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June 3, 2011

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

Re: Investigation of Pennsylvania's Retail Electricity Market
Docket No. I-2011-2237952

Dear Secretary Chiavetta:

On behalf of Direct Energy Services LLC ("Direct Energy") enclosed please find the original of its Comments along with the electronic filing confirmation page with regard to the above-referenced matter.

Sincerely yours,

Daniel Clearfield

Daniel Clearfield, Esq.

DC/lww
Enclosure

cc: ra-OCMO@state.pa.us w/enc.

BEFORE THE
PENNSYLVANIA UTILITY COMMISSION

Investigation of Pennsylvania's Retail Electric Market	:	Docket No. I-2011-2237952

COMMENTS OF DIRECT ENERGY SERVICES

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Date: June 3, 2011

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Direct Energy Services, LLC ("Direct Energy")[1] appreciates this opportunity to present these responses to the Pennsylvania Public Utility Commission's ("Commission" or "PUC") request for suggestions on how the Pennsylvania competitive market can be improved as well as to provide its answers to eleven specific questions posed by the PUC's Opinion and Order (entered on April 29, 2011) (the "Investigation Order") in the above-captioned proceeding.

A. EXECUTIVE SUMMARY

The Commission should determine that a properly functioning and workably competitive retail electric generation market does not exist in Pennsylvania, despite the PUC's significant efforts to attempt to enhance the competitiveness of the marketplace in the Commonwealth. Electric generation markets are progressing only as far as the current default structure will allow. Default service structures, pricing and operational

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[1] Direct Energy is an electric generation supplier ("EGS") licensed by the Commission at A-110164 to provide electricity and related services to retail customers throughout Pennsylvania. Direct Energy is one of North America's largest energy and energy-related service providers with over 6 million Residential and commercial customer relationships. Direct Energy provides customers with choice and support in managing their energy costs through a portfolio of innovative products and services. A subsidiary of Centrica plc, one of the world's leading integrated energy companies, Direct Energy operates in 46 states and 10 provinces in Canada. Direct Energy is committed to Pennsylvania, deciding in 2009 to locate its North American headquarters of Direct Energy Business, in Pittsburgh. Direct Energy acquired Clockwork Home Services in June 2010, which has 29 small businesses in the state, employing approximately 215 people, and its affinity group members employ another 314 people throughout Pennsylvania. In 2011, Direct Energy Residential has established the headquarters for its Northeast division in Pittsburgh, representing 30 additional jobs, and also acquired Gateway Energy, which has an office in Wilkes-Barre with approximately 40 employees. In total, Direct Energy's employment levels have increased from 225 to approximately 1,000 since 2009. Direct Energy has a significant annual economic impact, based on the salaries, taxes and community investment funds paid in the region. It is also active with charitable organizations and its employees provided over 4,000 hours of community volunteering in 2010 across the Commonwealth.

rules, combined with "status quo bias" are preventing, and will continue to prevent fully effective competition from developing. Rather than accept this limited degree of competition, the Commission has the opportunity to adjust the default service framework to enable the development of a truly vibrant competitive electric market in a way that that will benefit all Pennsylvanians while ensuring that customers will have access to reliable competitive service with default service continuing to be available as a back-stop.

Specifically, for customers to fully realize the benefits of competition, Direct Energy believes that the Commission must declare that its "end state goal" is a retail electric market in which customers are taking service from competitive suppliers, the EDC is removed from the default service function and default service is reconfigured to serve truly as a "back-up" service. Direct Energy recommends the following "transitional steps" and timelines to achieve this endstate:

1. Order that, by June 1, 2013, the default service function in each Pennsylvania EDC service territory shall be transferred to one or more alternative default service providers ("ADSP").

2. Establish a series of "Competition Enhancing Steps" to be implemented by the Commission as soon as possible with the goal of improving retail competition prior to June 2013. Those steps should include (but need not be limited to):

- Requiring an "applicant" or a moving customer to select a competitive supplier (leaving the EDC-provided default service available only if the applicant/customer specifically asks for it).
- Unbundling and allocating all costs associated with the provision of default service, placing those costs in the price to compare, and reassigning these "long term variable costs" to a non-bypassable recovery mechanism, to be recovered from all distribution customers as customers switch.

- Establish an EDC obligation and incentive mechanisms to encourage EDCs to promote and encourage retail switching.
- Conduct voluntary, opt-in auctions, in which customers could choose to be part of an aggregation pool in return for receipt of a "switching premium" or a promotional rate.
- Revise default service pricing to make it more market-responsive.
- Order the development of a coordinated, comprehensive consumer education effort which reaches out to electric customers to both educate and garner information and opinions, creating a two-way dialogue about the best ways to improve electric competition.

3. By September 30, 2011, complete Phase II of this investigation in which detailed plans for implementing the Competition Enhancing Steps shall be put in place no later than January 1, 2012. Phase II shall also determine the process by which ADSPs will be qualified and selected.

4. Starting January 1, 2013, conduct an investigation of the level of competition for each customer class in each EDC service territory.

a. If the large majority of customers in a customer class have already switched to a competitive supplier, the default service function, and the remaining default service customers may be switched one or more Commission approved ADSP(s), starting in June, 2013.

b. If the majority of customers remain on EDC-default service, conduct an opt-out auction of customer accounts, transferring those customers to participating EGSs, upon payment of an acquisition fee.

During the Phase II Investigation, the Commission shall determine the level of shopping in each service territory and for each customer class that would trigger an auction, as well as determine the specifics of the auctions process itself.

The result will be a robust and fully competitive market for all customers, delivering the benefits of competition – lower prices, greater innovation and better service – to all of the Commonwealth's electric generation service customers.

B. INTRODUCTION

Broadly speaking, the Commission's Investigation Order asked two questions: (1) what is the status of the current retail market;[2] and (2) what changes need to be made to allow customers to best realize the benefits of competition?

Status of the Current Retail Market

The theme of Direct Energy's response to this part of the inquiry is "Just ok is not good enough." In summary, Direct Energy submits that the amount of Residential and Small Business retail competition, in Pennsylvania, while pretty good to "ok" in some areas (PPL, Duquesne, Penn Power), is, frankly, weak in others (Met-Ed, Penelec, West Penn Power).[3] Many large business customers have taken advantage of competitive opportunities. But, there is, nonetheless, a disturbing number of business customers who have not switched - even though they are paying higher prices for default service

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[2] The relevant market to be examined is the retail market (not the wholesale market). The Commission directed the first phase of this investigation, inter alia, "to assess the status of the current retail market." Investigation Order, at p. 2 (emphasis added). *See also* Questions 2, 7 and 10, of the Investigation Order which explicitly focus on the competitive retail electricity market. Moreover, it must be remembered that the Competition Act provides that "customers of electric distribution companies" shall have the opportunity to purchase electricity from their choice of EGSs. 66 Pa. C.S. § 2806(a). It further provides that the "ultimate choice of the electric generation supplier is to rest with the consumer." *Id.* (emphasis added).

[3] The market has opened in earnest in the PECO service territory too recently, it is too early to make a definitive statement concerning the level of competitive activity. There is no reason to conclude that the Philadelphia area will see materially better shopping results than that which has been experienced to date in some of the other more active Pennsylvania service territories.

electricity than they could obtain from a competitive supplier. Thus, every customer class has a need (to a varying degree) for, and would benefit from, additional steps by the Commission to ensure a robust, sustainable competitive market.

As the Commission is well aware, in each territory, after an initial flurry of competitive activity, switching has leveled off and has never gotten above 20-40% of Residential and Small Business (i.e., 25 kW and below) customers.[4] One need look no farther than the Duquesne results for confirmation. In Duquesne's service territory, generation rate caps (which, while applied, made robust competition impossible) expired on December 31, 2001. But even though suppliers are making offers today to Duquesne Residential and Small Business customers that would save them as much as 5 to 10%,[5] only 27.7% of Residential customers have taken advantage of this opportunity.[6] The same pattern exists, different only in degree, in the other electric distribution company ("EDC") service territories. Even PPL, which is frequently touted as a great "success," only 38.3% of Residential customers have taken advantage of offers[7] that would save

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4 Smaller commercial customers (25 kW and below) exhibit switching characteristics and familiarity and comfort with the competitive market that are similar to the residential class. This can be evidenced by the Form 1 "Pennsylvania Retail Electric Choice Activity Reports" filed by the EDCs with the Commission. PPL's March 31, 2011 Reports shows Residential switching of 35% and GS-1 switching of 37%. Similarly, Duquesne Light's 2011 Quarter 1 Reports for January through March shows Residential Switching of 24.57% and Small Non-Residential switching of 25.84%.

5 "Direct Energy offering discount in Duquesne Light area," Pittsburgh Tribune-Review (September 28, 2010), which is available at: http://www.pittsburghlive.com/x/pittsburghtrib/business/s_701558.html.

6 *Weekly PAPowerSwitch Update,* "Customers Switching to An Electric Generation Supplier" (Wednesday, June 1, 2011). These updates are available at: http://www.papowerswitch.com/.

7 *Weekly PAPowerSwitch Update* (Wednesday, June 1, 2011).

them on average $100-150 per year.[8] Moreover, there is evidence that these switching rates are not sustainable. In PPL, the residential migration was driven by the confluence of highly-laddered procurements with anomalous market conditions, and does not equal a sustainable market, especially where retailers had to spend many millions of dollars, which could otherwise have gone to increased customer value, to achieve that result.

By any reasonable standard, and despite the best efforts of the Commission, the current level of shopping is not sufficient to characterize the markets as "properly functioning and workabl[y] competitive" the standard that the Commission has recognized as required by the Electricity Generation Customer Choice and Competition Act (the "Competition Act").[9] The Commission has previously concluded that a key requirement of a "workably" or "effectively" competitive market is one in which there are many low barriers to entry sellers and many buyers and the offering of a variety of products .[10] Plainly there are no Pennsylvania markets that fulfill this requirement for Residential and Small Business customers; i.e., 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. And this is not just a "start-up" phenomenon. No market in Pennsylvania has seen any material investment by EGSs in the infrastructure needed to offer non-price based products and service. Clearly the markets have not achieved

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8 Savings range based on whether an average residential customer chose the lowest or average offer being marketed at time of enrollment since the beginning of 2010. Calculation based on assumption of average annual usage and the difference between the competitive offer(s) and effective utility offer.

9 66 Pa. C.S. § 2811.

10 *Investigation into the Natural Gas Supply Market: Report on Stakeholders' Working Group (SEARCH)*, Docket No. I-00040103F0002, 2008 Pa. PUC LEXIS 31 (Order entered September 11, 2008), at p. 2 (emphasis added).

significant, real, sustainable competition for these customer groups regardless of how long the markets have been open to competition.

Why has the level of shopping stalled at just around one-third of customers? Direct Energy submits that all evidence points to the nature and structure of default service and its provision by the EDCs. The existing default service structure discriminates in a multitude of ways in favor of customers staying on default service (after being placed on the service without their affirmative consent in the first place) and relies on customers' natural reluctance to switch from "what they know" to keep them there. Why else would hundreds of thousands of customers not take the opportunity to save $100-150 annually simply by going on line and making a few clicks or by responding to a direct mail or telephone offer? While some claim that customers that remain on default service are somehow "affirmatively choosing" not to switch, the available evidence in the FirstEnergy and Allegheny Power service territories shows that about two thirds of respondents (64%) say they have never considered switching to another electricity supplier, while a fifth (20%) say they have considered switching. Fifteen percent (15%) "didn't know" it was even possible.[11] Similar findings were discovered in the PPL, PECO, and Duquesne service territories in a recently conducted 2011 survey where 66% of residential and small business respondents stated that they have not switched, with almost 50% of those not switching basing their decision on misinformation (e.g., default service more reliable; did not know switching was possible)

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[11] *See* Question 2 of the 2010 poll conducted by Zogby International for Direct Energy, which is attached hereto as Appendix A ("2010 Zogby Survey").

or lack of information. Nine percent (9%) were not even aware that shopping was possible.[12]

Moreover, current switching rules in Pennsylvania help to perpetuate default service as the service of "first resort." When a customer attempts to start new service (i.e., an applicant who was not previously the customer of record with the EDC) or to move existing service, the EDC requires the customer to take default service for at least one billing cycle, even if the customer requests competitive generation service from the outset. With such roadblocks, only the most intrepid customers will stick with their plan to immediately utilize the competitive market. For the rest, each EGS will have to try to wrest the customer away from default service, just as they must for all existing customers.

The effects of these discriminatory rules are exacerbated by "status quo bias," the tendency of consumers generally to stay with the service or product they find themselves using, regardless of whether they could save modestly if they switched. This natural tendency of consumers to tend to stick with the status quo and fail to take advantage of beneficial competitive offerings – a phenomenon amply demonstrated by the results of the 2011 Zogby Survey discussed above -- has to be considered as the Commission weighs the appropriate steps to enhance retail electric competition in the Commonwealth.

