customer is free to switch to another supplier, but any supplier that attempts to game POLR rates has no incentive to do so. (Dominion Retail Exc. at 8-9).

Strategic Energy argues that the proposed switching restrictions are "anticompetitive and illegally discriminatory." (Strategic Energy Exc. at 7). Strategic Energy states that there are ways to address seasonal switching problems in a pro-competitive manner, such as requiring that only the customer can initiate a switch and providing for seasonal rates for small and large business customers. (*Id.*). Like Dominion Retail and Direct Energy, Strategic Energy argues that the proposed switching restrictions violate the Act's requirements for direct access and comparable use of the transmission and distribution system. Further, Strategic Energy asserts that there is no evidentiary basis for the switching restrictions. (*Id.* at 7-10).

Constellation argues that the proposed switching restrictions violate Sections 2802(3) and 2804(2) of the Act which provide that customers should have direct access to the market place. Switching restrictions expressly limit that access and also discriminate "against the rights of a customer of an EGS to access the distribution system of [Duquesne]." (Constellation Exc. at 27). Constellation also argues that the switching restrictions unnecessarily add to the level of complexity for residential customers and small business owners attempting to enter the market. (*Id.* at 28).

In addition, Constellation argues that the switching restrictions will result in high levels of switching activities in a short period of time. This will affect the ability of EGSs to provide tailor-made product solutions since they will be restricted to marketing within limited time frames. Also, this will create a boom and bust marketing activity which will increase costs. (*Id.* at 29). Constellation argues that seasonal pricing with refreshed rates for returning customers would better control seasonal switching than the restrictions proposed. (*Id.* at 30, 31 and 32). Constellation also suggests that a volumetric price adjustment such as that adopted in Maryland, which adjusts the POLR

price if a certain percentage of load simultaneously returns to POLR service, would serve the purpose. (*Id.* at 33).

The OCA and the OSBA both support the switching restrictions as proposed. The OCA argues that nothing in the Act precludes imposing switching restrictions. The OCA asserts that the proposed restrictions "balance the need for shopping restrictions designed to prevent gaming with the need to allow new customers opportunities to shop." (OCA R.Exc. at 10). The proposed restrictions provide "modest protections" and "allow Duquesne to provide a stable rate…." (*Id.*).

The OSBA argues that the Exceptions on this issue do not adequately address the problems which led to the development of the switching restrictions proposed here. The OSBA also acknowledges that several Parties proposed seasonal rates as a method to manage switching problems, but no formula or procedure to develop such rates has been proposed. Similarly, there has been no other unified proposal which addresses the issues justifying the switching restrictions. (OSBA Exc. at 16).

Duquesne asserts that there is no prohibition in the Act against switching restrictions. In this context, Duquesne argues that switching restrictions apply equally to all customers, thus rebutting arguments regarding discrimination and comparable access to the transmission and distribution system. (Duquesne R.Exc. at 14-16). Duquesne further argues that substantial evidence supports the need for switching restrictions. In addition, Duquesne argues that there is no evidence of record to support the theory that switching restrictions have reduced or hampered shopping in its service territory. (*Id.* at 17).

Duquesne also argues that Exceptions which label the GRA onerous or too complex ignore the fact that the mechanism has worked in the past. Duquesne has also committed to ensuring that information necessary to perform GRA estimates will be

available to customers and EGSs in order to enable the customer to make informed choices. Access to the information will also permit the EGSs to market customers subject to the GRA provisions. (Duquesne R.Exc. at 18).

We believe the record before us establishes that there are seasonal contracting risks faced by the POLR provider, commonly referred to as the "beach" phenomenon – i.e., EGSs switch customers back to POLR service in the summer when market prices are high then switch them back to competitive service in other months when market prices are low. (Duquesne M.B. at 27). We agree with the OCA and Duquesne that the Act does not preclude the use of switching rules to adequately address this problem. Nonetheless, we will grant the Exceptions for several reasons.

First, we find that the proposed switching restrictions improperly discriminate between new and returning customers. In light of Section 2807(e)(4) of the Act, the proposed switching restrictions treat returning customers to POLR service differently than new applicants for service. Section 2807(e)(4) states:

> If a customer that chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy service.

66 Pa. C.S. § 2807(e)(4).

Duquesne argued, "It is only when the customer returns to POLR service, then seeks to leave again, that the switching rules come into play." (Duquesne M.B. at 27). The minimum stay requirement imposed on small customers prohibits a customer returning to POLR service from freely accessing the market for an entire year. A new customer, on the other hand, confronts no such restriction. The new customer is able to

freely switch to an alternative supplier at any time. This restriction clearly discriminates against the returning POLR customer.

Similarly, the GRA mechanism treats Small C&I Customers returning to POLR service differently than new customers by charging existing Small C&I Customers who return to POLR service an exit fee for switching to an alternative supplier. New Small C&I Customers have no POLR exit fee, nor should one be imposed. There is simply no basis upon which to discriminate against returning customers by requiring them to remain on POLR service for one year or charging them exit fees, while new customers are free to choose competitive suppliers. Thus, we find that the restrictions as proposed violate the anti-discrimination provisions of Section 2807(e)(4) of the Act.

Second, competitive generation markets can only develop and mature if consumers have free and direct access to the competitive market, as contemplated by the Act. Section 2802(3) of the Act states, in pertinent part, that it is "now in the public interest to permit retail customers to obtain direct access to a competitive generation market" while Section 2804(2) states, in pertinent part, that "the Commission shall allow customers to choose among electric generation suppliers in a competitive generation market through direct access." 66 Pa. C.S. §§ 2802(3) and 2804(2). Clearly, the Act contemplated that the essence of a competitive market is the ability to choose. Minimum stay provisions and exit fees do just the opposite; they act as barriers to the marketplace.

Additionally, the complexities involved with the proposed switching restrictions, particularly with the GRA exit fee, will impose additional costs to the shopping customer. (*See, e.g.,* Tr. at 705, 779-780; Constellation M.B. at 8-9). The end result may be to potentially chill the development of the competitive retail marketplace. It also imposes additional costs to the utility in terms of customer service cost and to the EGS in terms of generation administration costs. (Constellation M.B. at 8). The

foregoing also supports our determination that the proposed restrictions are at odds with the Act.

Optimally, the Commission should seek market-based solutions to address the problem of seasonal gaming. The record demonstrates the existence of market-based solutions, including seasonal rates and volumetric risk mitigation measures. Other states have adopted such market-based solutions and they should be considered in Pennsylvania. Nonetheless, the record in this case has not been sufficiently developed to permit the implementation of such market-based approaches at this time. Rather, these solutions shall be more fully considered and addressed in the context of state-wide regulations for POLR service.

