

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held July 28, 2011

Commissioners Present:

Robert F. Powelson, Chairman, Statement
John F. Coleman, Jr., Vice Chairman
Wayne E. Gardner
James H. Cawley
Pamela A. Witmer

Investigation of Pennsylvania's
Retail Electricity Market

I-2011-2237952

OPINION AND ORDER

On April 29, 2011, this Commission issued an Order initiating the Investigation of Pennsylvania's retail electricity market. *Investigation of Pennsylvania's Retail Electricity Market*, I-2011-2237952 (Order entered April 29, 2011) (April 29 Order). We stated that the goal of the Investigation was to make "improvements to ensure that a properly functioning and workable competitive retail electricity market exists in the state." April 29 Order at 2. We requested comments on 11 questions:

1. What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?
2. Does the existing retail market design in Pennsylvania present barriers that prevent customers from obtaining and suppliers from offering the benefits of a fully workable and competitive retail market? To the extent barriers exist; do they vary by customer class?
3. What are the economic and managerial costs associated with electric distribution companies (EDCs) fulfilling the default service role?¹ Are the EDCs accurately passing those costs along to default service customers? Do default

¹ See generally 52 Pa. Code §§ 54.182 and 54.184.

service rates include any elements that are not cost-based? Is an examination of distribution rates needed to ensure proper cost allocation? Are there barriers to competition as a result of having EDCs provide default service?

4. Are there unintended consequences associated with EDCs providing default service, and related products, such as time-of-use rates?

5. Should default service continue in its current form? Does default service impede competition or otherwise prevent customers from choosing electricity products and services tailored to their individual needs? Does default service provide an advantage to the incumbent EDC and/or its generation affiliate(s)?

6. Can/should the default service role be fulfilled by an entity, or group of entities, other than the EDC? If the default service role should be filled by an entity other than an EDC, what mechanisms could be employed to transition the default service role away from the EDC and onto competitive electric generation suppliers (EGSs)? Are different approaches appropriate for different customer classes? What criteria should be used to ensure that EGSs are qualified to assume the default service role and maintain reliable service?

7. How can Pennsylvania's electric default service model be improved to remove barriers to achieve a properly functioning and robust competitive retail electricity market? Are there additional market design changes that should be implemented to eliminate the status quo bias benefit for default service?

8. What modifications are needed to the existing default service model to remove any inherent procurement (or other cost) advantages for the utility?

9. What changes, to Regulations or otherwise, can the Commission implement on its own under the existing default service paradigm to improve the current state of competition in Pennsylvania?

10. What legislative changes, including changes to the current default service model, should be made that would better support a fully workable and competitive retail market?

11. Are there, or could there be, potential barriers being created by the implementation of the EDC Smart Meter plans?

April 29 Order at 2-4.

Finally, the April 29 Order also announced that an *en banc* hearing would be scheduled for June 8, 2011, to allow interested parties the opportunity to discuss the topics raised in this proceeding. In response to the April 29 Order, 39 parties filed comments² which are available on the Commission's website, http://www.puc.state.pa.us/electric/Retail_Electricity_Market.aspx . These comments were further discussed at the June 8, 2011 *en banc* hearing where representatives of consumer interests, electric distribution utilities, electric generation suppliers and regulators were invited to testify. Also invited to testify was Dr. Andrew Kleit, from the Electricity Markets Initiative at the Pennsylvania State University, to discuss the findings of his research of electricity shopping in the PPL market.

Discussion

We have reviewed all of the comments filed in this matter, as well as the testimony presented at the *en banc* hearing. Based upon that review, this Order will initiate the second phase of this Investigation. Our purpose is to provide specific direction to Commission Staff and interested parties regarding the issues to be addressed in this phase of the Investigation.