Another factor discriminating in favor or default service is that, today, default service rates do not reflect the full cost of providing the service, failing to include a share of shared costs such as billing, customer care and credit risk. Thus, EGSs are not

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12 *See* Question 4 of the 2011 poll conducted by Zogby International for Direct Energy which is attached hereto as Appendix B ("2011 Zogby Survey").

permitted to compete on a level playing field against the default service rates that are subsidized by all ratepayers.

Moreover, most default service is procured using laddered wholesale auctions with delivery dates many months in advance of the purchase. In addition, EDCs also include a quarterly reconciliation mechanism to recover over or under-recoveries, further distorting the default rate in comparison to wholesale market prices. The result is a default service price that constantly lags and distorts the wholesale market.

Finally, the provision of default service by the EDC enables the utility to exploit the name recognition and brand loyalty created by the EDC. As a result, to the extent that customers do switch, they are more likely to switch to the utility's affiliated EGS, thereby creating competition in name only. For example, in Ohio, the generation affiliate of the FirstEnergy utilities accounts for more than 80% of all retail and default service sales in its affiliated Ohio franchise service territory.[13]

Indeed, an "unintended consequence," of the present default service supply structure is that, while the EDC may not have a direct economic interest in keeping customers on default service, the plain facts are that their generation affiliates benefit from a large default service load, because it provides a large and relatively low risk demand for their generation assets. Moreover, the EDC's EGS affiliate benefits from the EDC's name recognition and brand loyalty as the "electric service provider" to most

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[13] *See* "FirstEnergy Solutions Increases Share of Sales at Affiliated Ohio Utilities to 81.4%", Energy Choice Matters, February 17, 2011, which is available at: http://www.energychoicematters.com/stories/20110217d.html. In fact, FirstEnergy's First Quarter Results for 2011 states sales increased by 3.1% in Ohio over the First Quarter of 2010. These Results are available at: http://investors.firstenergycorp.com/phoenix.zhtml?c=102230&p=irol-IRHome.

customers, which make the EGS affiliate more successful in making competitive offers in the service territories of its EDC affiliates.

Based on the foregoing, the Commission should determine that "effective competition" does not exist in the retail electric market statewide, and is not likely to develop on its own, without significant modifications and changes.

The Needed Changes

In light of above-described barriers, what does the Commission need to do if customers are going to receive the benefits of a fully functioning competitive market? Most importantly, the Commission should declare that its end state goal is a retail electric market in which customers are taking service from competitive suppliers, the EDC is removed from the default service function and default service is reconfigured to serve truly as a "back-up." This is plainly the end state vision that the General Assembly contemplated when it enacted the Competition Act over ten years ago.

Direct Energy believes that the most efficient way to accomplish this goal would be to (a) order that the EDCs must exit from the generation supply function and transfer the default supply function to non-EDC provider(s); and (b) order that remaining default service customers be transferred to competitive suppliers via a Commission approved, opt-out auction.

Because of the relative paucity of competition in some service territories, and for some customer classes (e.g., residential customers in the Met-Ed, Penelec and West Penn service territories) the Commission may wish to delay transferring the default function until customers have a chance to get more experience with competition and its benefits. If so, Direct Energy proposes a transitional approach with the setting of a presumptive date certain that the utility exit would occur (June 1, 2013) and the ordering of interim

competition enhancing steps, such as: (a) encouraging new or moving customers to immediately take competitive service[14] (rather than being placed automatically on default service); (b) "opt-in auctions;" and (c) a greater PUC, utility and supplier coordinated effort to increase consumer education and awareness in an attempt to increase the level of competition, prior to ordering the that the default service be transferred to a competitive provider.[15] In any event, *it is crucially important that the Commission declare at the conclusion of this phase of the Investigation, that its overall and long term end-state goal is a retail electric market in which most customers receive service from competitive suppliers and the EDC is removed from the default service function.*

Immediate Action Necessary – Modification of Default Service Procurement Plan Terms

In the shorter-term, the Commission needs to take action to ensure that the new, competition enabling steps will not be delayed until the current multi-year default service procurement plans run their course. The currently effective default service plans expire on May 31, 2013[16] EDCs will need to file their new default service plans to be effective June 1, 2013. What is concerning is that EDCs could begin to file their proposed plans[17] before the Commission is able to finish its Phase II Investigation. Accordingly, as part of

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14 Such customers should be prompted to affirmatively elect to receive either default service or service from a competitive supplier.

15 Additional "Competition Ehancing Steps" are discussed in response to Question 7.

16 The default service procurement plans for Allegheny (West Penn), Duquesne, Met-Ed, Penelec, Penn Power, PECO, PPL, Citizens Electric of Lewisburg and Wellsboro Electric expire on May 31, 2013.

17 It is likely that the EDCs will file in or before February 2012 to allow time for Commission approval, 66 Pa. C.S. § 2807(e)(3.6), and to allow time to complete any necessary procurements that will begin delivery at the beginning of the next procurement period.

its Phase I Order, the Commission should mandate that: (1) EDC proposed default service procurement plans should not be filed until the conclusion of the Phase II investigation so that they can incorporate the findings and policies established there, as well at the inclusion of Phase I; and (2) the Commission should put the EDCs and wholesale generation suppliers on notice that any or all of the competition enhancing steps that Direct Energy has recommended may be put in place (or continued) during the pendency of the forthcoming default supply plans, and any wholesale auctions must proceed with full knowledge of that potential.

C. DIRECT ENERGY'S ANSWERS TO THE COMMISSION'S SPECIFIC QUESTIONS

1. What is the present status of competition for retail electric generation for customers, by class and service territory, and for alternative suppliers?

a. The "End State" Of Electric Competition Under The Competition Act

Before describing the current "status" of retail competition in Pennsylvania, Direct Energy believes that it is important to define the appropriate "end state" for competition in the Commonwealth. Direct Energy has focused on this crucial issue consistent with the Pennsylvania General Assembly's commitment to competition in the Pennsylvania electricity markets.[18]

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[18] 66 Pa. C.S. § 2802(5) ("Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."). In the Competition Act, the Legislature stated that "[e]lectric 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." 66 Pa. C.S. § 2802(9). The Legislature further recognized that "[t]he cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth." 66 Pa. C.S. § 2802(6).

In initiating this Investigation,[19] the Commission announced its vision of the proper end-state when it stated that its principal goal was to ensure that a properly functioning and workable competitive retail electricity market exists in the Commonwealth.[20] While the Commission did not articulate a more detailed vision of "properly functioning and workabl(y) competitive," standard, it has defined the virtually identical term – "properly functioning and effectively competitive" – under the Gas Competition Act.[21] In that context the PUC stated that a market with "effective competition"[22] would have the following attributes:

- Participation in the market by *many sellers* so that an individual seller is not able to influence significantly the price of the commodity.
- Participation in the market by *many buyers*.
- *Lack of substantial barriers to supplier entry and participation in the market.*
- *Lack of substantial barriers that may discourage customer participation in the market.*

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19 *Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Co and FirstEnergy Corp. for a Certificate of Public Convenience Under Section 1102(a)(3) to change control of West Penn Power Co and TransAllegheny Line Co.,* Docket Nos. A-2010-2176520; A-2010-2176732, Opinion and Order entered on March 8, 2011.

20 *Id.* at 45-47.

21 66 Pa. C.S. § 2204(g).

22 In its Report to the General Assembly on Competition in Pennsylvania's Natural Gas Markets, the Commission formulated indicia for the definition of "effective competition" after extensively reviewing the definitions of various terms related to "competition" from multiple sources. *See Investigation into the Natural Gas Supply Market,* Docket No. I-00040103, Report to the General Assembly on Competition in Pennsylvania's Retail Gas Market (dated October 2005), at pp. 15-25. This Report is available at: http://www.puc.state.pa.us/PcDocs/570097.pdf.

- *Sellers are offering buyers a variety of products and services.*[23]

In essence, the above criteria can be boiled down to one overarching standard: Has the market in a particular service territory reached the point where customers rely primarily, if not exclusively, on the competitive market rather than regulated utility offerings to provide electricity and related services, such that competitors have a sufficient incentive to invest capital in that market in order to give all customers more options and the ability to take control of their energy usage through a wide array of commodity and value-added options? To the extent that the answer is no – with a majority of customers being served by the default option and only price-based service being offered, Direct Energy submits that the market cannot be characterized as "workably competitive," under the PUC's own definition of the term. This is clearly the case in most of the electricity markets and for most customer classes throughout the Commonwealth.

b. The Status Of Electric Competition In The Commonwealth

Direct Energy does not dispute that, presently, the market for energy in several utility territories is among the most active in the country based on shopping statistics. The Commission reports that (as of June 1, 2011) a total of 1,146,479 customers have now switched to competitive electric suppliers.[24] Overall, there are 5,650,102 total

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23 *Investigation into the Natural Gas Supply Market: Report on Stakeholders' Working Group (SEARCH)*, Docket No. I-00040103F0002, 2008 Pa. PUC LEXIS 31 (Order entered September 11, 2008), at p. 2 (emphasis added).

24 *Weekly PAPowerSwitch Update* (Wednesday, June 1, 2011).

customers in Pennsylvania.[25] The levels of overall switching in several EDC service territories now are in the 30-35% range, even though, on a state-wide basis, only 20.3% of all customers are shopping.

Moreover, wide variation in the percentage of customers shopping exists by customer class. On a statewide basis (as of June 1, 2011), 59.1% of industrial customers have switched to a competitive supplier.[26] This vigorous level of switching provides clear evidence that customers are sufficiently familiar with and engaged in the competitive market that there is little need to maintain utility-provided default service for these large customers.

The available public data provides a less clear picture for commercial customers. Overall, 29.4% of commercial customers have switched to an EGS with switching levels ranging from 4.87% to 66%.[27] While many large business customers have taken full advantage of competitive opportunities (and therefore have less need for EDC-provided default service), Direct Energy believes that smaller business customers exhibit switching characteristics and a lack of familiarity and comfort with the competitive market that are similar to the residential class.

The least active shopping customers are in the Residential class. Overall, only 18.7% of Residential customers have switched to an EGS. Residential shopping (as of June 1, 2011) ranges from less than 5% in the service areas of UGI, Met-Ed, Penelec, and West Penn Power to 38.3% in the service area of PPL service territory.[28] This is a broad

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25 *Id.*

26 *Id.*

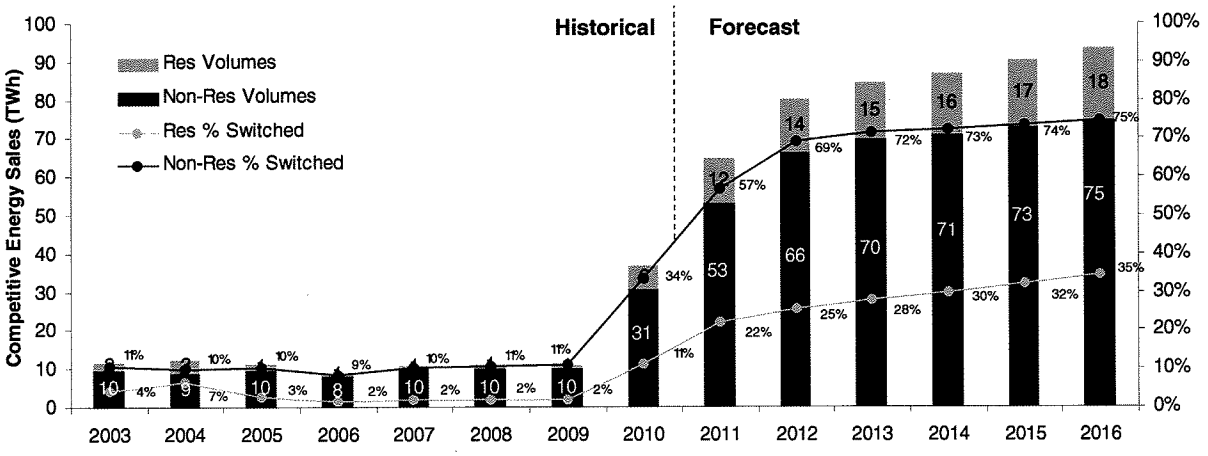
27 *Id.*

28 *Id.*

range but the results are consistent with a number of open markets due to the unique circumstances in each utility marketplace and importantly how they price their default service.