The record in this case does provide substantial support for two measures in order to protect against seasonal gaming. First, an EGS should not be able to initiate a switch. Strategic Energy suggested that if the Commission provides that the *customer* is the only entity who can initiate a switch, then EGSs cannot game POLR rates in the high-cost summer months. Strategic Energy correctly argues that there is little likelihood that a large number of residential customers would engage in coordinated, timed switching. (Strategic Exc. at 10). Accordingly, we will direct that Duquesne alter the POLR III Plan to provide that only customers can initiate a switch back to POLR service.

Second, Duquesne shall be able to seek relief from the Commission in the event it believes that an EGS is exploiting the seasonal variations of the market. Duquesne shall carefully monitor the migration of consumers between POLR service and EGSs. In the event that Duquesne observes a significant migration of consumers from an EGS to POLR service, and has reason to believe that the EGS will seek to reacquire those consumers in an effort to exploit the seasonal variations in the market, then Duquesne may petition the Commission for any appropriate relief. In such a proceeding, the Commission shall consider, *inter alia*, whether to prohibit the EGS from reacquiring

those consumers for a period of up to 12 months from when they commenced POLR service.

These two rules are consistent with the intent of the Act as well as Commission policy to further competitive retail markets. The combination of these proposals eliminates the opportunity for an EGS to initiate customer migration and removes the financial incentive for an EGS to engage in seasonal gaming. At the same time, the proposals result in similar treatment for *all* customers, allowing returning customers, new applicants, and existing customers to have free access to the competitive market. These two rules address the actual harm (EGS gaming) with the least impact on customer access to the market, rather than anticipate the potential for harm and preemptively act on the customer's ability to access the market.

For the foregoing reasons, we will grant the Exceptions of Constellation, Strategic Energy, Dominion Retail and Direct Energy consistent with our discussion of this issue. We stress that we prefer market based approaches to this type of problem. Thus, our decision here should not be interpreted to foreclose options such as seasonal pricing or volumetric bands in the future.

d. Comprehensible and Complete Plan

Constellation, Direct Energy and the OTS all argue that the ALJ erred when he based his approval of the POLR III Plan, in part, on the determination that it was the only comprehensible and complete plan offered on the record. (Constellation Exc. at 4-7; Strategic Energy Exc. at 18-21; OTS Exc. at 4-5). Constellation argues that it presented a plan that provided for a competitive procurement process similar to those now in place in New Jersey and Maryland. (Constellation Exc. at 4). Strategic Energy notes that it described a "Better Choice Plan" that was complete and fairly supported on the record. (Strategic Energy Exc. at 18). The OTS argues that it would be incongruous to challenge

opposing Parties to present a complete plan when Duquesne has the burden of proof to show that its POLR III Plan meets the statutory requirements. (OTS Exc. at 5).

We will grant these Exceptions to the extent that the ALJ erred when he stated that no other comprehensible plans were presented on the record. Our determinations relating to the POLR III Plan, and modifications thereto, are not based on whether other Parties proposed competing plans. Nor should our action here be interpreted as forever precluding concepts such as seasonal rates and different forms of switching rules in future POLR proceedings. Our decision in this proceeding is grounded in both the statute and the record, with the full recognition that Duquesne bears the burden of proof. 66 Pa. C.S. § 332(a). In similar fashion, the record as developed also does not support adoption of any of the alternative plans in their entirety.

e. Rate Redesign for Small C&I Customers

Strategic Energy excepts to the ALJ's approval of the proposed rate redesign for Small C&I Customers which has the effect of shifting revenue requirement responsibility from low load factor customers to high load factor customers. Strategic Energy argues that the effect of the rate redesign will be to diminish the low load customers' interest in shopping by further reducing their generation rates and thus reducing their competitive options in the marketplace. According to Strategic Energy, there is no evidentiary support for the change. Strategic Energy argues that since it costs more to serve low load customers, it is inappropriate to reduce their rates. Strategic Energy also argues that the rate redesign runs counter to the Act's mandate that the Commission encourage a fully competitive market. (Strategic Energy Exc. 15-16).

Duquesne responds that the proposed rate redesign produces shopping credits for smaller customers in the 9 cents/kWh to 11 cents/kWh range. Duquesne argues that no opposing Party submitted evidence that contends that those prices are

below market. In addition, Duquesne asserts that even with the rate redesign, the low load factor customers will still pay rates in excess of those paid by higher load factor customers. Duquesne also argues that any suggestion that the rate redesign will reduce incentives for these customers to shop is too speculative. (Duquesne R.Exc. at 10).

The OSBA argues that the rate redesign and other modifications (such as the demand charge reduction and tail block increase) proposed in the OSBA Stipulation are supported by substantial evidence. The OSBA asserts that the smaller customers will see a slight reduction in rates, "bringing them incrementally closer to a market-based rate. The larger GS/GM and GMH customers will have their generation rates raised, not only bringing them closer to the market, but also making them more inviting targets for Marketers." (OSBA R.Exc. at 18).

We will deny this Exception. The OSBA is correct in its argument that the record supports the rate redesign proposed in the OSBA Stipulation. On this issue, we are particularly persuaded by the OSBA's evidence regarding the alignment of intra-class generation rates and the effect of the current Duquesne demand charge. (OSBA R.Exc. at 19; OSBA St. No. 4 at 3).

C. Description of the Large Customer Plan[4]

1. Position of the Parties

Duquesne's Large Customer Plan sets forth the terms and conditions under which Duquesne will provide POLR III service beginning on January 1, 2005, through Duquesne's "first planning period following the effective date of statewide post-CTC POLR regulations…." (DII Stipulation ¶ I 4.). Duquesne proposes to offer two Large

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[4] The Large Customer Plan applies to Rate Schedules GL, GLH, L and HVPS.

C&I Customer POLR products during the term of the POLR III Plan. One product will be an hourly priced service (HPS) and the other product is to be a fixed price default service (FPDS). (R.D. at 21). Of the two product offerings, the FPDS is the default service to which customers will be assigned if they do not affirmatively chose HPS or competitive supply from an EGS. (*Id.* at 22).

For the FPDS, Duquesne will obtain bids in a wholesale request for proposal (RFP) process for the entire Large C&I load, then translate that wholesale price into a fixed retail price for each rate schedule. Duquesne will develop on-peak and off-peak rates for each rate schedule. Duquesne will also use each customer's estimated PJM capacity obligation as the billing demand for generation service, which is a change from the Company's existing practice. (DII M.B. at 19-20).

For HPS, most of the pricing elements are a flow through of PJM market charges for hourly energy, ancillary services and losses. Duquesne originally proposed to develop the capacity charge through an auction process. Pursuant to the DII Stipulation, Duquesne has modified that aspect of its proposal and will develop the capacity price based on the PJM capacity market prices. (*Id.* at 20-21).