² AARP, American Public Power Association, BlueStar Energy Services, Brighten Energy, Citizen Power, Citizens' Electric & Wellsboro Electric, City of Philadelphia, Community Legal Services of Philadelphia, Consolidated Edison Solutions, Constellation NewEnergy & Constellation Energy Commodities Group, Direct Energy Services, Dominion Retail, Duquesne Light, Energy Association of PA, Exelon, FirstEnergy Solutions, Future Times Energy Aggregation Group, Hess Corporation, IECPA and Other Industrial User Groups, Liberty Power, Met-Ed, Penelec, West Penn Power & Penn Power - the FirstEnergy Companies, Mid-Atlantic Renewable Energy Association, National Energy Marketers Association, NRG Energy, Office of Consumer Advocate, Office of Small Business Advocate, PA Coalition Against Domestic Violence, PA Energy Marketers Coalition, PA Utility Law Project, PennFuture, PPL Electric Utilities & PPL EnergyPlus, ResCom Energy, Retail Energy Supply Association, State Representative C. George, Stream Energy PA, Washington Gas Energy Services, and York Solid Waste & Refuse Authority

Our review of the comments and testimony reveals that while some participants are relatively comfortable with the existing paradigm of Pennsylvania’s retail electric markets, there is a substantial countervailing opinion which holds that the current paradigm contains both structural and operational impediments to a fully functioning, robust competitive retail marketplace. As we discuss further below, the overwhelming weight of the comments and testimony reveal that we must examine changes to Pennsylvania’s retail electric market in order to improve the competitive landscape.

One of the clearest statements of the current problem is found in the comments filed by Direct Energy Services, LLC (Direct), a licensed EGS in the Commonwealth. Direct observes that this Commission has held in the past that a truly competitive market is one in which there are low barriers to entry, many sellers, many buyers and offerings of a variety of products.³ Direct Comments at 6. Direct states, and we agree, that “there is no service territory in which even a majority of customers are being served by something other than the default service offering of the EDC.”⁴ *Id.* Direct further states that “No market in Pennsylvania has seen any material investment by EGSs in the infrastructure needed to offer non-price based products and service.” *Id.*

³ In the Investigatory Order and Report to the General Assembly in our Investigation into the Natural Gas Supply Market, we adopted the following standard for evaluating a competition in a retail market:

participation in the market by many buyers and sellers, the lack of substantial barriers to market entry for suppliers, the lack of substantial barriers that would discourage customer participation, and the presence of sellers offering buyers a variety of products and services.

Investigatory Order entered October 6, 2005, at Docket No. I-00040103, p. 4.

⁴ We are aware that Pike County Light and Power Company does have a majority of customers receiving service other than the default service of the EDC, however that is an unusual situation and does not take away from the point made by Direct.

During the *en banc* hearing, Dr. Andrew Kleit, Professor of Energy and Environmental Economics at the Pennsylvania State University, testified about findings from a study he and his colleagues conducted of shopping in the PPL Electric Utilities service territory. Dr. Kleit determined that the current retail market model in the Commonwealth produces a boom and bust cycle which will not support a sustainable competitive market. Kleit Testimony at 6. Dr. Kleit stated:

Thus, under the Pennsylvania structure, in times of declining prices, competitive retail generation providers will be able to offer a competitive product until the default supply rate is reset or prices start to rise. In a period of rising prices, however, competitive retail generation providers who do not lock in supply (regardless of whether they own generation or not) until they obtain a group of customers, will be unable to compete. This boom-bust cycle undermines sustainable market success and makes it difficult for retailers to commit long term to the market. In the last few years we have been in a declining price environment and consequently a period where robust competition in most customer classes exists. Once the price curve reverses, however, it will be difficult for retail providers to successfully offer competitive products.

Id.

Some of the comments argue that all of Pennsylvania's electric consumers are participating in competitive supply based upon the state of wholesale electric markets. Office of Consumer Advocate (OCA) OCA Comments at 2-3. Other comments argue that there is no basis to find that there are substantial impediments to a robust retail market. Office of Small Business Advocate (OSBA) Comments at 7. We disagree with both positions. First, this Investigation involves an examination of whether and what changes should be made to Pennsylvania's *retail* electricity market to improve that market. Second, there is a substantial basis upon which to find that there are impediments to a fully functioning, robust retail market.