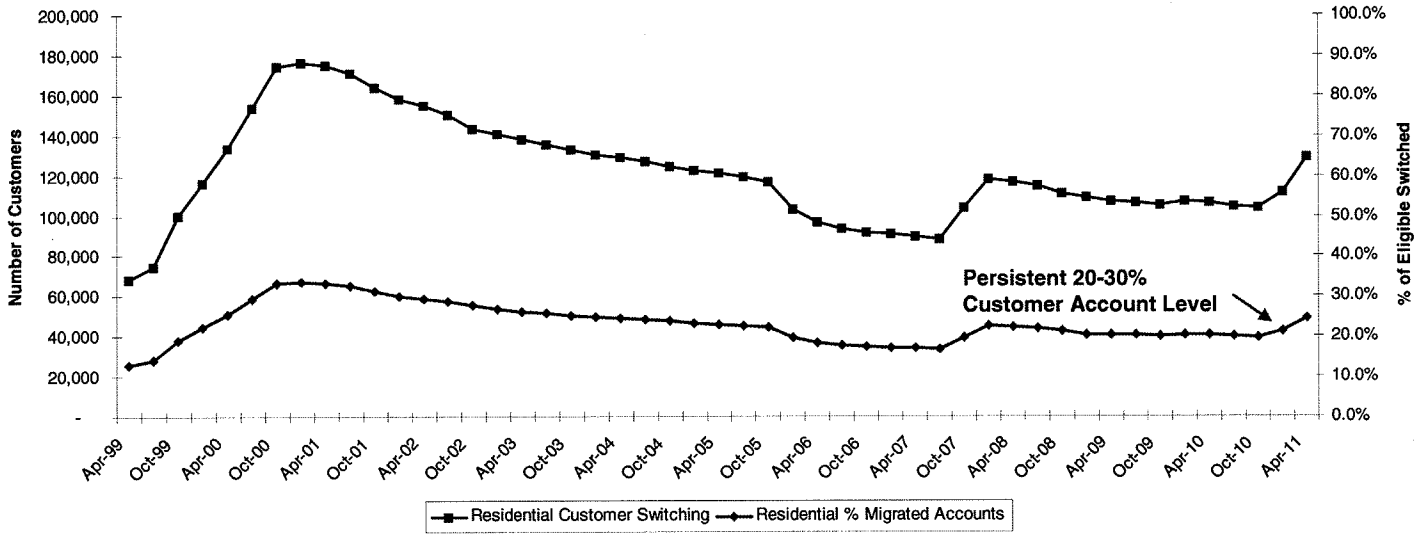
Importantly, while the current model has supported increased levels of competitive activity it is not likely to continue to show the same growth. In fact, the most realistic projection for the next five years of switching activity is for a steady state at about one-third of the residential market (on a statewide basis). In the absence of changing the underlying default service model, it is likely that the market will only continue to exhibit small, incremental switching from the levels we see today. (**See Figure 1**). This steady state is shown by analysis of the Duquesne market over the past 10 years. It shows that, despite the removal of price caps almost a decade ago, and the presence of competitive offers for much of that period, residential switching in Duquesne has never exceeded the 20-30% range. **(See Figure 2).** A similar pattern can be seen by examining the data for Penn Power, which has been fully open to competition since 2006. **(See Figure 2A)**. This "switching ceiling" for Residential customers is also observable in New York and other PJM markets such as Maryland and New Jersey. **(See Figure 3).**

Figure 1: Five Year Outlook for Switching in Pennsylvania



Source: "Retail Energy Outlook," KEMA (April 2011), based on State Commission Switching Data.

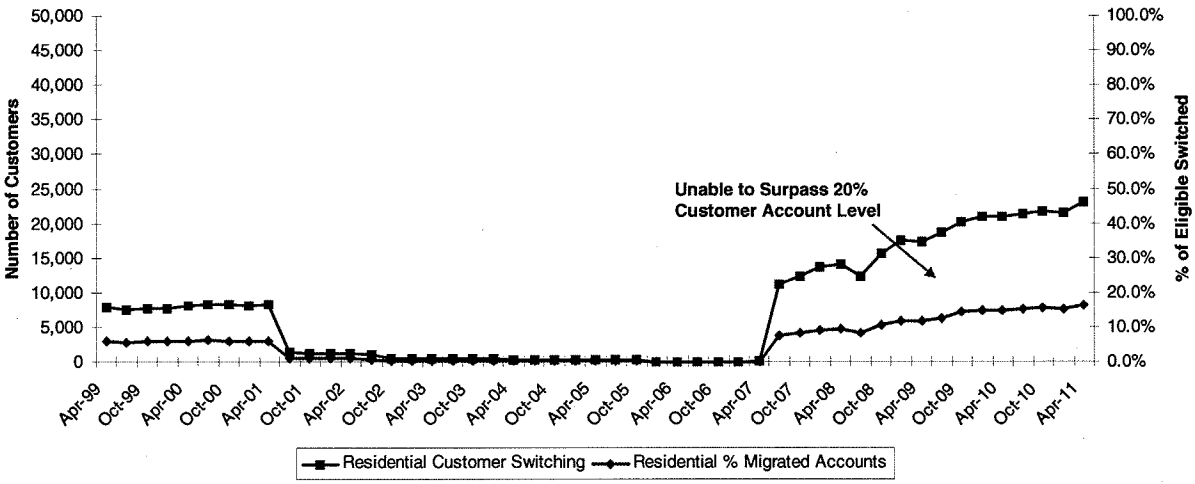
Figure 2: History of Residential Switching in Duquesne Light



Note: Generation rate caps expired effective January 1, 2001.

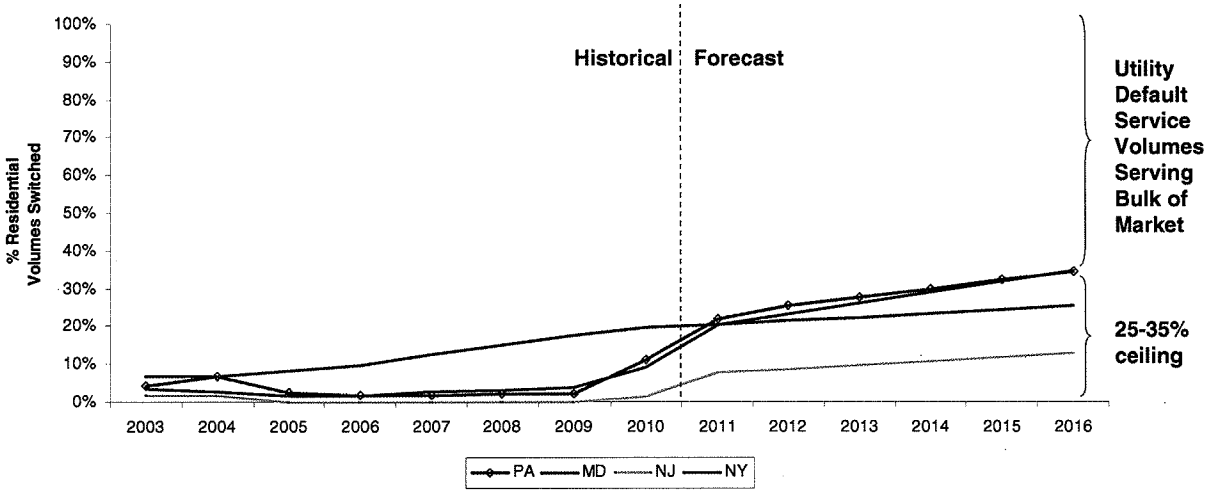
Source; PA Office of Consumer Advocate, " Pennsylvania Electric Shopping Statistics, April 1, 1999-April 1, 2011.

Figure 2A: History of Residential Switching in Penn Power



Source; PA Office of Consumer Advocate, " Pennsylvania Electric Shopping Statistics, April 1, 1999-April 1, 2011.

Figure 3: Pennsylvania Residential Switching Compared to Other Open Markets



Source: "Retail Energy Outlook," KEMA (April 2011), based on State Commission Switching Data.

Importantly, a common aspect of most of these markets is the presence of an EDC-provided default service option on which all Residential and Small Business customers were originally placed as well as a default service pricing scheme that decouples the default rate from changes in the wholesale market pricing.

The conclusion is clear: absent a clear sea change in the structure of the market, it is highly unlikely that residential switching will ever exceed the 1/3 level. The reason this is important is because on a load basis the residential and non-residential markets size is similar. However, when looked at in terms of customers, the residential market accounts for 88% of Pennsylvania consumers.[29] Therefore, for the market to be competitive it must have a structure that supports providing the benefits of competition to the majority of residential customers in the Commonwealth. In addition, even with increased migration levels that compare well with other states, there is no evidence that robust competition exists even in these states (NY, MD, NJ).

The most convincing evidence of robust competitive markets are in the markets where the utility has fully exited the merchant function entirely (TX power, UK power, and GA gas markets) and, as a result, switching rates are 100% in terms of customers switching from regulated utility provided supply service to a service offered by competitive suppliers (whether they are affiliated or unaffiliated with the incumbent utility). This type of market structure encourages and supports competitive suppliers to make investments in product and service innovation as well as longer term investments in

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29 *Weekly PA PowerSwitch Update*, (Wednesday, June 1, 2011). There are 4,970,057 residential customers out of a total of 5,650,102 total customers. *Id.*

generation because the entire customer base is active in the competitive market for the long term.

(i) Workably Competitive Markets Support Service and Product Innovation

While customer switching is a key indicator of how competitive retail electric markets are, another measure of competitiveness is the ability of all customers to select from a range of competitors and variety of products. Currently competition in the Pennsylvania electric market is extremely limited in that it revolves around a set of suppliers largely competing against a quasi-regulated, published energy price. Even if there are high switching rates this is not a robustly competitive market. The equivalent would be suppliers in the pre-divestiture era offering the same black phone at a rate slightly discounted to AT&T's. More effective competition emerges when competition erupts around a broader set of products and services in addition to the pure price a consumer plays for energy. It is generally reported that in the UK, arguably one of the most competitive energy markets in the world, a significant group of customers (2/3) have opted to have their energy supplier supply both gas and power. This option was not available, and consumers could not reveal their preference for this option, until both the gas and power markets deregulated. In the UK, customers have revealed a preference for different types of payment plans with about 1/3 using standard credit, 1/2 using direct debit and 1/6 using pre-payment options. There are also suppliers offering a number of different pricing structures as in US markets. Lastly there are suppliers offering products that align with their energy offering. These are often in the traditional "home services" space and revolve around gas/power heating/cooling, installation, repairs, insurance and maintenance plans. In other words, as customers become more educated, and the market

opportunity is of sufficient size, competitors can enter the market and freely compete, creating intense competition and product innovation. In addition, the market has now segmented itself along the lines of the payment plan that customers choose with their energy supplier. The offers, and savings, are different depending on whether the customer wants to send a check each month as they always did, have a monthly debit to their account or enter into a prepayment plan. There are also suppliers offering a number of services in addition to the energy supply. In other words, as customers become educated, competitors can enter the market and freely compete, there can be intense competition and product innovation.

In some areas in Pennsylvania, suppliers are offering a variety of differently priced products to enable customers to realize the benefits of competition. For example, Direct Energy offers 1 and 3 year "price " products to Residential customers in the PPL service area.[30] We also offer a Renewable Wind Energy price product and special priced products for senior citizens and the military.

But in a truly competitive market one would expect to see a wide variety of "value added" products and services being offered by competitive suppliers. Such products could include demand side management and products that bundle electricity sales with other products and services, such as appliance repair. For example, at this time the only state in which Direct Energy currently offers advanced or value-added services, including those that rely on technological innovation such as smart metering infrastructure, is Texas. In the other states in which Direct Energy sells retail electricity, the utility remains the default service provider and retains a dominant position in the

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30 http://Residential.directenergy.com/EN/Energy/Pennsylvania/Pages/ELE/res-ele-default.aspx.

Residential and Small Business sectors. The products and services that Direct Energy is offering in Texas have included (but are not limited to) the following:

- **"Power-to-Go"** – a smart meter-based technology that allows customers to exercise a far greater level of control in their purchasing and consumption of electricity than would be available from a traditional regulated utility.

- **CPL BrightHome Program** – a first-of-its-kind demand-response and energy efficiency pilot program for residential customers. Participants in the CPL BrightHome pilot will receive: a full home energy audit from CPL's HERS (home energy rating system) rated home energy auditors; whole-home weatherization measures; and a new programmable thermostat capable of receiving and displaying messages, and turning back the air conditioning, during peak usage periods.

- **City of Houston and Centerpoint Weatherization Programs (REEP)** – Through these programs Direct Energy has provided home energy audits to low-income neighborhoods in the City of Houston. Households that have participated in the program have saved an average of 19 percent on their electricity consumption.

- **Home Energy Audit Program** – Direct Energy also offers to its customers home energy audit services similar to those available to participants in the REEP program.

- **Energy Star Certification Program** – Direct Energy's Energy Star certified master technicians offer training to employees of other companies, allowing them to become certified Energy Star technicians and to implement the HERS rating system through home energy audits.

- **"Home Energy Manager"** – Through a relationship with Open Peak, and a planned retail pilot with Best Buy, Direct Energy is introducing a smart-meter compatible home energy manager that will allow homeowners an unprecedented level of control over their home energy usage.

- **HVAC Filter Program** – Through a collaboration with Hallmark, a Direct Energy company, Direct Energy offers customers the ability to subscribe through a web-based program to receive a new, high-grade HVAC filter every six months, to improve HVAC performance and indoor air quality.