As initially proposed, Duquesne would collect its reasonable costs for providing the HPS and FPDS by collecting a fixed retail adder of 5 mil/kWh. The purpose of the retail adder was to compensate Duquesne "for: (1) accepting risks associated with providing Large C&I POLR services; (2) conducting auctions; and (3) performing new retail and management functions." (DII M.B. at 21). The DII Stipulation modified that aspect of the Large Customer Plan by proposing two separate adders. The first adder will be a .05 cents/kWh adder applicable to all sales to Large C&I Customers, whether they take service under the POLR III Plan or receive generation from an EGS. The second adder will be recovered only from POLR III customers and is designed to compensate Duquesne at approximately the same revenue level as the adder

Duquesne currently collects under the POLR II Plan. The revenue requirement per rate schedule is based on distribution cost allocators from Duquesne's most recent cost of service study, performed in 1996. These adders range from .035 cents/kWh for Rate Schedule HVPS to .354 cents/kWh for Rate Schedule GL. (R.D. at 23).

The DII Stipulation added several other provisions to the Large Customer Plan. Included in those additional provisions are the following.[5] First, two customers on Rate Schedule HVPS remain on POLR I rates and continue to pay competitive transition charges. Under the DII Stipulation, those customers "will be required to pay the net incremental charges associated with their electric requirements as a result of the Company joining PJM effective January 1, 2005." (DII Stipulation ¶ I.4.c.). Second, similar to the OCA Stipulation, Duquesne has agreed not to seek an increase in distribution rates that would become effective prior to January 1, 2008, unless a governmental entity or an RTO required upgrades to Duquesne's distribution system, the cost of which would prevent Duquesne from earning a fair rate of return. (*Id.* at ¶ I.4.d.). Third, Duquesne agrees that during the term of the distribution rate cap, it will continue to meet or exceed the reliability requirements for distribution service. (*Id.* at ¶ I.4.e.). Fourth, the FPDS price will be "refreshed" on a quarterly basis for HPS or EGS customers that elect to return to the FPDS product for the remainder of the price application period. (DII Stipulation at ¶ I.4.g.(4)). Fifth, Duquesne will assume supplier default risk and will not alter its retail rates for Large C&I customers, but does not waive the provisions of Section 2804(4)(iii)(A)(C) or (D) of the Act, 66 Pa. C.S. § 2804(4)(iii)(A)(C) and (D) (relating to rate cap exceptions). (*Id.* at ¶ I.4.g.(5)). Sixth, Duquesne will endeavor to ensure that Large C&I Customers on POLR service will be able to participate in applicable load management programs offered by PJM. (*Id.* at ¶ I.4.g.(7).

[5] There are additional provisions. We have summarized some of the more significant items here.

Switching restrictions apply to customers taking service under the FPDS. Those customers will commit to remaining on FPDS for the duration of the price application period (i.e., January 1, 2005 through May 31, 2006 for the initial RFP and Enrollment Period) until the next RFP is conducted. A Large C&I Customer could depart FPDS service by paying a GRA. The GRA would be paid to the winning bidders for FPDS supply. If that customer later returned to FPDS, it would pay the refreshed FPDS rate. (Duquesne R.B. at 17-18). There are no switching restrictions on customers taking HPS. (*Id.*)

2. ALJ's Recommendation

The ALJ recommended approval of the Large Customer Plan as modified by the DII Stipulation. The ALJ "stressed" that in his view, "the plan is clearly submitted as an interim or bridge between the POLR II rates that expire on December 30, 2004, and the rates that will be developed following implementation of the Commission's post-transition regulations." (R.D. at 30). As he stated in his ruling on the Small Customer Plan, the ALJ found that the proposed POLR III Plan as modified by the DII stipulation was "the only comprehensible and complete proposal on this record." (*Id.* at 31). The ALJ also found that Duquesne had adequately supported the proposed switching restrictions on the FPDS. For the foregoing reasons, the ALJ recommended approval. (*Id.*).

3. Duquesne's Motion to Strike Reply Exceptions of Reliant

On June 16, 2004, several Parties, including Reliant and Duquesne, filed Replies to the Parties' Exceptions filed June 9, 2004. Reliant's Reply Exceptions request that the Commission modify Duquesne's POLR service for large commercial and industrial (Large C&I) customers by implementing revisions to the POLR Retail Tariff sponsored by Duquesne as Exhibit WVP-1. Specifically, Reliant requests that

Duquesne's Retail Tariff be revised to amend switching restrictions and to implement transition to an hourly only default rate. (Reliant R. Exc. at 2). Duquesne moved to strike Reliant's Reply Exceptions arguing that they are not responsive to any Exceptions filed by the Parties and initiate new arguments to the Recommended Decision. Duquesne avers that pursuant to the Commission's Regulations, the purpose of reply exceptions is to rebut arguments raised by a party in a prior exception. (Duquesne Motion at 3). Duquesne argues that if Reliant's Reply Exceptions are not stricken, Duquesne will be placed at a disadvantage as the Commission's Regulations do not allow parties to file responses to reply exceptions. (*Id.* at 4).

"[I]t is improper for a party to use Reply Exceptions to initiate arguments of error in initial, tentative and recommended decisions. Sections 5.533 and 5.535 clearly contemplate that Exceptions are to focus on initial, tentative or recommended decisions while Reply Exceptions are to focus on the arguments raised by the Excepting party. 52 Pa. Code §§ 5.533(a) and 5.535(a)." *Petition of Core Communications, Inc. for Resolution of Dispute with Verizon Pennsylvania, Inc. Pursuant to the Abbreviated Dispute Resolution Process*, Docket No. A-310922F7000, 2003 Pa. PUC LEXIS 21,*9 (Order entered May 27, 2003).

As stated in the *Core Communications* case, our Regulations clearly provide that the purpose of reply exceptions is to respond to issues raised in exceptions taken to Initial or Recommended Decisions. Reply exceptions are not an avenue by which a party can interject late-filed exceptions into the record. That being said, we do not consider Reliant's Replies to be improper. Reliant's Reply Exceptions address arguments raised by the other Parties in their Exceptions and continues the themes stated in its own Exceptions. Each of the EGSs addressed the issue of switching restrictions and/or the GRA in the following Exceptions: Reliant at 5-6; Constellation at 24-33; Strategic at 6-7; Dominion at 8-9; and, Direct Energy at 5-7. The issue of transitioning to an hourly default rate for Large C&I users was also addressed in these Exceptions:

Reliant at 5, Constellation at 34-38; and, Strategic at 12. Duquesne was on notice that Reliant, as well as other Parties, took exception to the ALJ's decision on the above-discussed issues. As such, Reliant gains no unfair advantage by continuing its arguments related to these issues in its Reply Exceptions. Accordingly, Duquesne's Motion to Strike Reliant's Reply Exceptions is denied.