Based on shopping statistics alone, consumers are not moving into the retail market place at a rate that we would expect in a well functioning market. The current shopping rate in Pennsylvania is approximately 22% as shown on the Commission's Power Switch website as of July 20, 2011. This is despite the fact that in several service territories, competitive offers with substantial savings over default service are available. Direct Comments at 7, 13-14. Equally as important is the view from the supplier/product side of the market. Testimony at the June 8th *en banc* hearing described several innovative products now being offered to retail customers in Texas. Programs such as prepaid energy plans and customer access to real-time energy consumption information to enable usage control were described. Testimony of James Steffes, Direct at 2. *See also*, Direct Comments at 22. However, these types of products are not currently available to Pennsylvania consumers. *Id.*

Several comments discussed why Pennsylvania's retail market is lagging behind expectations. Most of these focused on the existing default service model. We think the most succinct characterization was made by James Steffes at the June 8th *en banc* hearing: "The chief culprit is that default service is the provider of first resort, not the provider of last resort." Testimony of James Steffes, Direct at 3. Similarly, the Retail Energy Supply Association (RESA) and Direct both describe the phenomena of "status quo bias," that is, the current default service model actually encourages customers to remain with default service rather than explore options in the marketplace. *See, e.g.*, RESA Comments at 8-10. RESA also describes issues involving default supply acquisition for an entrenched customer base providing opportunities of scope and scale not available to EGSs; customer acquisition costs not incurred by default service providers; supply portfolios which lead to boom and bust cycles as described by Dr. Kleit which prevent sustainable market entry by competitors; access to customer data; and, the failure to fully recover the full costs of default service within the default service charge. *Id.* at 10-13.

In addition to issues revolving around the current default service model, several commenters have raised issues involving EGS and EDC interactions which can pose barriers to entry and make customer acquisition much more difficult than it needs to be. For example, Constellation NewEnergy, Inc. and Constellation Commodities Group (collectively, “Constellation”), highlight concerns about the current mechanism for data delivery and timeliness of that delivery as hampering the ability of EGSs to market to customers. Constellation Comments at 11. Constellation specifically points to the lack of uniformity in EDC/EGS coordination protocols across the state as a major issue which has hampered market entry and development. *Id.* at 11-13.

The foregoing discussion provides just a few examples of comments and testimony which lead to the inescapable conclusion that Pennsylvania’s current retail market requires changes in order to bring about the robust competitive market envisioned by the General Assembly when it passed the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801, *et seq.*, in 1996. Having determined that change needs to be examined, what form(s) should it take? With the direction provided in this Order, the second phase of this Investigation will address that question.⁵ The second phase of this Investigation will focus on three broad categories which will involve changes to the existing retail market model.

First, we agree with several of the commenters that there are some changes which can be made to the existing market model that can be taken relatively quickly. The OSBA

⁵ We note that several commenters forcefully argue that structural changes to the existing default service model are not authorized by the Public Utility Code, 66 Pa. C.S. §§ 101, *et seq.* (Code). These commenters argue that substantial structural change is actually prohibited by the Code. *See, e.g.*, OSBA Comments at 14-16; OCA Comments at 6-7. However, these concerns overlook this Commission’s direction that, to the extent necessary, legislative changes are to be examined. We are also well aware of the suggestions made by some commenters that little, if any, legislative change would be needed to modify the existing default service paradigm in certain ways. Direct Comments at 60; RESA Comments at 30-34.

suggested that “the Commission could improve the flow of information to small business customers by improving Power Switch and the individual EDC websites” because currently, “information for small business customers is not easily available through Power Switch.” OSBA Comments at 16, 17. The OCA recommends speeding up the supplier switching process, examining the quarterly changes to the Price-to-Compare (PTC) to determine if it discourages shopping, and placing the PTC and other shopping information on bills and increased education efforts. OCA Comments at 27-29. Direct and the RESA also suggest eliminating the practice of automatically placing new customers or customers moving to a new service address onto default service. Those customers would be provided information about active EGSs and encouraged to select a supplier rather than move to default service. *See, e.g.*, Direct Comments at 57-59; RESA Comments at 11-12, 27-28. We have also noted Constellation’s comments about the need for accurate and timely data access. Constellation Comments at 11-13. Most of these issues can be examined in an intermediate timeframe.