For the most part the Pennsylvania market shows little evidence of such products being offered. This reflects the concern that competitive inroads in the mass markets

have hit the "switching ceiling" and the serious potential that suppliers are not ready to make the long term investments that are necessary to offer such products without a greater likelihood that the competitive market is capable of continuing to grow. Further suppliers may well be concerned that what limited success Pennsylvania has seen is vulnerable to reversal if wholesale prices reverse course and start climbing back up.

The absence of the opportunity for entry into a market at a sufficient scale of service reduces the ability and incentive for EGSs to deploy innovative technology and value-added services in that market. Introducing most value-added services, whether they involve technologically advanced equipment or such "low tech" services as weather-stripping and insulation, is a capital intensive undertaking that may be difficult for a retailer to justify in a market where they have few customers and little prospect of obtaining significant increases. EGSs in such markets will typically have to deploy capital first in an effort simply to acquire customers from the regulated utility's default service. Only after the achievement of sufficient scale through this organic process would one expect retailers to make the kinds of investment that would lead to scale deployment of advanced and value-added services. Thus, without economies of scale, it is not economically rewarding for the EGSs to aggressively pursue Residential and Small Business customers on a large scale and to invest in innovative and value-added services. Moreover, small numbers of customers limit EGSs' buying power in the wholesale market, and result in higher costs for the EGSs and lower benefits for the retail customers they serve. The only way this will be reversed is if the majority of customers are taking service from the competitive market and the utility-provided default service does not continue to be the most formidable competition.

c. Conclusion

In summary, while the present status of retail electric competition in Pennsylvania has improved in the past few years due to the expiration of rate caps, and customer switching has increased in several utility territories, as well as for the large business classes, it is likely that competitive development for Residential and Small Business customers will continue to lag at the 30% level. Even the higher level of switching of large business customers still reflects a concerning number of non-switchers. Development of a more efficient and effective model for all classes, that yields the highest benefits would require as a first step the exit of the utility from being the default service provider, the appointment of alternative supplier(s) to serve this role, and a concerted effort by all players in the market to educate consumers and deliver product and service innovations which are the true hallmarks of an effectively competitive marketplace.

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?

a. Barriers Associated With Default Service Continue To Exist In Pennsylvania

The existing retail market design, and particularly, the structure, pricing and provisioning of default service by the EDCs, present barriers that prevent customers from obtaining and suppliers from offering the benefits of a fully workably competitive retail market. Such barriers include, but are not limited to, the following:

(i) The Structure Of Default Service

The existence of default service is legislatively mandated[31] and, in each service territory, default service is set up as a backstop for customers in a fully competitive market.[32] In 2004, this Commission recognized that default service "should primarily serve as a backstop to the competitive retail market."[33] This recognizes the wisdom of the General Assembly's determination that competition provides the right tools to deliver the best service to retail electric consumers.[34]

As a backstop, default service provides customers with short-term protection against defaulting suppliers.[35] In other words, default service is intended to be a "safety net" service designed to provide energy for short periods of time, such as when a customer is between competitive suppliers.[36]

However, this backstop service was created in such a way as to create structural barriers to a fully workable and competitive retail market. First, the role of DSP was initially assigned to the EDC. The law requires electric distribution companies, unless the Commission approves an alternative supplier, to provide default electric generation

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31 66 Pa. C.S. § 2807(e); 52 Pa. Code §§ 54.181, *et seq.*

32 66 Pa. C.S. § 2807(e)(3.1).

33 *Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. § 2807(e)(2),* Docket No. L-00040169, Proposed Rulemaking Order (entered December 16, 2004), p. 5.

34 66 Pa. C.S. § 2802(5) ("Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity."). Importantly, the passage of Act 129-2008 did not change this. None of these legislative findings were altered and, while the standard for pricing default service was specified as "least cost" the nature and availability of default service, or the rules associated with its provisioning to existing or new customers was not affected. Accordingly, Direct Energy's proposals here take into account, and are fully consistent with Act 129 requirements.

35 66 Pa. C.S. § 2807(e)(3.1).

36 Act 129 did not change this end-state goal; it merely established pricings and procurement rules for the "safety net" service.

service.[37] But, at that time, the Commission determined that it had "no choice but to initially designate the EDC to assume the DSP role."[38] At the time, the Commission saw this step as necessary because retail competition had not yet begun and customers and the PUC had very little experience with competitive electric providers. While this decision may have been rational then, it nonetheless allowed the incumbent EDC to continue as the dominant generation service provider, despite the separation of generation, transmission and distribution service.

Second, at the time of unbundling, customers without the benefit of affirmative choice, were simply placed on default service (then called "Provider of Last Resort" or "POLR" service). This was done, apparently, because the Commission wanted to make sure that all customers continued to receive safe and reliable service at reasonable prices, and the EDC could not refuse to serve electric customers within its designated service territory.[39] In addition, the wholesale electric markets were just beginning to fully develop, and there was both a real and perceived need for a local entity, such as the EDC to coordinate electric supply and balancing.[40]

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37 *See, e.g.*, 66 Pa. C.S. § 2803 (definitions); 66 Pa. C.S. § 2807(e) (obligation to serve); 52 Pa. Code §§ 54.181, *et seq.*

38 *Rulemaking re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807(e)(2),* Docket No. L-00040169, Final Rulemaking Order (entered on May 10, 2007), p. 11-12.

39 *Id.* at p. 11-12.

40 PJM opened the first wholesale electric market in 1997. http://www.pjm-miso.com/about/downloads/media-kit-backgrounder.pdf. In 2007, PJM began operation of its Reliability Pricing Model, which operated as a buy auction for forward commitments to deliver new generation and transmission. http://pjm.com/markets-and-operations/rpm.aspx.

The awarding of nonswitching customers to the EDC (a) gave (and continues to give) the EDC and their affiliated EGSs an unearned competitive advantage because they are providing service to customers that never selected them; and (b) acts as a barrier to entry for non-affiliated competitive suppliers seeking to win customers from the default supply. While there may have been valid reasons for assigning this function to the EDCS at that time, those reasons no longer exist. There is now a mature competitive market with many licensed EGSs and many more customers have gained experience with the competitive electric market. Moreover, PJM now assures that all customers receive reliable electric supply regardless of who their supplier may be. Thus, EDCs are no longer needed to procure electric generation supply service for their distribution customers. The EDCs simply act as the "middlemen'" signing contracts with wholesale suppliers for delivery and paying them after PJM assures that the power is delivered, from proceeds collected from default service customers. Significantly, even though the "end state" envisioned by the General Assembly was a fully competitive market where all or most customers would obtain service competitively,[41] the Commission has never reexamined its initial policy determinations that have prevented that vision from coming to fruition – until this Investigation.

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41 In the *FirstEnergy Merger Proceeding*, Nora Mead Brownell, a former Commission of the PUC (1997 to 2001) and FERC (2001 to 2006), testified on behalf of Direct Energy that: "The "end state" of retail electricity competition will occur when the goals of the Choice Act have all been satisfied and, consistent with this Act, consumers have direct and complete access to a fully functioning competitive retail market instead of being forced to take service from the monopoly EDC. In this end state, the generation service provided by the default service provider is truly a "last resort" service and not a first stop (and, potentially, the last stop) as it is today for most consumers in Pennsylvania. Consumers will, as a general rule, receive their generation service from the competitive market utilizing default service only in rare situations." *FirstEnergy Merger,* Direct Energy St. 2 (Nora Brownell), at p. 6, 8-14.

It is well to recognize that the decision to award all of the non-switched customers to the EDC represents between $600 million and $2 billion dollars in lost value to consumers, (based on the $150 to $500 rebate check that could accrue to customers per the Direct Energy auction proposal presented in the FirstEnergy merger proceeding).[42] Moreover, while opponents of transferring the default function claim lack of interest by consumers, in fact, 89% of FirstEnergy and Allegheny Power residential and small business customers supported the plan, along with 82% of PPL, PECO, and Duquesne residential and commercial customers, clearly, overwhelming support for this proposal.[43] Plainly a reevaluation of this initial decision regarding default service is justified.

(ii) EDC Rules: New Applicants and Moves

Adding to the initial decision to award default service to the EDCs, rules for new and switching customers were established by the EDCs that help to perpetuate the dominance of default service. Direct Energy believes that the rules in place for all Pennsylvania EDCs currently mandate that applicants (i.e., persons applying for service who have not previously had service in their name at that utility) or moving customers (i.e., people who are moving from one part of an EDC's service territory to another) must initially be served by default service for at least one billing cycle.[44] Thus, applicants and

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42 *FirstEnergy Merger,* Direct Energy St. 3 at 4, 10-12; Direct Energy St. 1 at 46-47; Tr. 1001-1005

43 *See* Question 13 of the 2010 Zogby Survey (Appendix A) and Question 15 of the 2011 Zogby Survey (Appendix B).

44 The application for new service does not allow a customer to identify their choice of supplier. *See* https://secure.dqe.com/dlx/customerservices/Electriweb/StartService/ResidentialApplication.pdf.

movers are not currently given the opportunity to immediately select an EGS.[45] This rule clearly decreases the chances that an applicant will switch to an EGS (even if the applicant had originally intended to take service from an EGS). Moreover, the impact of the rule means that a customer who has decided to utilize competitive supply and then moves from one part of the service territory to another, will actually have to give up their competitive service, take default service and then go through the process of switching back to their competitive supplier.

Customer "churn" (i.e., the addition of new customers together with customers moving from one part of the service territory to another) is not insubstantial. In the FirstEnergy service territories, the level of churn was over 10% of the total customers per year.[46] The net impact of that number, is that on average, every 10 years, 100% of customer count has churned and would be forcibly moved back to the EDC. This EDC policy erects a significant barrier to competitive market entry, competitive market investment and long-term sustainability of suppliers and is a hidden factor practically ensuring the continued dominance of default service in virtually every service territory in the State.

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45 *See, e.g.,* Duquesne's Applications for New Service, which is available at: https://secure.dqe.com/dlx/customerservices/Electriweb/StartService/default.cfm.

46 For example, all applicants for new service (which is 11-12% of the EDCs' total residential customers, or over 50,000 per year each for MetEd and Penelec) are required to take default service from the EDC for at least one billing cycle. *FirstEnergy Merger*, Direct Energy St. 1-SR, Exhibit MJM-4; Joint Applicants' Answers to Direct Energy VIII, 4 and 5.

(iii) Customer Status Quo Bias

While administrative decisions initially placed all customers on EDC-provided default service, the phenomenon of "status quo bias" helps to keep them there. Economists have recognized that consumers have a strong inclination to simply "maintain the status quo" in their consumer buying decisions.[47] The result is that a surprisingly high number of customers appear to be staying on default service simply out of inertia, misunderstandings or an inability or unwillingness to become aware of their choices.

In fact, a 2010 poll (conducted by Zogby International, a nationally known polling firm, for Direct Energy of Residential and Small Business customers in the FirstEnergy service territories) revealed that a material number of customers in the FirstEnergy service territory (15%) did not even know that they had the ability to choose a competitive supplier and some 64% had never considered a competitive alternative to the default service provided by the EDC.[48] As discussed previously, similar findings were

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[47] Behavioral economics combines economics and psychology to explain how people make decisions. It recognizes that people are susceptible to making predictable and avoidable mistakes. Ideas from behavioral economics include (but are not limited to) the status quo bias. *See* Ken Costello, "Electric-to-Gas Substitution: What Should Regulators Do?," National Regulatory Research Institute (May 29, 2009), at p. 9, n 16, citing, Richard H. Thaler and Cass R. Sunstein, Nudge: Improving Decisions about Health, Wealth, and Happiness (New Haven, Yale Univ. Press, 2008); and Robert H. Frank, The Economic Naturalist: In Search of Explanation for Everyday Enigmas (New York, Basic Books, 2007). This NRRI Report is available at: http://nrri.org/pubs/gas/NRRI_electric_to_gas_substitution_may09-07.pdf.

[48] *See* Questions Nos. 1 and 2 of the poll, which is attached hereto as Appendix A. The fact that in 2010 and 2011, almost one in seven First Energy and Allegheny Power customers and 9% of PPL, PECO, and Duquesne customers specifically cite that they are still unaware there are competitive alternatives to default service shows how difficult it is

discovered in the PPL, PECO, and Duquesne service territories in the 2011 Zogby Survey where 66% of residential and small business respondents stated that they have not switched, the majority of which stated reasons for their decision that are not factually correct or because they had inadequate information.[49] Nine percent were not even aware switching was even possible, a very disturbing result, in light of the substantial publicity customer choice has received in 2010 and 2011. Approximately 23% of these customers who did not switch cited "Not enough savings to make it worth my while," underscoring the fragile nature of the competition that has occurred and the total reliance on price competition.