4. Exceptions and Replies to the Approval of the Large Customer Plan, as Modified by the DII Stipulation

a. Overview

As with the Exceptions to the Small Customer Plan, the Exceptions to the Large Customer Plan can be organized into several distinct categories. The first category to be addressed is the nature of the POLR service to be offered. Several of the Excepting Parties object to the provision of any POLR product other than HPS. Constellation and Reliant raise this issue. Included in this category is an Exception filed by Strategic Energy which asserts that if two POLR products are to be offered, the default service should be HPS, not FPDS.

The next category we will address is the issue of the adders. Constellation, Strategic Energy and Reliant all filed Exceptions on this issue. Included in this category is not only the level of adders to be charged, but whether the administrative cost adder should apply to all customers or POLR customers only. The last category to be addressed is switching restrictions as they relate to the Large Customer Plan.

b. POLR III Plan Products

As noted above, Duquesne proposes to offer two products to Large C&I Customers on POLR service: HPS and FPDS. Constellation argues that only one service

should be provided as POLR service: HPS. Constellation states that the evidence reveals that Duquesne's service territory has strong shopping statistics and a high level of experience and sophistication of Large C&I Customers with retail choice. Given that evidence, Constellation argues that there is no need to offer two POLR products to these customers. (Constellation Exc. at 34-36). Constellation asserts that multiple POLR options only serve to interfere with the market response to customer demand for innovative products and pricing structures. According to Constellation, multiple POLR products will complicate the bidding process and increase administrative costs. (*Id.* at 36).

Constellation argues further that an HPS only product has stimulated large C&I market development in other jurisdictions such as New Jersey and Maryland. Constellation states that an HPS only product balances the needs of Large C&I Customers for a POLR product with the goal of promoting competitive markets. Constellation argues that characterizing an HPS only POLR as a penalty is misleading and ignores the Act's requirement that the Commission balance the requirement to promote competitive markets with customers' POLR needs. (*Id.* at 37). Constellation also argues that an HPS only POLR for Large C&I Customers is appropriate since it provides for market signals to those customers best able to react to price signals. (*Id.* at 38).

Reliant argues that a "POLR service that offers a variety of products becomes a substitute for retail supplier competition, and selects the features of products and services through regulation, not competition." (Reliant Exc. at 4). According to Reliant, the Large Customer Plan as modified by the DII Stipulation would become the Large C&I Customers' first choice, not a true last resort service. Thus, the POLR III Plan as proposed "will interfere with the development of a competitive market." (*Id.*).

Like Constellation, Reliant disputes the ALJ's finding that evidence showing high switching rates under an HPS only POLR demonstrates that customers do not want HPS. According to Reliant, high switching rates under an HPS only POLR service demonstrate that customers have found "even better deals by exploring the benefits of competition, such as competitors' superior prices and products (including both hourly-priced and fixed-priced products)." (Reliant Exc. at 4). Reliant also asserts that if the Commission approves two POLR products, the default service should be HPS and the FPDS should terminate after one year. (*Id.* at 5).

Strategic Energy argues that the ALJ erred by approving the FPDS as the default POLR service. Strategic Energy states that since HPS reflects actual market price changes, that would be the best default service "because it sends accurate price signals to customers so that the benefits from demand response and demand side management can be maximized for both customers and their suppliers." (Strategic Energy Exc. at 12). Strategic Energy also states that hourly pricing most accurately reflects the Act's requirement that POLR prices be based upon prevailing market prices for energy. (*Id.*).

Duquesne responded to the foregoing Exceptions and argues that the FPDS was proposed because no customers want hourly service. According to Duquesne, the fact of Large C&I Customers' preference also supports making FPDS the default option. For these reasons, Duquesne argues that we should reject the arguments which favor an HPS only POLR service. (Duquesne Exc. at 12).

DII argues that the FPDS is entirely consistent with the Act since the pricing will be established through an RFP and customers returning to the FPDS will be charged updated prices based upon the market at that time. The foregoing establishes that the FPDS will be provided at prevailing market prices as required by the Act. (DII R.Exc. at 6-7). DII also argues that an HPS only POLR product will subject Large C&I Customers to hourly and seasonal price fluctuations that will harm their competitive

positions in their industries. (*Id.* at 9-10). DII states that experience indicates that markets evolve over time. Accordingly, the FPDS as proposed is appropriate at this evolutionary stage of Pennsylvania's retail markets. Over time, DII asserts that the Commission should review the FPDS and make such modifications as are appropriate given the state of the market. (*Id.* at 14-15).

In its Reply Exceptions, Reliant again argues that the default service should be HPS, not FPDS. Also, Reliant urges the Commission to limit the provision of FPDS service to the first price application period only, ending that product option on May 31, 2006.

We will grant the Exceptions of Constellation, Reliant and Strategic Energy to the extent that we will modify the structure of the Large Customer Plan to provide that HPS service will be the default service. We will also adopt Reliant's suggestion that the FPDS product should be limited to the first price application period and terminate as a POLR product option on May 31, 2006. In making this determination, we are guided largely by Section 2802(3) of the Act which provides for direct access to the competitive market place. Thus, while we will approve the proposed FPDS for a limited time period, we recognize that the price application period commitment and GRA mechanism restricts the ability of customers on that service to move into the market place.

The HPS service provides the freedom for customers to move into the market at will, subject to administrative switching protocols. Accordingly, in a POLR universe with two product offerings, we find that the product with the most freedom to move into the market must be the default product in order to satisfy the mandates of Section 2802(3). We also find that this construct properly balances the policy considerations which strongly favor competitive markets as set forth in Section 2802(5) of the Act with the considerations requiring service on reasonable terms and conditions as set forth in Section 2802(9).

We disagree with Duquesne's suggestion that the structure of the POLR Plan should be completely aligned with customers' preferences. We also do not agree with DII that an HPS only POLR Plan will necessarily subject customers to seasonal fluctuations that will harm their competitive positions. As set forth in the Act, this Commonwealth has found that a competitive marketplace is better able to address those concerns than a regulatory construct. 66 Pa. C.S. § 2802(5).

