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Elizabeth A. Noël  
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October 30, 2003

Sanford Speight  
Acting Secretary  
Public Service Commission of the  
District of Columbia  
1333 H Street, N.W., 2<sup>nd</sup> Floor, West Tower  
Washington, D.C. 20005

10/30/03 11:11:33

Re: Formal Case No. 1017

Dear Mr. Speight,

Enclosed please find for filing in the above-referenced proceeding an original and fifteen (15) copies of the "Initial Comments of the Office of the People's Counsel in Response to Order No. 12932"

Please contact the undersigned at (202) 727-3071 if you have questions or need additional information.

Sincerely yours,

Lopa B. Parikh  
Assistant People's Counsel

Enclosures

cc: All parties of record

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE DISTRICT OF COLUMBIA

In the Matter of	)	
	)	
The Development and Designation	)	Formal Case No. 1017
Of Standard Offer Service In The	)	(SOS Regulations)
District of Columbia	)	

OFFICE OF THE PEOPLE'S COUNSEL

**INITIAL COMMENTS OF THE OFFICE OF THE PEOPLE'S COUNSEL  
IN RESPONSE TO ORDER NO. 12932**

Pursuant to Order No. 12932, issued by the District of Columbia Public Service Commission ("PSC" or "Commission")<sup>1</sup> on September 29, 2003, the Office of the People's Counsel of the District of Columbia ("Office" or "OPC"), the statutory representative of utility customers and ratepayers in the District of Columbia ("District")<sup>2</sup>, submits the following comments.

**I. INTRODUCTION**

As demonstrated in OPC's August 29 Comments, there is overwhelming evidence that retail competition is not working for residential consumers. The absence of viable retail competition for residential customers means that the standard offer service ("SOS") process chosen by the Commission is likely to be the sole source of electric service for the vast majority of the District's residential consumers for the foreseeable future. OPC is pleased that the rules and regulations issued on September 29 by the Commission for comment are modeled closely after the Maine retail solicitation model as presented in OPC's proposal. OPC is confident that final adoption of those rules and regulations, with the few modifications suggested herein, will protect the electricity consumers of the District of Columbia to the greatest extent possible.

<sup>1</sup> *In the Matter of The Development and Designation Of Standard Offer Service In The District of Columbia*, Formal Case No. 1017, Order No. 12932 at 37 (September 29, 2003) ("Order No. 12932").  
<sup>2</sup> D.C. Code § 34-804 (2001)

## II. SUMMARY OF OPC'S POSITION

- In the absence of effective competition, OPC believes multiple SOS providers are preferable to a single provider.
- OPC believes that a retail solicitation model provides greater advantages for consumers than does a wholesale solicitation model.
- OPC supports most of the provisions in the Commission's proposed rules and regulations that provide for a retail solicitation model with multiple providers.

## III. BACKGROUND

This proceeding was instituted to address two distinct but related matters: (1) to investigate the potential impact of the expiration of generation and transmission rate caps on District of Columbia ratepayers, and (2) to establish a procedure for selecting a new standard offer service ("SOS") provider to commence service upon the expiration of Potomac Electric Power Company's ("PEPCO") obligation to serve in 2004.<sup>3</sup> Order No. 17757, issued on June 24, 2003, directed the Office and the parties to present proposed regulations and to file comments addressing the latter issue. On August 29, 2003, the Office submitted proposed regulations and comments addressing the procedure for selecting a new SOS provider, along with affidavits of two experts, Dr. Karl R. Pavlovic and Nancy B. Bright ("August 29 Comments"). On September 29, 2003, the Commission issued Order No. 12932, which released proposed SOS rules and regulation for comment and requested the parties to file initial comments by October 30, 2003. Accordingly, OPC hereby files its initial comments on the proposed SOS rules and regulations.

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<sup>3</sup> *In the Matter of The Development and Designation Of Standard Offer Service In The District of Columbia*, Formal Case No. 1017, Order No. 12655 (February 23, 2003) ("Order No. 12655").