In fact, the EDC's status as the "wires" or distribution service provider, can result in customers mistakenly believing that EDC-provided default service is either more reliable, or that they are actually receiving a more reliable or "better" product from the EDC (when the EDC is simply passing on electricity it procures via auction in the wholesale market and has nothing to do with producing the supply).[50] This belief is perpetuated by characterizing default service as a service of the EDC, rather than as simply a pass through. That a troubling number of customers share this belief is reflected

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for EGSs not affiliated with the EDC to make inroads in the market. *See* Appendix A and Appendix B.

[49] This sum is reached by combining the following results in Question 4 of the 2011 Zogby Survey: I don't understand (17%); too much hassle (11%), I didn't know it was possible (9%), afraid (3%), not sure (2%) and half of the other responses (about 9%). Approximately half of the "other" responses was used because the listed responses denote misinformation or lack of information.

[50] See Question 3 of the 2011 Zogby Survey (Appendix B).

in the 2011 Zogby Survey result that 18% of customers[51] in PPL, PECO, and Duquesne service territories are under the mistaken belief that switching to a competitive supplier will somehow harm the EDC, or that the EDC-provided service is somehow "better" or more reliable.[52]

These results show that, despite the educational efforts of the Commission, the EDCs and EGSs, customers are remain reluctant to switch from "what they know" - even if they are paying higher prices for default service electricity than they could obtain from a competitive supplier, either because of incorrect assumptions, confusion or indifference. Together, these factors create a glue, maintaining the dominance of default service.

The results of this status quo bias is frequently misconstrued (intentionally or unintentionally) as an affirmative "choice" to want to receive their electric generation service from the "tried and true" utility. For example, in the FirstEnergy Merger proceeding, the reluctance of consumers to leave default service and shop was acknowledged by ALJ Weismandel. The ALJ observed that Pennsylvanians may not act in their own economic best interests when it comes to shopping for electricity.[53] However, he opined that some customers may wish to remain a customer of PPL because their parents and grandparents were PPL customers.[54] In his words, this is analogous to

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51 This sum is reached by combining the following results in Question 4 of the 2011 Zogby Survey: don't want EDC to lose business (15%), and afraid (3%). It should also be noted that some of the "other" responses also indicate concerns about reliability.

52 *See* Question 4 of the 2011 Zogby Survey (Appendix B).

53 *First Energy Merger,* Tr. 803-834, 927-930.

54 *First Energy Merger,* Tr. 833-834, 1052-1053.

"Buick men" who are "going to drive a Buick from now till hell freezes over, and they don't care if Toyota makes a better car."[55]

ALJ Weismandel's observations explain the nature of the problem. Indeed, there are apparently many customers who do not want to switch because they are under the mistaken belief that they would have to leave the EDC entirely, that their default service is actually being provided by the EDC, that they will not have outages repaired or will lose some other benefit if they switch, or that the PPL generation product is somehow "better" than that which is available from EGSs. Of course, none of these assumptions is true, and, as the ALJ also observed, in most cases competitive alternatives which offer the opportunity to save money are not being pursued. The obvious conclusion is that any attempt to enhance competition in Pennsylvania is going to have take account of the consequences of these misperceptions and biases and craft solutions that will help the market overcome them. Otherwise the losers will be customers who will continue to spend more, get less and not obtain the satisfaction of having a choice.

(iv) Cost Allocation to Default Service

As more fully explained in answer to Question Number 3, the Competition Act required EDCs to unbundle transmission, distribution and generation rates for retail customers.[56] All costs and risks related to utility provided default service should be reflected in default service rates. Progress has been made towards unbundling. However, rates have not yet been fully unbundled.[57] Many costs that clearly contribute to the

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55 *See First Energy Merger,* Tr. 834.

56 *See* 66 Pa. C.S. § 2802(14); *see also* 66 Pa. C.S. §§ 2801-2812.

57 Phase II should include a discussion of the various costs (such as customer acquisition costs, customer care costs, credit costs and capital costs) that must be

provision of default service are not assigned to be recovered in the default service rate and instead are recovered in distribution rates. These costs include customer care costs, billing costs, marketing and customer assistance. The result is that EGS competition with default service is not on a level playing field. Misallocated default service costs result in shopping customers paying twice. Once in their distribution rates to the EDC, and again to the EGS through their generation price.

(v) Prices For Default Service

An additional barrier associated with default service is the method by which this alternative is procured and priced. It has been well established that default service pricing can have a profound effect on the ability of competitors to compete. The price charged for default service must be market reflective and the procurement process must also reflect market conditions. But today, default service pricing is dominated by longer term (more than 3-6 month) contracts which are procured in "laddered" auctions, at points many months prior to delivery.[58] The result is a price that "lags" the market, creating the likelihood that the default service price will either overstate or understate real market conditions. Suppliers, on the other hand must price their products on the basis of the market that exists at the time the customer is being solicited. The end result is that, in

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unbundled. *See* footnote 82 and the accompanying text, *infra*. Following this discussion, the Commission can order the full cost allocation of default service costs to default service.

[58] Details on the procurement plans that run through May 31, 2013 may be found at the following dockets: P-00072342 (Allegheny (West Penn)), P-2009-2135500 (Duquesne), P-2009-2093053 (Met-Ed), P-2009-2093054 (Penelec), P-2010-2157862 (Penn Power), P-2008-2062739 (PECO), P-2008-2060309 (PPL), P-2009-2110798 (Citizens Electric) and P-2009-2110780 (Wellsboro). Details on the other procurement plans can be found at P-2010-2194652 (Pike County), which runs through May 31, 2012, and P-2009-2135496 (UGI), which runs through May 31, 2014.

times of rising prices, EGSs may find it impossible to "beat" the default service price, making it impossible to continue to compete.

Because of this pricing approach, it is only in times of falling market prices where EGSs will be able to make competitive offers. The shopping results seen in PPL are a perfect example of this phenomenon. PPL procured its supply for its 2010 Bridge Plan in 2007, 2008 and 2009. Because much of its procurement was done while prices were very high, customers were able to see 20% or more savings when the market opened in 2010. While this was a good result for suppliers and customers, it is not a sustainable proposition, and eventually, prices will rise again and customers will migrate back to default service, if it is allowed to remain in place as it is today. So, the "successful" competitive results from PPL may not be sustainable in the long run.[59] In comparison, intensified competition is more likely to yield sustainable lower rates for consumers.[60] Thus, increasing participation in the competitive market appears to be a crucial element in reducing residential electric rates and creating a properly functioning and robust competitive market.

(vi) Competitive Products Being Offered By The EDCs

Beyond its roles in providing distribution service and default service, in some instances, the EDCs themselves are offering the same or similar services as part of the

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[59] As noted herein, the results in PPL are driven by the confluence of the procurements and market conditions.

[60] Mine Yücel And Adam Swadley, "*Did Residential Electricity Rates Fall After Retail Competition? A Dynamic Panel Analysis,*" Federal Reserve Bank of Dallas (Research Department, Working Paper 110) (May 2011), which is available at: http://dallasfed.org/research/papers/2011/wp1105.pdf.

"default" service. For example, several utilities are offering time of use or "critical peak" tariffs as part of the default service.[61]

The existence of optional plans from the DSP (now the EDC) helps the DSP/EDC to compete for customers. Some customers will prefer a plan other than "plain-vanilla" default service. EDC's that are seeking to maintain a long run presence in the retail market recognize that, by making such options available, they can better retain existing customers and attract new ones. At the same time, the absence of such non-traditional offerings from competitive suppliers in many service territories is a clear indication that those markets are not sufficiently developed to justify the investment required to develop and market such offerings. The absence of these value-added services even in markets of substantial size, as are common in Pennsylvania, is strong evidence of the chilling effect on investment created by the continued presence of the regulated EDC as an active competitor in those markets.[62]

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61 Examples include: *PPL Electric Utilities Corporation Supplement No. 94 To Tariff Electric – Pa. P.U.C. No. 201 – Time-of-Use Rates*, R-2010-2201138, Order (entered December 2, 2010); *Petition of PECO Energy Company for Approval of its Initial Dynamic Pricing and Customer Acceptance Plan*, M-2009-2123944, Order (entered April 15, 2011); *Petition of West Penn Power Company d/b/a Allegheny Power for Approval of its Dynamic Pricing Plan for Time of Use Rates*, P-2011-2218683; and *Petition of West Penn Power Company for Approval of its Dynamic Pricing Plan for a Residential Critical Peak Rebate Rate Offering and a Non-Residential Critical Peak Pricing Rate Offering,* P-2011-2224781.

62 Recently another barrier associated with default service was discovered. Several EDCs are taking the position that a customer may only avail themselves of the EDC's net metering tariff if they are default service customers. For example, customers who generate their own power and who shop are not qualified to annual compensation for excess power. See, FAQ's for PPL Electric Utilities, Customer-owned Renewable Generation Projects, Response to Question 12, which is available at: http://www.pplelectric.com/NR/rdonlyres/839A1915-FA9C-444D-9185-789930323FE8/0/RenewableenergyFAQs.pdf and PECO Energy Company's Customer-Owned Renewable Generation Project FAQ's, Response to Question 9, which is available at: http://www.peco.com/NR/rdonlyres/84A46407-58CC-4FF8-89E5-

b. The Barriers Vary By Customer Class

The above-described barriers have the most pronounced impact on the Residential customer class. Residential competition in the electricity sector has failed to match the growth of competition in other customer classes. This issue is reviewed in more detail as part of the response to Question 1 (above). As markets grow and customers become more knowledgeable, price remains an important element of competition. It is clear that the biggest customers or the highest load customers have disproportionately switched, and are more actively switching, to competitive suppliers. Why? An important reason is that these classes are exposed to prices that are the most reflective of the costs of default service. The Residential class has the least exposure to market reflective prices. And, the Residential class remains (to a large extent) "stuck" on default service.

3. What are the economic and managerial costs associated with electric distribution companies (EDCs) fulfilling the default service role?[63] Are the EDCs accurately passing those costs along to default service customers? Do default 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?

a. All default service supply-related costs need to be identified and examined in detail to ensure proper cost allocation and recovery

552FEFF4B397/8628/PECOFAQs2182011Finalforuploading1.pdf. This obviously will put any customer considering distributed energy options, such as solar in the position of having to stay on default service if they wish to use net metering. This was confirmed by the Question 3 of the 2011 Zogby Survey (Appendix B), wherein a response was that it was not possible to switch suppliers because they had solar panels.

63 *See generally* 52 Pa. Code §§ 54.182 and 54.184.

Direct Energy supports a detailed examination into the EDC's default service costs to ensure that *all* costs associated with the EDC providing default service are properly identified, allocated, as well as recovered in an avoidable rate so that a customer who chooses to exercise his choice to leave utility-provide default service is not paying these costs as part of an unavoidable rate. Only through a detailed examination of each EDC's costs can the Commission be assured that there are no supply-related costs being inadvertently collected in the distribution charge. Only when the default service supply costs associated with each EDC are thus identified can the PUC determine with specificity the extent to which such costs are being accurately passed on to consumers or may contain some costs that are not cost-based. Direct Energy looks forward to reviewing the responses of the EDCs participating in this proceeding and the availability of information stemming from a more thorough examination by the Commission into the nature and level of these costs.

Direct Energy believes that all supply-related costs (whether they are in the supply or distribution charge) should be identified and potentially avoidable for switching customers. More complete unbundling can be observed in other markets. For example, in New York State the utilities have separated out the costs associated with the utility providing default service and put them in a specific "Merchant Function Charge" line item. The intent of this charge to is to include all supply-related costs that were previously in delivery rates so that they could be avoided if a customer switches to a competitive supplier. One utility, Consolidated Edison ("ConEd"), includes the following cost categories: uncollectibles, credit and collections, the costs of running a supply group and a return on working capital for gas in storage in their charge. Direct

Energy submits that as long as the utility is in the default service role *all* costs should be readily identifiable and avoidable if customers choose to exercise their choice and switch off of the utility provided default service.

b. A detailed examination should include full unbundling of retail service costs in addition to supply-related costs

Direct Energy encourages the Commission to go one step further in any detailed cost examination and broaden the inquiry to include retail-related costs (e.g., customer service, billing) as well as default service supply-related costs.[64] An examination into the broader unbundling of costs/rates is warranted to ensure not just that supply costs are identified and examined but that the various components of customer care associated with providing default service are also separately identified and considered for proper cost allocation and collection. Direct Energy submits that a more complete unbundling of costs with proper allocation between avoidable and non-avoidable rates would lead to greater savings to consumers (beyond just commodity savings).