We find that there is some merit in DII's argument that the retail market continues to evolve. Thus, we have not adopted Constellation's position that only one POLR product is appropriate at this time. The FPDS option should be made available for the first price application period to provide both Large C&I Customers and EGSs with additional experience in the market and planning time to prepare for an HPS only POLR offering. Duquesne's status as a new member in PJM is an additional factor supporting the FPDS product option for a limited period of time.

c. Retail Adders

As set forth in Section 2807(e)(3) of the Act, Duquesne is entitled to recover all reasonable costs incurred in providing POLR service. After modification by the DII Stipulation, the mechanism Duquesne and DII proposed to accomplish that cost recovery is two retail adders designed to compensate Duquesne for the risk involved in providing Large C&I Customer POLR service and for the costs associated with providing the service. There will be no reconciliation or true up.

The first adder is set at 0.05 cents/kWh and applies to all sales to Large C&I Customers, including POLR sales and sales supplied by an EGS. This adder is designed to recover administrative costs associated with providing the Large C&I POLR services as well as to recover the costs of litigating this proceeding. (DII Supp.B. at 5).

A separate adder applies only to Large C&I Customers taking POLR service and applies to customers on both HPS and FPDS. This second adder is designed to compensate Duquesne for the risks associated with providing POLR service and is set at approximately the same revenue level as the adder it currently collects pursuant to the POLR II Settlement and is based on the distribution cost allocators from Duquesne's most recent cost of service study. (DII Supp.B. at 5-6; DII Stipulation at ¶ I.4.b.).

Reliant excepts to the ALJ's recommendation to approve the proposed adders stating that the adders are too low and do not accurately reflect the costs of service risk and retail activities necessary to provide the POLR service to the Large C&I Customers. Reliant argues that the ALJ merely accepted the adders agreed to by Duquesne and DII without any cost evidence in the record. Reliant argues that this is born out by the experiences in New Jersey and Maryland which indicate that an appropriate total adder would be in the range of 5.0 to 6.5 mils/kWh. Reliant asserts that setting the adders too low will remove any opportunity for an EGS to actively participate in Duquesne's service territory because there will be insufficient headroom for a return. (Reliant Exc. 7-8).

Strategic Energy also excepts to the recommendation to approve the adders as proposed. Strategic Energy argues that the first error is that the administrative cost adder should not be assigned to all Large C&I Customers, including those taking generation service from EGSs. Strategic Energy argues that universal application of this adder would require EGS customers to pay the administrative costs of providing generation service twice: once to their EGS and again to Duquesne. In addition, Strategic Energy argues that such a plan removes any opportunity of an EGS to compete on the basis of administrative efficiency since the EGS customer pays the costs of Duquesne's administration regardless of whether it takes Duquesne's service or not. (Strategic Energy Exc. at 15-16).

Strategic Energy also excepts to the risk adder on the basis that the level of the proposed risk adder does not reflect the evidence of record. According to Strategic Energy, the evidence suggests that the risk adder is more properly in the range of 3.4 mils/kWh on an average basis rather than the 2.2 mils/kWh as proposed. (*Id.* at 17). In addition, Strategic Energy finds fault with using a distribution plant allocator for what is essentially a risk premium for generation service. The more appropriate allocator, according to Strategic Energy, would be a generation plant allocator. (*Id.* at 17-18).

Constellation argues that there is no cost support in the record for either the administrative cost adder or the risk adder. As to the risk adder recovering an equivalent revenue level as that of the POLR II Plan, Constellation argues that the POLR II margin was actually 3.57 mil/kWh rather than the 2.2 mil/kWh proposed. (Constellation Exc. at 21-22). This means that the risk adder "represents a significant reduction from the POLR II settlement…." (*Id.* at 22). Constellation also argues that Duquesne's POLR service is "subsidized extensively through distribution rates." (*Id.* at 23). Constellation argues that there should be an allocation of some distribution costs to the administrative adder in order to more accurately develop that figure. (*Id.* at 23-24). Constellation also argues that it is unlawful to charge the administrative adder to non-POLR customers. (*Id.*).

Duquesne rejoins that the record establishes that Duquesne will incur substantial incremental costs to provide POLR service. In addition, Duquesne asserts that there is no dispute that it will assume significant risks of supplier default on the FPDS service. Duquesne states that although that "risk cannot be quantified precisely, that is not a basis for denying" recovery. (Duquesne R.Exc. at 13).

Duquesne asserts that the risk adder is set at an appropriate amount. Duquesne states that although the Excepting Parties are correct that the actual adder is "slightly lower, on a mills/kWh basis (due to the addition of HVPS loads during POLR III), it should still be sufficient to facilitate retail competition." (*Id.*). On the allocation

issue, Duquesne argues that the allocation method is consistent with that used in POLR II where the size of the adder declines by rate schedule as the size of the customers increase. According to Duquesne, this is consistent with economic development given the sensitivity of large customers to electric costs and their ability to relocate. (*Id.*). Duquesne also argues that universal application of the administrative adder is appropriate because "shopping customers benefit from having the option to return to POLR service…." (Duquesne R.Exc. at 13-14).

DII responds and argues that the record indicates that Duquesne presented substantial evidence that it would incur "approximately $3 million in costs related to conducting the annual request for proposal ('RFP') processes and administering the program." (DII R.Exc. at 17). According to DII, this supports a .5 mil/kWh administrative adder applicable to all sales. Further, DII argues that the costs used to develop this administrative adder were the only administrative costs that have been established and quantified on the record for the Large Customer Plan. (*Id.* at 17-18).

DII also argues that there is no basis in the record to find that any portion of distribution rates will subsidize the POLR Plan. DII points out that Rate HVPS customers currently pay less than 1 mil/kWh for distribution, while other C&I rate schedules pay in the range of 6 to 9 mills/kWh. Given the foregoing, it is "patently illogical to believe" that C&I customers have 5 mills of generation related costs in their distribution rates. (DII R.Exc. at 23).

With regard to the risk adder, DII argues that the proposed design to recover $10 million is consistent with the margin for each rate schedule on POLR II. DII states that while the system average margin may equate to 5 mills for all rate schedules, the actual margins for Large C&I rate schedules are much lower. In addition, DII argues that use of the distribution plant allocator is appropriate. DII states that this allocator was used consistent with DII's expert testimony on appropriate cost allocations; testimony

that was not challenged by the Excepting Parties at hearing. According to DII, absent valid, competing testimony, the risk adder design is based upon the only evidence of record. (DII R.Exc. at 20-22).

We will grant the Exceptions of those Parties objecting to the universal application of the administrative adder. We will deny the Exceptions relating to the level of the two adders and the methodology of determining the risk adder. We agree with DII that the record contains substantial evidence which supports the cost build up of the administrative adder, noting the testimony of DII's Witness Baron on the types of costs involved. Also, as we stated in our discussion of the Small Customer Plan, if there is a question regarding distribution rate subsidies, this record does not support a finding on that issue.