#### IV. COMMENTS

##### A. **SOS Procurement with Multiple SOS Providers is Preferable to Single Provider Procurement.**

In its August 29 Comments, OPC submitted a set of proposed rules and regulations modeled closely on the SOS procurement regulations which have been successfully employed by the state of Maine for the last four years to provide SOS to retail customers. The Maine regulations rely on retail competitive bidding to ensure that retail customers continue to have reliable electricity supplies at reasonable rates. Retail SOS solicitation is also the manner of selecting an SOS provider that is mandated by the District's Retail Electric Competition and Consumer Protection Law of 1999 ("1999 Act"). As discussed below, a retail SOS solicitation has numerous advantages for consumers over the alternative wholesale solicitation model.

The Commission's proposed SOS rules and regulations provide for the selection of multiple SOS providers for each SOS class (Section 2908.11). This is preferable to the provisions of the 1999 Act, which requires a single SOS provider. As explained below, allowing for multiple providers will both maximize participation in the solicitation and minimize the impact in the event of a post-award provider default.

There is currently in the District little or no viable retail competition. As of August 2003, 88 percent of District customers representing 55 percent of the District's 2,245 megawatt ("MW") load were being served under PEPCO's transition SOS – 1,237 MW consisting of residential 383 MW, small commercial 150 MW, and large commercial 703 MW.<sup>4</sup> Restricting the solicitation to a single 1,200 MW block of load would preclude participation by both small suppliers and large suppliers that, at the time of bidding, do not have a large uncommitted block

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<sup>4</sup> PEPCO Interim Electric Choice Monthly Report Form for August 2003, filed September 15, 2003 in Formal Case No. 945.

of electricity available or who do not feel that they would be able to procure a large block of electricity. Thus, by providing for multiple providers for each SOS class (Section 2908.11) and by soliciting bids in 20 percent increments of each SOS class load (Section 2907.8), the proposed rules will maximize participation in the solicitation.

In the event of post-award default by a provider, having multiple providers has clear benefits over a single provider. First, any negative price impact on customers would be diluted by the fact that the defaulting provider was not serving the entire load. If the provider was supplying, for example, a third of the load, the impact will only be a third of what it would have been were the provider supplying the entire load. Second, the proposed rules provide for the defaulting provider's load to be offered to the remaining providers (Section 2909.1). In the event the remaining providers elect to pick up the defaulter's load, the default will be handled seamlessly with no impact on customers.

**B. The Retail SOS Solicitation Model Is Far More Protective of Retail Consumer Interests than the Wholesale SOS Solicitation Model.**

In retail competitive procurement the SOS provider is selected through competitive price bidding. Thus, the retail SOS rate consists of a single competitively determined price. In contrast, in wholesale competitive procurement the retail SOS provider is administratively designated (not competitively selected) by the regulatory agency and the designated provider procures the electric supply for SOS via competitive bidding among wholesale electric suppliers. In wholesale competitive procurement the retail SOS rate paid by customers consists of (1) the competitively determined wholesale price of electricity plus (2) the administratively determined

costs of the SOS provider. Retail competitive procurement is more likely to produce SOS rates that reflect the competitive price level for two reasons.

First, in retail competitive procurement, the bidders submit retail price bids, i.e., the price retail customers will pay. If the solicitation is competitive, these price bids will be at or near each bidder's marginal cost of supplying electricity to the customer. The SOS provider(s) selected are then the bidder(s) with the lowest bid(s), i.e., the lowest marginal costs. Thus, in retail competitive procurement the entire retail rate is subject to competitive discipline. In wholesale competitive procurement, the regulator designates the SOS provider, which then procures wholesale electric supply competitively. In the wholesale procurement, the bidders submit wholesale price bids. If the solicitation is competitive, the wholesale price bids will be at or near each bidder's marginal cost of supplying wholesale electricity. The retail SOS rates customers will pay consists of the winning bidder(s) wholesale price plus the designated SOS provider's costs of delivering the wholesale electricity to the retail customer as determined by the regulatory agency.

Second, in wholesale competitive procurement, the SOS provider procures wholesale supply and then simply passes its cost of supply through to retail customers. The SOS provider is not at risk for the expenses it incurs in procuring wholesale supply and, thus, has no financial incentive to ensure that the its wholesale procurement is in fact competitive. In contrast, in retail competitive procurement, the retail SOS bidder has incentive to bid as close to its marginal cost as is necessary to win the bid and the regulatory agency, the entity conducting the solicitation, has a statutory mandate to ensure that the resulting retail prices are just and reasonable. The retail bidding process, therefore, more properly aligns incentives with the ultimate of goal of adequate, reliable supply of energy at the lowest reasonable cost.