Customers should potentially see greater savings when supply and retail related costs are unbundled from the utility distribution and transmission rates based on the experience in other states/provinces that have fully unbundled rates and where the utility completely exited the merchant (supply) function. A detailed examination of supply and customer service costs will ultimately show what level of savings is potentially achievable in Pennsylvania. The regulators/legislators in the Texas power and Georgia gas markets also supported the premised that when the utility exits the merchant function

64 The Competition Act foresaw that there could be further unbundling of costs (beyond the original unbundling into generation, transmission and distribution (T&D) charges). *See* 66 Pa. C.S. § 2804(3).

there is associated pressure for cost reduction and/or service improvement in customer service functions such as customer care, billing, etc. In each of these states, once the utility was out of the merchant function, there was intense regulatory scrutiny to ensure that any expenses or costs recoverable through transmission and distribution rates post-deregulation were demonstrably related to the transmission and distribution function. Costs related to generation or retail sales could not be included in transmission and distribution rates in either of these two states (in the territories fully open to competition).

The persistence of the construct in the market of having the utility as the default supplier is more costly for consumers. In a recent rate case before the Illinois Commerce Commission, the incumbent utility, Commonwealth Edison ("ComEd") filed a study that showed it had the same level of customer care costs regardless of the level of customer switching in the marketplace. They modeled three different switching scenarios: 0%, 10% and 100%.[65] ComEd concluded that they had the same level of customer care costs (a disputed number in the case ranging from $125.8 to $267.7 million) whether they supplied electricity to all or none of the customers. The reason for this outcome was attributed to ComEd being the default service provider. In other words, as long as ComEd was the default service provider (even if they were serving just 1 customer on that service) they were burdening customers with the entire costs of their customer care organization.[66]

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65 *Commonwealth Edison Company Proposed General Increase In Electric Rates,* State of Illinois, Illinois Commerce Commission, Docket No. 10-0467, Final Order (entered on May 24, 2011)

66 The Illinois Commerce Commission ("ICC") agreed with ComEd that there was no evidence indicating that ComEd's customer care costs would diminish to any significant degree, if 10% or a greater amount of its supply customers switched to retail electric suppliers. *Id.* at 210. But, the ICC noted that the alternative electric supplier

Experience in other competitive retail markets show that consumers can benefit when the utility not only exits the supply function, but also the retail business and customer service costs and default service supply costs can be unbundled from transmission and distribution rates.[67] Direct Energy submits that this is the ultimate end state in open deregulated markets. As a result, during any interim period on the development of markets to this ultimate end state, these costs should be properly included in the default service rate (and thus avoidable) versus being collected in the unavoidable transmission and distribution rates.[68]

c. Economic costs and barriers to competition

As discussed in answer to Question 2, Direct Energy believes that there are barriers to competition as a result of having EDCs provide default service. To remove these barriers, Direct Energy submits that the EDC's should exit the merchant (supply) function. Details on Direct Energy's plans to remove the EDC from this function can be found in answer to Question 7.

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market was just beginning to blossom. *Id.* So, it remained possible that, in the future, ComEd's customer care costs could differ from what they are now, in terms of the amounts involved and the types of services involved. *Id.* at 210-211. Thus, the ICC concluded that issue should continue to be explored in the future as market conditions evolve. *Id.*

[67] Under the Texas model, the default provider is the Provider of Last Resort (POLR). This is a retail electric provider, certified by the Texas PUC, to provide basic, standard retail service to requesting or default customers. A default customer is one who is automatically assigned to the POLR because the customer's retail provider no longer serves the customer. This service is priced above market to discourage customers to stay on it for an extended period of time. The service is intended to be a *temporary* resting place until the customer chooses another supplier. There was never was a time when the utility acted as the default service provider (even during the transition period).

[68] Direct Energy's proposal for full unbundling is designed so as not to cause the EDCs any economic harm by incurring stranded costs. See the answer to Question 7.

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

There are two significant "unintended consequences" of the EDC providing default service and related products, which both accrue to the advantage of the EDC's affiliated EGS, giving them a competitive edge against EGSs who do not enjoy such advantages.

a. Brand Recognition Is Strengthened

Default service provides an advantage to the incumbent EDC and its generation affiliate(s). The continuation of generation service by the EDC allows the EDC to continue to build name recognition for its "brand" which, in turn builds name recognition for its affiliated generation service. Moreover, by continuing to offer a similar product, the affiliated supplier is better able to convey the impression that its product is positively associated with the "utility service" that the customer has always used. This relationship is particularly evident in the Ohio market. In the Duke Energy of Ohio service territory, 73% of generation load continues to be served by Duke Energy Ohio as the default supplier or its affiliate Duke Energy Retail after 10 years of deregulation. The advantage of its affiliate is demonstrated by the fact that Duke Retail serves 60% of the switched load with the remaining 40% of switched load divided among the other 15 competitors active in the marketplace.[69] The situation is even worse in the service territory of DPL where 95% of the load is served by either DP&L as the default supplier (53%) or its affiliate DPL Energy Resources (42%). DPL Energy Resources serves 89% of the

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[69] Duke Energy, "First Quarter Earnings Review and Business Update," May 3, 2011.

switched load with the remaining 11% of switched load divvied between the other competitors active in the marketplace.[70]

An affiliated EGSs can attempt to leverage the EDC's brand and the EDC's long term relationship as the customer's distribution and default service provider. As a rule, the EGS has been in existence or a shorter period of time than the EDC. In turn, the EGS has fewer long-term customers relationships than the EDC. But, brand identification with the EDC can also lead to confusion or a misunderstanding that the service provided by the affiliated EGS is somehow more reliable, economic or safer. Brand identification can also create a competitive advantage for the affiliated EGS, which, generally speaking, tend to be the most successful in its affiliated EDC service territories. This appears to be happening in Ohio where FirstEnergy Solutions ("FES"), the affiliated EGS of FirstEnergy, makes more than 80% of all retail sales in its affiliated Ohio franchise service territory, either as default service provider or as the EGS supplier.[71]

Thus, the EDC family of companies is given two (or more) opportunities to "win" customers in the competitive market. Because the deck is stacked in favor of EDC-related service, customers will not be receiving the benefits of a truly competitive market. They will instead face a future where, to paraphrase Henry Ford (with only slight overstatement), they will be able to choose any electric supplier they want – as long as it is from an EDC or EDC affiliate.

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70 DPL, "First Quarter 2011 Earnings Review."

71 *See* footnote 13, *supra.*

b. Incentive of EDC to Keep Customers on Default Service

Default service is provided as a pass through to customers by most EDCs. Accordingly, when acting in the role of DSP, most EDCs have no ability to "profit" or otherwise earn a return of the provision of default service. Yet, in many instances, the EDC/DSP oppose transferring the default service function and migrating customers to the competitive market. Why?

One possible reason may be that the current default service structure provides a "market" for the EDC's generation affiliates. A large default service load provides a large and relatively low risk demand for their generation assets. The unintended consequence of this procurement structure is the creation of a disincentive on the part of the generation supplier's utility parent to support any changes in the default service structure pricing or provisioning that would materially reduce the number of small customers being served by default service. This strong interest in maintaining a large default service load that can, at least partially, be served by its generation affiliate may be why EDCs also appear to have a strong interest in maintaining the status quo, even though the EDC itself does not profit from the provision of default service.

In fact, one prong of FirstEnergy's retail marketing strategy in Ohio is to provide generation service to default customers by being the winning bidder in the FirstEnergy affiliated EDC default service auctions.[72] Obviously this prong of its marketing strategy

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72 *FirstEnergy Merger*, RESA St. 1, at Exhibit RJH (at OCA-I-1, Attachment FE 1-22); Joint Applicants' St. 1-SR Attach. 1, p. 50.

is entirely dependent upon there being a significant number of default service customers. So, FirstEnergy has a clear incentive to keep customers on default service.

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)?

a. Default Service Should Not Continue In Its Current Form

Direct Energy submits that the nature and structure of default service must change if the retail electric markets are ever going to be fully and workably competitive. As discussed in greater detail in answer to Questions 1 and 2, continuation of the current structure of default service will consign two-thirds of Pennsylvanians to a dysfunctional competitive market that will be subject to domination by EDCs and their affiliates. This will rob those customers of the extensive benefits of a robust competitive market: lower prices and innovative products and services. A market cannot be characterized as "effectively competitive" where: a) virtually no Residential or Small Business customers are shopping and only a handful of suppliers are doing business in the FirstEnergy service territories three months after the removal of all rate caps; b) only around 20% of customers are shopping in PECO and Duquesne, even though, with respect to Duquesne, the markets have been fully open for almost a decade; and, c) in PPL,[73] while there is some reasonable levels of shopping the competitive offerings remain focused on "price-discounts" and do not reflect the kind of value-added services that reflect significant capital investment and are the hallmark of a permanently competitive market.

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[73] *See* Direct Energy's response to Question 1, at ¶ (c)(i).

Direct Energy submits that appointing an alternative supplier (or suppliers), other than the utility, is a step towards getting customers educated about electric competition and their available choices beyond mere reliance on their traditional utility supplier. This is a *first step* in the process of helping them become active, educated consumers. The biggest single barrier to switching in the energy marketplace is default service. This is because the customer must do something in order to "opt-off" it and switch. If the customer does nothing he still gets electricity delivered to his home uninterrupted. This is one of the features unique about the energy market that tends to favor the existing utility default supplier. For almost any other service a consumer considers a necessity, or otherwise part of their monthly bill pile, the customer must enter into some form of term contract and make a conscious choice of the supplier of that service. As a result of these regular conscious decisions consumers become more educated about competing suppliers and offers in the marketplace and become more confident about their decision to go with a particular supplier and plan. Cellular phone service is a prime example of how a prior regulated monopoly service (long distance service) has not only become highly competitive in terms of the suppliers and products in the marketplace but how consumers have become educated to shop and select among a large variety of sophisticated service plans that require more involvement than simply paying the bill to AT&T each month for the black phone in the kitchen.

b. Does default service impede competition or otherwise prevent customers from choosing electricity products and services tailored to their individual needs?

As discussed in answer to Question 2, default service as currently structured plainly impedes the development of full competition and prevents customers from being

offered a full range of products and services that become available when a market is fully competitive. The best evidence of that is to compare the types of products and services being offered by EGSs in Pennsylvania and those that are available in Texas, the most competitive market in the U.S. Some of the value-added products offered by Direct Energy in Texas are described in response to Question 1. In contrast, in no Pennsylvania market has an EGS been able to attain the economies of scale and scope that has resulted in the capital investment that would permit the offering of wide-ranging value added services and products.

c. Does default service provide an advantage to the incumbent EDC and/or its generation affiliate(s)?

As extensively discussed in answer to Questions 2 and 3 the current structure, cost allocation and pricing of default service, together with customer status quo bias, and rules for new and moving customers that discriminate in favor of default service provide significant advantages to the incumbent EDC in maintaining customers on default service. A large default service load provides an attractive market for the EDC's wholesale generation affiliate (thus providing the company with a clear reason for wishing to perpetuate the existing discriminatory structure). The EDC's provision of default service also helps to maintain the reputation of the EDC as the reliable and safe electricity provider, a reputation that gives an advantage to the EDC's affiliated EGS in marketing to customers.

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?**

a. Can/should the default service role be fulfilled by an entity, or group of entities, other than the EDC?

As an ultimate goal, the Commission should establish that the default service role can, and should be fulfilled by an alternative supplier approved by the Commission. The existence of default service is legislatively mandated.[74] But, the Competition Act (and the Commission's regulations) plainly allows for an ADSP.[75] The statute leaves to the Commission's discretion the decision to replace the EDC as default supplier. The use of an ADSP would break the inherent bias in favor of the EDCs' default service and expose customers to the competitive market. Transferring this responsibility would also mitigate the EDC's retail market power, and bring a sufficient number of non-affiliated service providers into the market to reduce the merged company's ability to dominate the market.

It should be noted that nothing in the establishment of an ADSP is intended to, or will actually, deprive customers of the benefits and protections afforded by Act 129 of 2008 ("Act 129"). The ADSP would need to comply with default service procurement requirements of Act 129. With an ADSP, few customers should remain on default service. This means that most, if not all, customers will be served by competitive electric generation suppliers. In that instance, the only "prudent" or "wise or judicious" mix of

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74 66 Pa. C.S. § 2807(e); 52 Pa. Code §§ 54.181, *et seq.*

75 *Id.*

supply for those few customers who likely will remain on default service would be real-time spot market procurement. It would be unwise, frivolous and very expensive to procure what would effectively be long-term options at a fixed price for such a small number of customers. Moreover, this approach will produce the lowest prices for default service over time. Short-term prices, over time, yield lower prices than longer-term contracts because such a procurement strategy avoids risk premiums for market price changes as well as volume and migration risk. The best evidence that a short-term pricing mechanism will, in fact, be sufficiently stable for customers is the results in Pike County, where default customers have been taking default service using a spot market pricing mechanism (three month average spot market prices with a true up) for some time. The true-up decreases price volatility, which can result in price spikes one month followed by significant decreases the next. Thus, it is possible for the ADSP to procure, through a competitive process (the PJM spot market), a "prudent mix" of electricity that meets the least cost over time standard and takes into account the benefits of price stability.