We disagree that simply because POLR service stands ready to serve all customers, all customers must pay the costs of its administration. That type of plan requires shopping customers to pay the administrative costs of generation twice: once to their EGS and then again to Duquesne for generation not used. Universal application of the administrative adder will eliminate, dollar for dollar, any benefits achieved through administrative efficiencies gained by the competitive market.

The foregoing result violates the bedrock principle expressed in Section 2802(5) of the Act relating to the ability of competitive markets to control costs. In addition, there is nothing in this record or in the Act which suggests that it is inappropriate for customers to factor the avoidance of POLR administrative costs in their decision to move into the market. To the contrary, the Act and common sense suggest that is exactly the kind of behavior to be expected in a competitive market construct.

We agree with DII that the risk adder has been appropriately designed and developed. We do have some reservations regarding the use of a distribution plant

allocator for the reasons expressed by Strategic Energy in its Exceptions. However, DII is correct that use of that allocator has been substantially advanced by the record in this case, while no such evidentiary support exists for any competing theory. Accordingly, on the basis of the record in this case, we will deny the Exceptions relating to the risk adder. We wish to emphasize that our decision here is based upon this record and should not be interpreted as precluding other solutions to this issue in future proceedings.

For the foregoing reasons, we will approve the adders set forth in the DII Stipulation except to the extent that the administrative adder may only be applied to POLR III customers. Accordingly, Duquesne will necessarily be required to revise the level of the administrative adder to reflect our determination of this issue.[6]

d. Switching Restrictions

Constellation, Strategic Energy and Reliant all excepted to the ALJ's recommended approval of the switching restrictions for the Large Customer Plan. (Constellation Exc. at 24-34; Strategic Energy Exc. at 6-12; Reliant Exc. at 6-7). We will deny these Exceptions. We have altered the proposed POLR structure so as to provide that Large C&I Customers will be defaulted to HPS, a service for which there are no switching restrictions. Accordingly, to the extent that Large C&I Customers *choose* to participate in the FPDS, they will do so having knowingly subjected themselves to the switching restrictions which include a stay-out provision with a GRA mechanism.

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[6] We note that Constellation Cross-Examination Exhibit No. 7 discussed this issue. There is some merit to Duquesne's position that the use of 2003 POLR sales to build the administrative adder will not yield revenues equivalent to those derived from the use of total sales due to switching activity. As set forth below, we will adopt Duquesne's suggestion of a working group approach in the compliance phase. This calculation issue can be properly resolved in that setting.

The fact that Large C&I Customers can only subject themselves to these restrictions by a knowing choice eliminates the concerns which led us to modify the switching restrictions in the Small Customer Plan. Here, Large C&I Customers default to the HPS, where no restrictions exist. Since the Large C&I Customers will default to the HPS, they can only be subject to switching restrictions upon a voluntary and affirmative choice to participate in the FPDS option. Accordingly, we do not find that the restrictions on FPDS erect the same barriers to the market as those proposed for the Small Customer Plan.

As we stated in our resolution of switching restrictions for the Small Customer Plan, there is a lack of evidence, on this record, that supports the implementation of specific seasonal rates or other types of restrictions such as volumetric triggers. Again we stress that this determination is based upon the record before us and it should not be interpreted to foreclose innovative and market-based approaches in future proceedings.

<u>V. PJM West Membership</u>

As part of the POLR II Settlement, Duquesne was required to commence negotiations to join the western region of PJM (PJM West) by January 1, 2005. PJM is the RTO approved by the FERC to: (1) operate the bulk transmission system for the region encompassing all or parts of Delaware, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, West Virginia, and the District of Columbia; and (2) to administer a competitive wholesale power market. (PJM M.B. at 1).

In its Petition to provide POLR service beginning January 1, 2005, Duquesne states that it intends to join PJM West by December 31, 2004, if the Commission permits it to recover the costs associated with joining the RTO. (Duquesne M.B. at 48). Duquesne's Rider No. 1 proposes a surcharge of 0.0708 cents/kWh to be

applied to all customers who purchase their electric generation requirements from the Company. (Duquesne Exh.WVP-1, at revised pg. 82).

ALJ Nemec observed that no Party opposed the PJM West proposal and posited that Commission approval of membership was likely unnecessary. ALJ Nemec, nonetheless, approved Duquesne's request to join the RTO and pass on PJM related costs through the Surcharge. (R.D. at 31, 32). No Party filed Exceptions to the issues of Duquesne joining PJM West or the PJM Surcharge.

This Commission has stated that we support and encourage RTO participation by the electric industries operating in the Commonwealth. *See*, *Competitive Safeguards for the Pennsylvania Electric Industry*, Docket No. L-00980132, April 28, 2000. PJM West membership will bring Duquesne's customers the benefit of what is arguably the most robustly competitive wholesale market in the country. Joining PJM West will allow Duquesne to maintain high levels of reliability and provide access to PJM's liquid energy markets for both POLR and switching customers. (Petition at 4).

PJM will provide a wide range of services to Duquesne, its customers, and EGSs, including the administration of markets for energy, capacity, and ancillary services, planning, load management, and market monitoring. (Duquesne R. Brief at 37). To recoup the costs of providing these services, PJM charges market participants under its open-access transmission tariff. Duquesne proposes to pass those charges on to its POLR customers via the PJM surcharge.

The OCA and Duquesne agreed that Duquesne's Small Customers would receive service at the fixed POLR III rates for 2005-2007 proposed by Duquesne in Duquesne Exhibit WVP-1, as modified in Revised Exhibit WVP-2 for the addition of the PJM surcharge. (OCA Stipulation at ¶ I.4.(a)). For the period 2008-2010, the OCA agreed that rates should be bounded by a floor and a ceiling sufficient to provide

adequate compensation to Duquesne for the risks incurred to serve small customers. (OCA Stipulation at ¶ I.4.(b)). The OSBA and Duquesne agreed to fix the PJM Surcharge without reconciliation for Small C&I Customer POLR service for the six-year POLR III period at the rate identified in Rider No. 1. (OSBA Stipulation at ¶ I. 4.(b)). For reasons noted earlier in this Opinion and Order, we rejected Duquesne's proposed six-year term in favor of a three-year term. The PJM surcharge will, therefore, be applied to the three-year fixed price. At the conclusion of the approved three-year term, Duquesne may again seek recovery of the PJM Surcharge from Small Customer Plan customers pursuant to Section 2807(e)(3) of the Act.

DII and Duquesne agreed that the PJM Surcharge would apply only to POLR customers. DII and Duquesne further agreed that similar costs incurred by EGSs would be the responsibility of EGSs and their customers. (DII Stipulation at ¶ I.4.(g)(9)). Two of the industrial customers on Rate HVPS remain POLR I customers and will continue to pay stranded costs after January 1, 2005. Their stranded cost recovery is expected to continue through June 2005. (DII M.B. at 42). The Act at Section 2804(4)(ii), 66 Pa. C.S. § 2804(4)(ii), provides that a generation rate cap applies to customers paying a CTC.