**C. The Commission's Decision Not to Require Concurrent Retail SOS and Wholesale SOS Solicitations Will Potentially Harm District SOS Customers.**

D.C. Code Section 34-1509 governs the provision of SOS to retail customers in the District of Columbia. Section 34-1509(c)(4) requires that the rules and regulations adopted by the Commission for the selection of a post-January 1, 2005 SOS supplier must include "[a] contingency plan in the event of insufficient bids."

OPC's August 29 Comments recommended that the Commission adopt the successful Maine approach and require that PEPCO, as the Electric Company, conduct a wholesale solicitation concurrent with the retail solicitation to be conducted by the Commission for the selection of an SOS provider(s).<sup>5</sup> If the retail solicitation did not lead to a sufficient number of bids, the Commission would then have the authority to direct PEPCO to use the results of its wholesale solicitation to provide SOS until a new SOS provider could be chosen through a new retail bid process.<sup>6</sup> Order No. 12932, however, does not provide for concurrent retail and wholesale SOS solicitations. Instead, it provides for a "subsequent" wholesale bidding process in which the wholesale bidding process will commence, if at all, after the retail bid process, and perhaps only after it has been determined that the retail solicitation has failed.<sup>7</sup> The Office submits that the Commission's decision to authorize a "subsequent" wholesale solicitation, as

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<sup>5</sup> D.C. Code Section 34-1509 (c) provides for the selection of "an electricity supplier" to provide SOS after January 1, 2005. As explained in OPC's August 29 Comments, it would be advisable to change the 1999 Act to permit the selection of multiple SOS providers. The suppliers would serve the retail load in increments of 20% of each customer class's load. This would facilitate obtaining supply diversity and maximizing participation in the retail bidding process. See August 29 Comments at 21; Attachment C at Section 5(F).

<sup>6</sup> August 29 Comments, Attachment C at Section 8(D).

<sup>7</sup> Proposed Section 2905.8(a) appears to contemplate the possibility that the wholesale bid could be ordered by the Commission after the retail bidding is concluding but before a final determination that the retail bid has failed. There are no criteria specified as to how the Commission would make the decision to order a wholesale bid process before it decides that the retail process has failed. Moreover, given the tight

opposed to "concurrent" retail and wholesale SOS solicitations could, after the initial solicitation, have significant adverse consequences for District SOS customers.

During the initial bidding process, the change may make little difference because of the timing of the solicitation and commencement of SOS by a new SOS provider mandated by the 1999 Act. The process for choosing a provider to begin providing SOS on February 7, 2005 (if pending legislation is adopted), is required to be completed no later than July 1, 2004. Thus, if the initial retail SOS solicitation fails to attract a sufficient number of qualifying bids, there will still be at least seven months available in which to conduct a wholesale solicitation.

In subsequent bidding periods, however, conducting a subsequent wholesale SOS solicitation as opposed to concurrent retail and wholesale SOS solicitations could have significant adverse consequences. First, there are the timing issues. Proposed Section 2907.1 gives the Commission discretion to determine the duration of the initial SOS period, which may be as short as one year. In order to allow enough time for a subsequent wholesale SOS solicitation in the event of retail SOS solicitation failure and not leave a gap in which District retail SOS customers would be without a SOS provider, the Commission would have to conduct the retail bidding process several months in advance of the beginning of the SOS service period to which the bidding process pertains. Requiring potential bidders to bid well in advance of the actual service commencement date imposes additional business risk<sup>8</sup> on the potential bidders that they in turn will seek to pass on to District SOS customers in the form of higher bids. The additional uncertainty of having to provide bids for a period which is relatively far in the future,

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time frames involved in the SOS selection process, waiting until the retail bid process is almost complete is still likely to present all of the problems discussed in this section.

<sup>8</sup> Generally, the longer the period between the date on which a price is quoted and service actually commences, the greater the risk premium the seller will demand in the form of a higher price.

therefore, is likely to result either in higher bid prices, or in fewer bids being received if potential suppliers decide the risk of bidding too far in the future is unacceptable.