Second, comments and testimony we have reviewed leave no doubt that the current default service model stands as a substantial barrier to market entry and competitive product offerings. Direct, RESA and Constellation all suggest substantial changes to the existing default service model. For example, Constellation suggests that default service should provide for a single rate for each rate class, leaving more sophisticated products to the competitive marketplace. Constellation Comments at 9. Direct offers similar suggestions. Direct Comments at 35-36. Several commenters suggest that, after a transition period, EDCs should not offer default service at all. *See, e.g.*, Direct Comments at 46, 56-59; RESA Comments at 18-21; Constellation Comments at 9-10.

Accordingly, we will direct that Phase II of the Investigation also examine the structure of the current default service model to determine what changes need to be made to that model to eliminate or at least minimize the impact of default service on the

competitive retail market. We believe that the examination of the structure of the current default service model will have a longer term than the intermediate issues noted above. We also believe that moving to a more uniform EGS/EDC coordination platform (such as billing systems) as well as accelerated switching time-frames (such as mid-cycle meter reads) will include long range steps. In this regard, we note that several commenters, including the OCA and Constellation, commented that Phase II of the Investigation should examine EGS/EDC coordination issues to further improve the competitive marketplace. OCA Comments at 27; Constellation Comments at 11-13.

Finally, there has been near unanimous agreement that an aggressive consumer education project must be initiated to inform consumers about Pennsylvania's retail electricity market and how to take advantage of competitive services. We anticipate that development of the consumer education project will have both intermediate and long term aspects.

Phase II

Phase II of the Investigation will be conducted by our Office of Competitive Markets Oversight (OCMO). OCMO is directed to work with interested parties to produce a report for the information of the Commission which will provide specific recommendations in each of the three broad categories noted above. Based upon our review of the comments and testimony filed in Phase I of this Investigation, we have decided that the issues presented will be best managed by a series of technical conferences lead by OCMO.⁶ OCMO will be free to convene working groups, as needed, to review discrete issues and provide specific proposals for issue resolution

⁶ It should be noted that we will not require OCMO to produce a consensus document, although agreement should be sought as much as possible.

within the context of the technical conferences. However, the primary process will be managed through the technical conferences.⁷

We have also determined that Phase II of the Investigation will include two work plans: one for the intermediate steps involving changes to the existing market model and a second one for the long range steps involving structural changes to the default service model. We anticipate that the intermediate work plan will be presented to this Commission in December of 2011. The long range work plan will be presented in the first quarter of 2012. However, the Investigation will proceed with both tracks simultaneously.

For both the intermediate plan and the long range plan, OCMO's recommendations will include a work plan for each specific recommendation, including whether any legislative or regulatory change is needed, together with proposed language to implement the proposed change. It is anticipated that prior to the formulation of OCMO's recommendation for each plan, the Commission will hold *en banc* hearings to review the issues involved. The first *en banc* hearing has been scheduled for October 27, 2011. An agenda for that hearing will be provided at a later date.

With regard to intermediate steps, OCMO is directed, without limitation, to examine the following areas:⁸

1. Prohibition of marketing of default service;

⁷ We are not soliciting comments to this Order. However, OCMO, in its discretion, may seek comments at various stages of the Investigation. It is also possible that this Commission will seek comments in advance of the *en banc* hearings discussed below.

⁸ This list of items is taken, in part, from former Secretary Hanger's Statement at 3.

2. Assignment of new customers or customers on default service who move to new addresses to EGSs, *i.e.* eliminate the automatic assignment of customers to default service;
3. Customer referral programs;
4. Information access, including smart meter data;
5. Annual auction of customers on an opt-in basis;
6. Examination of current default service procurement schedules;
7. Accelerated switching time frames, *e.g.* examination of 16 day waiting period;
8. Uniform EDC/EGS coordination protocols, *e.g.* credit standards;
9. EDC supplier charges

We reiterate that this is not meant to be an exhaustive list. During the technical conferences, OCMO and other participants are strongly encouraged to recommend additional changes to the current model which can be accomplished relatively quickly and without legislative changes.