Prior to reaching the agreed upon DII Stipulation, DII argued that the PJM surcharge could not be applied to those Large C&I Customers which continue paying CTCs pursuant to Section 2804(4)(ii). However, as a member of PJM West, Duquesne will serve HVPS and special contract customers as a LSE under the PJM transmission tariff. The PJM Surcharge directed here is not for the purpose of collecting generation charges. On that basis, we find that the PJM surcharge does not disturb the POLR I generation rate cap. In addition to the fact that the PJM Surcharge does not represent generation charges, we find that the charges incurred by Duquesne by virtue of its new membership in PJM West constitute charges for services purchased from markets previously not available to Duquesne customers. Thus, the charges are for the recovery

of the costs of new services. The Act's rate cap provisions do not apply to new services offered after its effective date. 66 Pa. C.S. § 2804(4)(vi).

Because the PJM costs are not for generation supply, and because the Surcharge covers costs related to new services, the PJM Surcharge does not violate the rate cap provisions of Section 2804(4)(ii). PJM membership will benefit all customers receiving POLR service. As such, Duquesne is entitled to recover the prudently incurred, incremental costs associated with joining PJM, as expressed in the proposed PJM Surcharge, from all POLR customers.

VI. Miscellaneous Matters

A. Marketing of POLR III Service

Constellation excepts to the failure of the ALJ to provide a specific prohibition against Duquesne's marketing of its POLR III service. Constellation argues that such a prohibition would ensure that Duquesne does not use its customer service centers that provide distribution functions to actively market its POLR III services. Constellation points out that this type of express prohibition was contained in the POLR II settlement. However, Constellation does acknowledge that Duquesne will necessarily have to provide objective POLR and rate information to customers, Commission personnel and EGSs. Constellation suggests that Duquesne voluntarily provide that type of information with EGSs in advance of distribution to customers to avoid problems and misunderstandings. (Constellation Exc. at 39-40).

Duquesne responds that this is an issue best left to state-wide POLR Regulations. Duquesne states that it has no intent to act in an anticompetitive manner. Duquesne states that it "intends only to ensure that customers understand their options." (Duquesne R.Exc. at 21-22).

We will grant this Exception and direct that the marketing condition set forth in POLR II Settlement remain in force for the POLR III Plan. Even though we agree with Duquesne that this is an issue that should be discussed in the context of state-wide POLR Regulations, that does not preclude consideration of that issue here. As a general concept, we agree with Constellation that a POLR provider should not "market" its services as if it were a competitive product in the marketplace. On the other hand, Duquesne is correct (and Constellation recognizes) that objective consumer information regarding POLR services is essential. From these arguments, it appears that Duquesne intends to conduct itself consistent with the current condition in place. Accordingly, continuation of that condition is appropriate until state-wide POLR Regulations address the issue.

B. Waiver of POLR Regulations

Direct Energy filed an Exception stating that the ALJ erred by ignoring Direct Energy's proposal that Duquesne's Small Customer Plan be superseded by the Commission's post-transition POLR Regulations. (Direct Energy Exc. at 7). Duquesne responds to this Exception and flatly states that "Duquesne cannot accept this condition." (Duquesne R.Exc. at 22). Duquesne argues that it cannot make commitments for its supply portfolio as proposed "if it does not have assurance that the long-term, fixed rates set forth in the POLR III Plan will remain in effect, and will not be revised or terminated by generic PUC rulemakings." (*Id.*).

We will not grant this Exception as presented. However, in ruling on this Exception, we decline to give Duquesne an advanced, blanket waiver from regulations that have yet to be developed or even proposed. At this juncture, any such pronouncement would be far too premature. Simply put, we have absolutely no basis upon which to determine whether such a waiver would be in the public interest, or not.

In response to Duquesne's argument relating to commitments in support of its supply portfolio, we again emphasize our intent to adhere to the requirements of Section 2807(e)(3) of the Act that a POLR supplier must recover all reasonable costs and acquire energy at prevailing market rates. Duquesne has gone to great lengths in this proceeding to prove that its proposed rates for the Small Customer Plan satisfy these statutory requirements. We have determined that they are consistent with the Act for the initial three-year period. Nothing in this determination suggests that Duquesne will be unable to obtain the same determination for a subsequent term, depending on the evidence presented at that time. Also, nothing in our determination of this Exception will impact any request for waiver which may be presented by Duquesne, if Duquesne believes that such a waiver is required. Simply put, there is no way to know, at this juncture, whether a waiver would even be required.

C. Strategic Energy's Exception on Consolidated Billing

In this Exception, Strategic Energy argues that the ALJ erred in denying Strategic Energy's proposal to make consolidated billing available. Strategic Energy asserts that its proposal is justified because it benefits the competitive market and consolidated billing will mitigate the anti-competitive effects of Duquesne's POLR Plan. (Strategic Energy Exc. at 22). Duquesne responds and asserts that Strategic Energy fails to explain why this issue should be decided in this proceeding. Duquesne suggests that this is an issue that may be considered in post-transition POLR Regulations. (Duquesne R.Exc. at 22).

We agree with Duquesne that this is not the appropriate proceeding in which to decide this issue. Accordingly, this Exception is denied.

D. OSBA, OCA and DII Stipulations: Conditions on Distribution Rates and Renewable Energy

The OCA Stipulation, the OSBA Stipulation and the DII Stipulation all contain a provision which restricts the opportunity of Duquesne to seek a distribution rate increase until some specific time in the future. While we will in large part approve the proposed POLR III Plan as modified by these Stipulations, the record before us contains no evidence which would support such a stay-out provision. Indeed, we question whether it is appropriate in the first instance to direct a distribution rate condition in the context of a POLR proceeding. Accordingly, we will not adopt that provision here.

The OCA Stipulation also contains a provision which mandates that Duquesne will utilize renewable and environmentally beneficial resources for at least 2% of its small customer supply portfolio during the years 2005-2007, even in the absence of legislation mandating such a commitment. Duquesne is free to voluntarily adopt this provision and we encourage it to do so. Also, we would expect that Duquesne would comply with any statutory direction in this area. However, we will not direct such a condition in this proceeding on the basis of the litigated record before us. This is an appropriate issue to be developed in state-wide POLR Regulations if no statutory direction is forthcoming.