Second, by employing a subsequent wholesale solicitation, the Commission would deprive itself of the ability to use the results of the wholesale solicitation to evaluate the retail bids it receives. There should be a correlation between wholesale bids and retail bids. In the Maine concurrent solicitation model, the results of the wholesale solicitation, in addition to providing a "safety net," provide a valuable check on the reasonableness of the retail SOS bids.

If the retail solicitation is not carried out far enough in advance of the service period to avoid the gap in SOS service discussed above, a range of other equally serious problems are created. In the absence of a fall back wholesale bid in hand, as provided in the Maine model, a failed retail SOS solicitation would require the Commission to rely on proposed Sections 2908.13 (in the case of no bids) and 2908.15 (in the case of insufficient bids) to select an interim provider. In all material respects, here relevant, the two sections are identical. The sections provide that, if no bids or "insufficient bids" are received to provide standard offer service to a particular class, the Commission:

will by order, either select a standard offer service provider for that class through alternative means or direct the Electric Company to provide standard offer service to that class through purchases from the regional wholesale bulk power markets, contracts with wholesale suppliers or other appropriate arrangements, as specified by the Commission, until the selection of a standard offer service provider is made through a new bid process.

By failing to provide for a concurrent wholesale bidding process, the Commission would create substantial and unnecessary uncertainty about what would actually happen in the event that no bids or insufficient bids are received in the retail bidding process. Rather than having the concrete assurance of a wholesale SOS bid in hand, as would be the case if the retail and

wholesale bids were sought concurrently, the Commission, upon failure of the retail SOS solicitation, will have to hurriedly assess the remaining options. First, it will have to determine whether to choose a SOS provider through alternative means, or to direct PEPCO to provide SOS service itself. If it chooses the latter course, the Commission will have to decide whether PEPCO should provide SOS service through purchases from the spot market operated by PJM, through contracts with wholesale suppliers (and how those suppliers will be chosen, if not through a wholesale bidding process), or through other appropriate arrangements. All this (and the subsequent implementation of whatever option is chosen) will have to occur in whatever time period is available between the Commission's decision to order a wholesale bid, in light of the failure or anticipated failure of the retail SOS solicitation and the end of the arrangement with the pre-existing SOS provider. Such a process would not be conducive to careful consideration of the available alternatives.

The absence of an existing wholesale SOS bid at the time it is determined that the retail SOS solicitation has failed creates the clear possibility that District SOS customers will be forced to pay higher energy prices for an extended period of time. Of particular concern is the possibility that SOS customers could be required to take the Market Price Service (as described in proposed Section 2903.10) until the wholesale bidding process can be completed, or, if no wholesale bidding process is conducted,<sup>9</sup> until the next retail solicitation takes place. Market Price Service, by its terms, is specifically designed for large commercial customers who cannot stay on SOS for at least twelve months. Rates for the service are to be "determined by the PJM LMP for energy for the PEPCO zone, the PJM posted and verifiable market capacity price,

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<sup>9</sup> Proposed Section 2905.8(a) provides that "the Commission may direct the Electric Company to conduct a subsequent solicitation of wholesale standard offer suppliers." (Emphasis added.)

transmission, ancillary services, line losses, appropriate taxes and a fixed retail adder of 6 mills per kWh.”

It is clear that Market Price Service would be particularly unsuited to serve as the only SOS option for any customer class, even on an interim basis. This is especially true for residential customers, who are least likely to have competitive alternatives to SOS. Given the lack of competition for these customers, and given that the SOS provider will be serving virtually all of the District’s residential customers, the SOS provider will not be incurring any risk in procuring supplies for residential customers. Under these circumstances, there is no justification for an SOS provider to receive a 6 mill per kWh adder for simply passing spot market purchases through to captive customers.

For all of these reasons, OPC renews its recommendation that the Commission’s SOS Rules and Regulations provide for PEPCO to conduct a wholesale bidding solicitation concurrent with the retail bidding process to be conducted by the Commission.

**D. The “Market Price Service” Referenced in Section 2903.10 of the Proposed Rules Requires Clarification**

As noted above, Section 2903.10 of the proposed rules provides that large customers that cannot remain on SOS for twelve consecutive months may choose an “hourly priced standard offer service” the rate for which “will be determined by the PJM LMP for energy for the PEPCO zone, the PJM posted and verifiable market capacity price, transmission, ancillary services, line losses, appropriate taxes and a fixed retail adder of 6 mills per kWh.” Beyond the reservations expressed above concerning the possible, and inappropriate, use of this service to provide SOS to

residential customers, there are a number of points concerning the mechanics of this service that the Commission needs to clarify.