Additionally, it should be noted that the transfer of the role of DSP from the EDC to an EGS should not create operational issues for the electric grid. PJM[76] must keep the electric grid operating in balance by ensuring there is adequate generation to satisfy the demand for electricity at every location in the region both now and in the future. PJM's markets for energy and ancillary services help maintain the balance now while the PJM market for capacity aims to keep the system in balance in the future. Participation in the

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[76] PJM is a FERC approved RTO charged with ensuring the reliability of the electric transmission system under its functional control and coordinating the movement of wholesale electricity in all or parts of thirteen states and the District of Columbia, including most of Pennsylvania and New Jersey.

PJM capacity market allows a company (such as the EDC or an EGS) to monetize its ability to reduce demand for electricity and to monetize energy efficiency measures they have implemented. Thus, PJM functions as the ultimate backstop to the DSP – whether that role is provided by the EDC or an EGS.

b. 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)?

The Competition Act, as well as the Commission's existing regulations allow consideration of a non-EDC as the provider of default service. "The Commission may reassign the default service obligation for the entire service territory, or for specific customer classes, to one or more ADSPs when it finds it to be necessary for the accommodation, safety and convenience of the public."[77]

The Commission has determined that it will use a competitive process to determine the ADSP.[78] This process shall be as follows:

> (1) An entity that wishes to be considered for the role of the ADSP shall file a petition under 66 Pa. C.S. § 2807(e)(3) (relating to duties of electric distribution companies).
>
> (2) Petitioners shall demonstrate their operational and financial fitness to serve and their ability to comply with Commission regulations, orders and applicable laws pertaining to public utility service.
>
> (3) If no petitioner can meet this standard, the incumbent EDC shall be required to continue the provision of default service.
>
> (4) If one or more petitioners meets the standard provided in paragraph (2), the Commission will approve the DSP best able to

77 52 Pa. Code § 54.183(c).

78 52 Pa. Code § 54.183(c), (d).

> fulfill the obligation in a safe, cost-effective and efficient manner, consistent with 66 Pa. C.S. §§ 1103 and 1501 (relating to procedure to obtain certificates of public convenience; and character of service and facilities) and 2807(e).
>
> (5) A petitioner approved to act as an ADSP shall comply with applicable provisions of the code, regulations and conditions imposed in approving the petition to act as an ADSP.[79]

Importantly, the PUC's regulations do not require that the Commission find that the existing EDC is unfit to provide the default service role. The regulations merely state that the Commission should make a "finding" about the fitness of the service provided by the default service provider.[80] And the statute makes no reference to fitness. Indeed, Direct Energy does not believe that any of the EDCs in Pennsylvania are not financially or operationally capable of acting as the DSP; that's not the issue. The issue is whether transferring the default service role would advance the public interest by enabling the development of a workably competitive market. There is no question that such a step would have a salutary effect on competition and thus such a move should plainly satisfy the public interest standard.

c. Are different approaches appropriate for different customer classes?

As discussed in answer to Question 1, the pace of competitive development has varied depending upon the customer class. The competitive market is more robust for large business customers, while the opposite is true for the Residential and Small Business classes. In part this is likely due to the fact that large business customers are more sophisticated and can avail themselves of resources in order to identify options and

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79 52 Pa. Code § 54.183(d).

80 52 Pa. Code § 54.183(c).

strategies that will reduce their costs and maximize profits. Moreover, the decision to serve most large business customers from the hourly spot market and to price the service accordingly, has resulted in much more market-reflective pricing, which has undoubtedly enabled EGSs to make competitive offers that were beneficial to customers. Accordingly, transferring default service role to an alternative provider could occur almost immediately for all large business classes and in all service territories in the Commonwealth.

While the large business markets are reasonably competitive, leaving the large business default service responsibility with the EDC may well continue to provide the EDC's affiliates a competitive advantage. The EDC's continued role as the default service provider creates name recognition and brand loyalty that gives the EDC's affiliated EGS an unfair competitive advantage in competing for customers in the service territory of its affiliated EDC. Thus, the default service role should be transitioned away from the EDC as soon as possible for this class, as well as for all customers.

Direct Energy also anticipates that the nature of the service provided by the non-utility DSP would vary by customer class and would also depend on the type of transitional mechanisms used by the Commission in moving to a non-utility DSP. Direct Energy strongly endorses continuation of hourly service for those customers who would be eligible only for such service under their current default service plans. For smaller customers, the specifics of the default service for which they would be eligible should be determined in the Phase II Investigation. Should the vast majority of smaller customers be transitioned away from default service in advance of the transfer of the responsibility to a new entity, Direct Energy continues to believe that a default service based on hourly

prices (which would be a monthly variable price for non-interval metered customers) would represent the least cost service over time. Other transitional scenarios might require a different result, but in no event should the use of highly-laddered procurement strategies continue.

d. What criteria should be used to ensure that EGSs are qualified to assume the default service role and maintain reliable service?

From an operational standpoint, the process of procuring and supplying generation for default service is largely handled by PJM, with the default service provider's main responsibility to act as "middleperson," purchasing the electricity from the wholesale market, collecting payments from retail customers and passing them on to the wholesale providers. Thus, the DSP's duties are largely to make the financial arrangements. The primary requirement for any alternative ADSP, therefore, would be to demonstrate that it had the necessary financial assets to participate as a load serving entity in PJM and to satisfy those extremely rigorous financial requirements. Those credit and bonding requirements will provide assurances that all wholesale generation providers would be held harmless if the ADSP became insolvent or otherwise did not live up to its PJM obligations.

While this should mean that retail customers would also be protected, the Commission could also impose credit and bonding requirements to similarly assure that retail customers would be held harmless in the event of an ADSP failure. The ADSP would be required to post a bond or other security so that, in the unlikely event that the ADSP stopped operating or became insolvent, any immediate financial responsibilities

would be covered. The Commission could then quickly transfer the ADSP role to another entity.

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?

There are three steps that should be considered by the Commission to achieve a properly functioning and robust competitive retail electricity market:

a. Progress Towards Competitive End-State

The Commission should declare that its overall and long term goal is a retail electric market in which most customers are receiving service from competitive suppliers, the EDC is removed from the default service function and default service is reset to serve truly as a "back-up" service. It is crucially important that the Commission establish this "end-state" goal because it will help to keep the process on track and avoid time consuming attempts to side track and delay the process. It will also provide the ability to judge the efficacy of any policy or operational decisions that are required in the interim: "Will this step advance the end-state goal of full competition and EDC exit from the default function?" If the answer is no then that proposed policy must be rejected.

The most immediate and direct way to accomplish that would be to order: 1) the removal of the EDCs from the role of DSP and its transfer to alternative qualified entity (or entities) via a RFP or other process selected by the PUC; 2) the transfer or assignment of customers from default service to a competitive supplier via opt-out auctions (where customers after being transferred, would be free to switch to other EGSs without penalty); and 3) the restructuring of the new default service as a back-up, with power

procured and priced on a real-time hourly basis. Each EDC would initially provide billing and collection, via its POR program, to each EGS serving customers as a result of the auction, but, ideally, a separate "Billco" would be established to provide these (as well as other functions) to the EGSs.

Direct Energy firmly believes that this combination of actions is the best, most efficient and quickest way to create a market in which competitive companies are the main providers of service and default service continued to exist only as a true "back-up." Transferring the default service role to a separate entity not affiliated with an EDC would remove or mitigate many of the barriers discussed herein. In a competitive market, the right to serve default customers should not be regarded as an inherited right of the EDC, but should be won through a competitive process that benefits consumers. An opt-out customer auction would transfer customers to the competitive market and provide both immediate benefits, in the form of an EGS-provided acquisition payment, as well as long term benefits from the creation of a robustly competitive market where customers would save money, enjoy a variety of "value added" products and services, and have the benefit of true choice.

It is clear that the decision to award all of the non-switched customers to the EDC represents between $600 million and $2 billion dollars in lost value to consumers, based on the $150 to $500 rebate check that could accrue to customers per the Direct Energy auction proposal. Moreover, although opponents to this plan may think they perceive lack of interest by consumers, in fact, 89% of FirstEnergy and Allegheny Power residential and small business customers support the plan, along with 82% of PPL,

PECO, and Duquesne residential and commercial customers. Clearly, over-whelming support for this proposal.[81]

Direct Energy submits that these steps should be ordered now, in order to bring the benefits of competition to Pennsylvania customers as quickly as possible.

b. "Transition To "Competitive Excellence" Before Removal Of The EDC From The DSP Role

The Commission might conclude that the level of competition in some areas of the Commonwealth or for some rate classes, is not sufficiently developed such that customers might not yet have sufficient experience with or be comfortable receiving service from competitive suppliers. If so, the Commission could consider a transition plan that would consist of immediate efforts to increase the level of competition and the establishment of an outside date certain when the EDC would be removed from the default service role and customers would be served in the competitive market (as described above). Such a transition plan should contain the following elements:

- Establish an "outside date certain" when the Commission intends to transfer the default role from the EDC to one or more ADSPs and to transfer any remaining customers on default service to competitive supply via opt out auctions. Direct Energy suggests that June 1, 2013 is an appropriate "not to exceed" date. This date is appropriate because it would synch the transfer of the default function with the start of the next default service supply periods, thus assuring that the Commission would not have to attempt to "unwind" default service supply contracts entered into by the EDCs in its default service provider role or wait several years until the new default service plan period is completed.

- After the completion of the Phase II Investigation, immediately order the initiation of "Competition Enhancing Steps" (including, but not limited to, those described below) designed to increase competition in each of the

81 *See* Question 13 of the 2010 Zogby Survey (Appendix A) and Question 15 of the 2011 Zogby Survey (Appendix B).

EDC service territories. The specifics of each step, plus any other measures the Commission finds would further the end state goal described above, should be established in the Phase II Workshops and should be implemented as quickly as possible, but no later than January 1, 2012.

- Six months prior to the date-certain for the transfer of the default service function to an ADSP, the Commission should conduct a review of the level of competition present in each EDC service territory and for each customer class. The customer class review should examine residential, small commercial (25 kv and below) medium commercial (all other commercial customers not receiving hourly priced default service) and large commercial and industrial customers (served by hourly priced default service). In instances in which only a relatively small low level of customer load (or customers) remain on default service (to be determined by the Commission) the default service function should be transferred to one or more ADSPs (pursuant to a Commission established and supervised RFP process) together with the remaining default service customers.

- In instances in which the Commission finds that a majority of customer load (or customers) continue to be served by the EDC-provided default service, then the Commission should order opt-out customer account auctions in which EGSs that agree to participate would bid to serve tranches of default service customers who do not opt out of participation of the Commission-approved and supervised auction (after being transferred in the auction, the customers would not be subject to any minimum stay provision or contract termination fee). The rules for the auction would be determined by the Commission in Phase II. A remaining "back-stop" default service, to be provided by an ADSP or ADSPs selected by the PUC, would be priced on a real time hourly basis and be available as a temporary service for customers who are transitioning from one supplier to another or whose supplier exited the market.)

c. Take Interim, Competition Enhancing Steps Prior to Ordering the EDCs' Exit From the Default Service Function

The following is a list of possible competition enhancing steps that the Commission could order to enhance the level of competition prior to ordering the steps that would more directly address the problem – removing the EDC from the merchant function. These steps admittedly do not address head on this core problem, but these "tweaks" could serve to improve competition and lessen the dependence on default

service that the great majority of Residential and Small Business customers (as well as a surprisingly large number of medium commercial, and even, in some service territories, large industrial and commercial customers) continue to demonstrate by their non-action and failure to take advantage of the money savings opportunities that exist in the competitive market. Such "incremental steps" could include:

- Requiring an "applicant" (i.e., as defined in the Public Utility Code) or a "change" (i.e., a customer moving from one part of the service territory to another) to select a competitive supplier (leaving the EDC-provided default service available only if the applicant/customer specifically asks for it).

- Unbundling and allocating ALL costs associated with the provision of default service,[82] including costs that will only be variable in the longer or medium term (such as billing and customer care). Include those costs in the price to compare. As customers switch to competitive supply reassign these "long term variable costs" to a non-bypassable recovery mechanism, to be recovered from all distribution customer. In this way, customers will see the true cost of default service, EGSs will be able to compete on a level playing field, but EDCs will not be unfairly harmed by incurring stranded costs if customers leave default service more quickly than long term variable costs decrease.

- Establishing that EDC's obligation to provide adequate service includes objectively educating customers about the benefits of competition.

- Provide an incentive (i.e., a premium in the company's allowed return on equity) to the EDC in Pennsylvania with the greatest amount of customer switching.

- Ordering of voluntary, opt-in auctions in which customers could choose to be part of the aggregation pool in return for receipt of a "switching premium" offered by participating EGSs or a promotional rate that is less than the rate available in other contexts.