The second area to be examined is the current structure of default service. As we noted above, testimony and comments received during the first phase of this Investigation conclusively establish that the current default service model stands as a substantial impediment to a robust competitive retail market in Pennsylvania. Accordingly, changes to that model are clearly warranted. We direct OCMO and other participants to examine the existing model and provide recommendations regarding changes to the existing structure. In addition, longer range issues in EDC/EGS coordination protocols and accelerated switching time-frames should be reviewed. Areas to be examined should include, without limitation, the following:

1. The basic definition of default service, *i.e.* should default service be last resort service or open to anyone who simply declines to choose a provider;

2. Cost allocation, *i.e.* does the current structure capture all of the costs of default service, or are some of those costs retained in distribution rates;
3. Should default service remain with the EDCs;
4. Pricing of default service, including term and reconciliation;
5. Uniform EDC/EGS coordination protocols, *e.g.* billing systems;
6. Accelerated switching time frames, *e.g.* mid-cycle meter reads and integration of customer switching in smart-meter deployment.

The foregoing list is by no means exhaustive. Again, OCMO and other participants are strongly encouraged to examine other structural issues with the current default service model. One of the most important issues we expect to see addressed is the impact of any recommended changes on universal service programs and how those programs will be maintained in any new environment. In addition, impacts on Act 129 Plans and the Alternative Energy Portfolio Standards Act requirements must also be taken into account. Again, to the extent that legislative or regulatory changes are necessary to implement a recommendation, proposed language is expected to be provided.

The third category will involve a revised and enhanced customer education program. The Commission's Office of Communications will work with OCMO on this aspect of the Investigation. We expect Staff to explore the potential for increased Commission approved communications from EDCs to customers, which will include information about the retail market and EGSs. In addition, the potential for a coordinated state-wide education campaign which would include the Commission, EDCs and EGSs should be reviewed. As we stated with regard to the first two categories, Staff and all participants are encouraged to explore all opportunities to increase consumers' knowledge of the retail electricity market in order to improve their willingness to explore competitive options. As noted above, we believe that several aspects of an enhanced customer education program can be accomplished through the intermediate

recommendation while other aspects, such as the coordinated statewide program, will lend themselves more to the long range recommendation.

Interested parties who wish to be placed on the distribution list to receive electronic communications regarding the Investigation should send their contact information, including name, company/organization affiliation, email address and telephone number via email to: ra-RMI@state.pa.us. The phrase “RMI Distribution List” should be placed in the subject line.

Conclusion

For the foregoing reasons, we find that changes are necessary in order to improve the current retail electricity market model in Pennsylvania. We also find that the existing default service model presents substantial impediments to the development of a vibrant competitive retail market in Pennsylvania. As such, the existing retail electricity market model and the current default service model prevent this Commission from fully carrying out the legislative goals set forth in the Electricity Generation Customer Choice and Competition Act. Accordingly, we direct this Commission’s Office of Competitive Markets Oversight to initiate Phase II of this Investigation and provide recommendations to this Commission which will present specific proposals for changes to the existing retail market and default service model, including any necessary regulatory or legislative changes. The recommended changes should be targeted to the improvement of Pennsylvania’s retail electric market by providing for a more informed and involved consumer population, additional products and services as well as increased participation and investment in Pennsylvania’s retail electricity market by EGSs; **THEREFORE,**

IT IS ORDERED:

1. That the Commission's Office of Competitive Markets Oversight shall initiate Phase II of this Investigation consistent with this Order.

2. That this Order shall be served on all jurisdictional Electric Distribution Companies, all licensed Electric Generation Suppliers, the Office of Consumer Advocate, the Office of Small Business Advocate, the Energy Association of Pennsylvania, the Retail Energy Supply Association and all other parties who filed comments or testified in Phase I of this Investigation.

3. That inquiries regarding the second phase of this Investigation may be e-mailed to the Commission's Office of Competitive Markets Oversight at ra-RMI@state.pa.us.

4. That a copy of this Order shall be posted on the Commission's website at the Investigation of Pennsylvania's Retail Electricity Market web page: http://www.puc.state.pa.us/electric/Retail_Electricity_Market.aspx.

BY THE COMMISSION,

A handwritten signature in black ink, appearing to read "Rosemary Chiavetta", written in a cursive style.

Rosemary Chiavetta
Secretary

(SEAL)

ORDER ADOPTED: July 28, 2011

ORDER ENTERED: July 28, 2011