First, how will the provider of this service be determined? If the provider is to be selected competitively, what are the criteria for selection? If the provider is to be designated by the Commission, what are the criteria for designation?

Second, how will the Commission verify that the rates charged include the appropriate LMP, capacity price, transmission, ancillary services and line losses? Will the provider make a compliance filing with the Commission demonstrating the construction of the rate? Will the customers receiving this service have the right to protest the rate charged?

Third, what is the basis of and justification for the "fixed retail adder of 6 mills per kWh?" A 6 mills adder seems frankly excessive for simply passing through riskless spot market purchases to a customer. As a point of comparison, the wholesale procurement process adopted in Maryland provides for an hourly priced non-residential service with the same price components as the proposed market price service, but a maximum 3.75 mills adder.

Fourth, in what way or ways is the proposed 12-month minimum stay/market price service superior to the 12-month minimum stay/opt-out fee approach used in Maine? In the Maine model the opt out fee compensates the SOS provider for the risk of large blocks of load going on and off SOS. The 12-month minimum stay/market price service proposed by the Commission appears to simply create a windfall to the provider of the market price service.

- E. The selection of a new SOS provider should not release PEPCO from its obligations under any previous Commission Orders.**

Proposed rule 2903.4(c) correctly states that the price cap for low income Residential Aid Discount ("RAD") customers will be maintained until February 7, 2007.<sup>10</sup> In the Settlement and subsequent Order in Formal Case No. 1002, PEPCO agreed to fund the Reliable Energy Trust Fund ("RETF") until August 7, 2007 in an amount not to exceed \$0.00021 per kilowatt hour.<sup>11</sup> The RETF funds the RAD programs.<sup>12</sup> Prior to Order No. 12395, the RETF was funded by all the ratepayers. OPC suggests that the Commission include additional language indicating that PEPCO is responsible for making up the difference between the winning bidder(s)' prices and the price cap if the difference exceeds PEPCO's RETF kilowatt hour obligation to under Order No. 12395. Failure to include additional language to this effect would mean that ratepayers would be subsidizing PEPCO's responsibility under the Divestiture Settlement Agreement codified in Order No. 11576 and that ratepayers would not receive all the benefits contemplated in the Divestiture Agreement.

## V. CONCLUSION

OPC appreciates the opportunity to provide these comments and supports the general direction that the Commission is going through its proposed rules and regulations. The final adoption of these rules and regulations, with the few modifications suggested herein, will serve best to protect the electricity consumers of the District of Columbia.

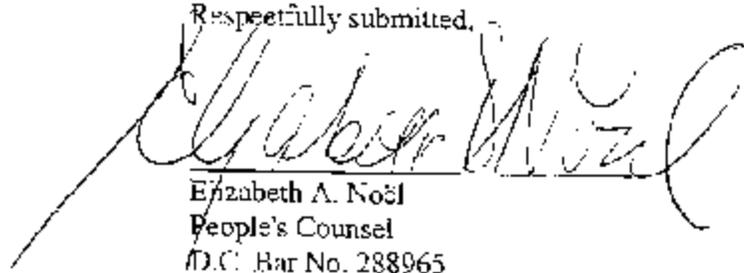
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<sup>10</sup> Formal Case No. 945, In the Matter of the Investigation into Electric Service Market Competition and Regulatory Practices, Order No. 11576 (December 30, 1999) ("Order No. 11576").

<sup>11</sup> Formal Case 1002, In the Matter of the Joint Application of Pepco and the New RC, Inc. for Authorization and Approval of Merger Transaction, Order No. 12395 (May 1, 2002) ("Order No. 12395").

<sup>12</sup> D.C. Code § 34-1514 (2001).

Respectfully submitted,



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## CERTIFICATE OF SERVICE

### Formal Case No. 1017

I hereby certify that on this 30th day of October, 2003, copies of the "Initial Comments of the Office of the People's Counsel in Response to Order No. 12932" were served on the following parties by hand delivery, facsimile, or first-class mail, postage prepaid:

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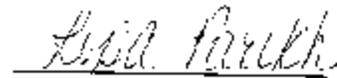
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