E. Regulatory Approvals

Duquesne addresses three specific regulatory approvals in the context of its POLR III Plan. First, Duquesne asks that we issue the findings required under Section 32(k) of the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. § 79z-5(k), in order to permit it to enter into a contract to purchase energy from Duquesne Power, an affiliated exempt wholesale generator. Next, Duquesne requests that we issue our approval, to the extent necessary, for Duquesne Power to acquire the Sunbury

generating station. Finally, Duquesne requests approval under Section 2102(b) of the Code, 66 Pa. C.S. § 2102(b), to enter into an affiliated interest agreement with Duquesne Power to procure power to serve customers taking POLR III service under the Small Customer Plan. (Petition at 22-24).

With regard to approval of the acquisition of the Sunbury generating station by Duquesne Power, an unregulated affiliate of Duquesne, it does not appear that Commission approval of that transaction is required.

Duquesne has also requested approval of the Duquesne – Duquesne Power supply arrangements as an affiliated interest agreement pursuant to Section 2102(b) of the Code. Duquesne asserts that the supply arrangements are reasonable and consistent with the public interest. (Duquesne M.B. at 57). We agree that the affiliated interest agreement for supply arrangements is in the public interest and we will approve that agreement as required by Section 2102(b) of the Code. In doing so, we acknowledge that the term of the power supply agreement extends beyond the term of the Small Customer Plan as approved herein. As we have discussed at length, nothing in this Opinion and Order prevents Duquesne from seeking to recover market based prices for energy acquired for POLR supply subsequent to the term mandated herein. Thus, we do not perceive our approval of the power supply agreement for purposes of Section 2102(b) to be at odds with our decision regarding the Small Customer Plan term.

As noted above, Duquesne also seeks approval of the power arrangement pursuant to Section 32(k) of PUHCA. In order to grant approval under that Section, we must find that the power arrangement: (i) will benefit consumers; (ii) does not violate any state law (including where applicable, least cost planning; (iii) would not provide the affiliate with any unfair competitive advantage by virtue of its affiliation or association with Duquesne; and (iv) is in the public interest. 15 U.S.C. § 79z-5(k)(2)(A)(ii). Based upon the record before us, we determine that the arrangement here under review will

benefit consumers and does not violate state law. The record before us contains no evidence that the arrangement will provide Duquesne Power with any unfair advantage by virtue of its affiliation or association with Duquesne. Finally, the record establishes that the arrangement is in the public interest. For these reasons, we will approve of the arrangement to the extent necessary pursuant to Section 32(k) of PUHCA. As we stated in our approval under Section 2102(b) of the Code, we do not perceive our approval here to be inconsistent with our determination of the Small Customer Plan term.

G. Compliance Filing Procedure

Duquesne requests that we provide for a compliance filing procedure. (Duquesne R.Exc. at 24-25). Duquesne anticipates filing a revised Retail Tariff, a revised Electric Generation Supplier Coordination Tariff and "procedures to implement the wholesale purchases by RFP required for" the Large Customer Plan. (*Id.*). Duquesne states that it will serve those materials on the Parties for comment. However, Duquesne also suggests that it may be necessary to schedule technical conferences with interested Parties to review the compliance documents and procedures. For these reasons, Duquesne requests that we direct that Duquesne propose a compliance filing schedule and procedure within thirty days after the entry date of this Opinion and Order. The schedule and procedure should be designed to permit the Parties to participate in the compliance procedures while ensuring that compliance is completed in sufficient time to enable Duquesne to begin offering POLR III service on January 1, 2005.

We agree with this proposal. While we have approved a majority of the POLR III Plan as proposed and as modified by the OCA, OSBA and DII Stipulations, we have directed certain modifications that will require attention in the compliance phase of this proceeding. Also, as Duquesne states, some of its proposed procedures require additional development. Because of time concerns, we will reduce the time period for response to fifteen days following entry of this Opinion and Order. Comments, if any, to

the proposed schedule and procedure must be filed within twenty-five days of the date of entry of this Opinion and Order. The schedule and procedure must provide for at least one technical conference with interested parties. The schedule must also be designed to ensure participation by the Parties and the completion of actions necessary to come into compliance with this Opinion and Order such that Duquesne can begin offering POLR III service on January 1, 2005.

Conclusion

For the reasons discussed above, we will grant, in part, and deny, in part, the Exceptions of the Parties in this proceeding. We will adopt the Recommended Decision of Administrative Law Judge Michael A. Nemec as modified by, and consistent with the foregoing Opinion and Order, and grant the Petition of Duquesne as modified by the Stipulations of the OCA, the OSBA and the DII, and as further modified consistent with this Opinion and Order; **THEREFORE,**

IT IS ORDERED:

1. That the Motion of Duquesne Light Company to Strike the Reply Exceptions of Reliant Energy, Inc. is denied.

2. That the Exceptions of the Office of Trial Staff, Reliant Energy, Inc., Direct Energy, Dominion Retail, Inc., Citizens Power, Inc., Constellation Power Source, Inc. and Constellation Newenergy, Inc., and Strategic Energy, L.L.C. are granted in part, and denied in part, consistent with this Opinion and Order..

3. That the Recommended Decision of Administrative Law Judge Michael A. Nemec is adopted as further modified by this Opinion and Order.

4. That the Petition of Duquesne Light Company for approval of its Plan for Provider of Last Resort service, as modified by the Revised Partial Stipulations between Duquesne Light Company and the Office of Consumer Advocate and the Office of Small Business Advocate, and as modified by the Stipulation between Duquesne Light Company and the Duquesne Industrial Intervenors is approved to the extent consistent with this Opinion and Order.

5. That the proposed sale of electric energy to Duquesne Light Company by Duquesne Power will benefit consumers; does not violate any state law; has not been shown to provide any unfair competitive advantage to Duquesne Power; and, is in the public interest under Section 32 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79z-5(k), consistent with this Opinion and Order.

6. That the proposed contract for power supply between Duquesne Light Company and Duquesne Power is approved pursuant to Section 2102(b) of the Public Utility Code, 66 Pa. C.S. § 2102(b), relating to affiliated interest agreements, consistent with this Opinion and Order.

7. That Duquesne Light Company's request to join the western region of PJM Interconnection is approved.

8. That within fifteen (15) days of the entry of this Opinion and Order, or such additional time as may be granted, Duquesne Light Company shall file for our consideration, a proposed schedule and procedure for the management of its compliance filings designed to implement the Provider of Last Resort Plan approved herein. The proposed schedule and procedure will provide for at least one technical working group and will be designed to permit Duquesne Light Company to begin offering service under the approved Provider of Last Resort Plan on January 1, 2005.

9. That within twenty-five (25) days of the date of entry of this Opinion and Order, or such additional time as may be granted, the Parties to this proceeding may file Comments to the proposed compliance schedule and procedure.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: August 19, 2004

ORDER ENTERED: August 23, 2004