- Revising default service pricing to make it more market-responsive. The Commission should order that greater reliance on spot market purchases will be used in default service procurement. Additionally, customers who

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82 The presence of the regulated revenue stream creates an credit advantage for the EDC. In Phase II, there should be discussion of mechanisms to reflect that cost in the default price.

leave default service and shop and then desire to return could be subject to hourly spot market or three month contract pricing. This would not only result in a greater market responsiveness for default service overall, it would likely have a positive effect on default service procurement auction prices, as the customer switching risk would be greatly reduced.

- Ordering the development of a coordinated, comprehensive consumer education effort to be implemented by the Commission, EDCs, and EGSs to address current education and awareness barriers, as well as the development and implementation of education plans to support any transitional measures identified in Phase I and II. The plan should include focus groups, surveys and social media in order to start a dialogue with customers to discover what competitive improvement steps would best meet their needs.

- Creating customer migration incentives for the EDCs. As was developed by the New York State Public Service Commission to help align electric and gas utility interest to transition to a competitive marketplace, per customer migration incentives should be developed which would allow EDCs to recover these via an over-earnings sharing mechanism or in the allowed rate of return on equity.

The Phase II process should encourage stakeholders to propose other innovative solutions designed to increase customer shopping and strengthen the competitive market prior to June 1, 2013. Indeed, active and sincere participation by the EDCs may well elicit valuable ideas that they have become aware of due to their position as default service provider.

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

The elimination of barriers to retail electricity competition should provide rate relief, create and retain jobs, and establish a favorable environment for new businesses to locate in the state and stimulate the overall economy. As discussed in response to Question 7, the are many options available to effectuate the transition between the current regulatory regime to a more competitive electric market.

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?

Direct Energy believes that the PUC has authority to implement all of the changes that it has proposed above. Moreover, as discussed in answer to Question 1, above, modifications to improve the competitiveness of the retail market would be consistent with the policy of the Commonwealth to promote competition.

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?

As discussed in answer to Question 9, Direct Energy does not believe that the changes that it has proposed require changes in the law. However, the Commission should reserve this question until the completion of Phase II. At that point, and after thoroughly studying the various options to transition to full EDC exit from the default role, it might identify competition enhancing steps that it believes should be enacted which require legislative changes. It could advance those changes to the General Assembly at that time.

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

Direct Energy believes that smart meters, and related technology, combined with supportive policy have significant potential to benefit consumers and improve the efficient management of resources. However, poor policy choices that erect barriers for competitive suppliers would be destructive to retail competition and limit the ability to optimize these technologies' potential.

In compliance with the provisions of the smart meter technology portion of Act 129,[83] the Commission directed jurisdictional EDCs with greater than 100,000 customers to submit for approval a smart meter plan.[84] EDCs can recover smart meter technology costs on a full and current basis through a reconcilable automatic adjustment clause.[85] The Competition Act also provides that the DSP shall offer rates to use smart meter technology.[86] Competition in this area should not be limited to just the utility.

The rollout of smart meters across Pennsylvania is underway. There are a number of elements in these rollouts, beyond ratemaking, which will help reach full potential of the technology, as well as support the competitive market. These elements, however, are not always consistently applied across the EDCs.[87] There are a number of different aspects which must be addressed to reduce barriers, outlined in **Table 1** below.

Smart meter deployments will improve the efficient management of energy resources and may enable the provision of high value added products and services. Direct Energy is broadly supportive of the move to smart meters as a means to provide consumer benefits and to support new business opportunities. Opportunities enabled by smart technologies include energy products based on time-of-use; demand response and demand side management; integration of distributed generation and electric vehicle technologies; and new technology installation, financing and servicing.

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83 66 Pa. C.S. §§ 2807(f) and (g).

84 *Smart Meter Procurement and Installation*, Docket No. M-2009-2092655, Implementation Order (entered June 24, 2009).

85 66 Pa. C.S. § 1307.

86 66 Pa. C.S. § 2807(f)(5).

87 PPL has ISO settlement with interval smart meter data rather than utility load profile, incenting more efficient usage of energy from the supplier and consumer. It is not clear this element is a part of all Pennsylvania EDCs at this time.

Smart meters should be deployed and implemented in a way that: (1) supports the competitive marketplace; (2) acknowledges customer ownership of meter data and the ability to assign data access to third parties; (3) provides fair cost recovery mechanisms which ensure benefits are realized by those who bear the costs; and (4) ensures that the deployment plan is the most efficient possible and the requirements for cost-recovery are adequately defined (in terms of minimum features) and will support product development.

Table 1

Policy area	Key point to address	Details
Meter data	Customers should own their own data	• Customers should own their data and be able to assign it to third parties • Once assigned, meter data should be available without a fee or wet signature requirement to obtain this information • Meter data should be accessible through an open standards-based protocol • Third parties should be given rights to real-time aggregated system data to optimize system load management
Third party meter access	Third parties should be able to send signals through the meter to enable load management	• Direct Energy supports third party access to two way communication with the meter. This could be achieved directly or indirectly (via a signal sent to the utility and from the utility to the meter) • Assignment of access to the meter should be aligned with policies implemented for meter data assignment • However achieved, there should be a means for retailers to communicate back through the meter with price signals or to offer services such as residential demand response and direct load control
Timely access to meter data	Meter data are time sensitive	• Third party suppliers should have quick and easy access to customer data through a robust network. Price signals are time sensitive. If there is no guarantee that a price signal will get to the customer or supplier, the ability to offer products and services such as TOU, DR and DLC become limited.
Behind the meter products and services	Regulated entities should not be permitted to provide products and services behind the meter – meter	• Consumer facing services, such as in home devices/displays, should be provided to the customer through a competitive market • Consumer facing services should be mostly funded through private sources of capital, although efficiency related rebates could be used to

	should be demarcation point	offset some costs • It is not a utility's responsibility or legal right to define or regulate activities behind the meter • Utilities should be precluded from offering competitive energy services, which could inhibit innovation and force customers to subsidize undesirable solutions which may potentially become obsolete
Consumer privacy and security	Ensuring privacy of customer data will be critical to the success of smart metering	• Direct Energy strongly supports policies which enable competitive solutions as well as those which protect consumers' privacy - methods should be found to ensure both. Multiple successful precedents exist in banking, telecommunications, cable, and health care industries, among others • Privacy should extend to the behind the meter technologies adopted in the home • Customers should be free to adopt their choice of technology in the home and utilities should not be able to mandate registration or access to these technologies without a customer's permission
Customer switches, moves and disconnects	Policies related to customer switches should be adapted to reflect enhanced technological capabilities	• All policies around advanced meter related transactions (moves, switches, disconnects, reconnects, etc.) should be revisited to reflect the progressive reduction in time and costs resulting from improved technological capabilities associated with smart meters. This is consistent with the goal to fully provide the benefits and functionality of smart meters to consumers
Meter tampering and theft	Utilities should be responsible for the full costs associated with meter tampering and theft	• Any meter tampering and the resulting financial burden should be the responsibility of the utility because the utility has the ability to recover for its losses by socializing costs and to institute a "hard disconnect" of customers.
Wholesale load settlement with interval data	Wholesale load settlement with interval data is required to enable innovative products based on time of use	• Following smart meter deployment, wholesale settlement between suppliers and utilities should be based on interval data rather than using the historic settlement process against load profiles • Wholesale load settlement with smart meter data will foster new products and services based on time differentiated pricing • Absent wholesale settlement, the benefits of shifting load to off peak may not be realized by consumers and suppliers
Regulated energy rates	Smart meter deployments should not be used by the utility to offer 'regulated choice'	• Utilities should not be allowed to offer multiple regulated rate offerings to a given customer • The competitive market alone should provide energy choice offerings • To the degree regulated choice is permitted, materials detailing these

		regulated choices should include a listing of competitive offerings and providers
Customer education	Customer education should include information about customer choice	• Customers paying for smart meters through rate base should be made aware of their expanded choices for managing their energy usage and bills which are enabled through smart meter technologies. Customers should be reminded of their choices in the competitive marketplace in educational materials as new products and services will be made possible through the meter
Platform and technology standards	Systems should be non-proprietary, with common standards and protocols	• Common protocols should be promoted across markets in order to provide the market a common set of principles and requirements around which to build products and ensures reliable and sustainable platforms • Technologies adopted with the implementation of smart meters should be based on open standards and protocols that comply with nationally recognized non-proprietary standards such as ANSI C12.22, including future revisions thereto • Meters should have the capability to communicate with devices inside the premises, including, but not limited to, usage monitoring devices, load control devices, and prepayment systems through a home area network (HAN), provided such devices are based on open standards and protocols that comply with nationally recognized non-proprietary standards such as ZigBee

Many activities associated with smart meter deployment could be performed by unregulated entities through a competitive process. Direct Energy supports competitive options for procurement, deployment, financing, installation and servicing of smart meters as a means to lower overall costs and find the best solutions. However implemented, smart meters have the potential to enable competitive choices and should not be used as a barrier or an alternative to the competitive marketplace.

D. CONCLUSION

The Commission should determine that "effective competition" does not exist in the retail electric market statewide, despite significant efforts by the Commission to enhance the competitiveness of the marketplace in Pennsylvania. The markets in the Commonwealth are progressing only as far as the current structure will allow. Rather

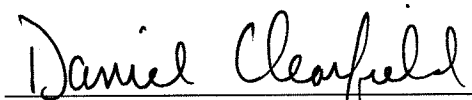
than accept this limited degree of competition, the Commission has the opportunity to set the adjust the default service framework for a successful competitive electric market in a way that that will benefit all Pennsylvanians while ensuring that these customers will have access to reliable competitive service and default service.

Direct Energy believes that the Commission must declare that its "end state" goal for the Pennsylvania retail electric market is one in which customers receive generation service from the competitive market and that a "back-stop" default service is provided by an entity other than the EDC, i.e., the utility should be out of the merchant function for competition to thrive.

Direct Energy recommends the transitional steps and timeline to achieve this end state that are summarized in the Executive Summary and explained in response to Question 7. Direct Energy is available to answer any questions that the Commission may have on these proposals.

Direct Energy appreciates the opportunity to present comments to the Commission's eleven directed questions. These comments have been provided with the objective of ensuring that a properly functioning and workable competitive retail electricity market exists in the Commonwealth. And, Direct Energy looks forward to working with the Commission and other stakeholders to produce a robust and sustainably competitive electric market.

Respectfully submitted,



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Date: June 3, 2011

Appendix A

Zogby International
Results from Pennsylvania Poll
(September 22, 2010)

Polling/Market Research
Public Relations Services
Marketing Strategies

Date: September 22, 2010

To: Ron Cerniglia
Direct Energy

From: Phil Vanno
Zogby International

RE: Results from Pennsylvania poll

Methodology

Zogby International was commissioned by Direct Energy to conduct a telephone survey of energy customers in most Pennsylvania counties.

The target sample is 802 interviews with approximately 29 questions asked from 9/17/10 to 9/20/10. Samples are randomly drawn from telephone lists of specific counties in Pennsylvania. Zogby International surveys employ sampling strategies in which selection probabilities are proportional to population size within area codes and exchanges. Up to six calls are made to reach a sampled phone number. Cooperation rates are calculated using one of AAPOR's approved methodologies[1] and are comparable to other professional public-opinion surveys conducted using similar sampling strategies.[2] Weighting by age, education, and gender is used to adjust for non-response. The margin of error is +/- 3.5 percentage points. Margins of error are higher in sub-groups.

[1] See COOP4 (p.36) in Standard *Definitions: Final Dispositions of Case Codes and Outcome Rates of Surveys.* The American Association for Public Opinion Research, (revised 2008).

[2] *Cooperation Tracking Study: April 2003 Update*, Jane M. Sheppard and Shelly Haas. The Council for Marketing & Opinion Research (CMOR). Cincinnati, Ohio (2003).

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Narrative Summary

1. Who is your current electric utility company?

Pennsylvania Electric Co.	31%
Allegheny Power	29
Metropolitan Edison	18
Penn Power	5
Other*	15
Not sure/None	2

***(Number in parentheses denotes frequency of similar response)**
FirstEnergy (11); REA Energy (10); Northwestern REC (9); Adams Electric (8); United Electric (8); Claverack (7); Tri-County REC (5); Wellsboro Electric (5); Borough (5); Central Electric (3); Royal Electric (3); Somerset REC (3); PPL (3); Warren Electric (3); TP Electric (2); Valley REC (2)
One each: Duquesne Light; Elwood City Electric; GPU; National Fuel; Ohio Edison; Bedford REC; Southwest Central REC; UGI

Most of the people surveyed have either Pennsylvania Electric Co. (31%) or Allegheny Power (29%) as their electric utility company, but 18% also have Metropolitan Edison.

2. Have you ever considered switching to another electricity supplier?

Yes	20%
No	64
I didn't know that was possible	15
Not sure	1

About two thirds of respondents (64%) say they have never considered switching to another electricity supplier, while a fifth (20%) say that they have considered doing so. Fifteen percent didn't know it was possible to switch suppliers.

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3. How important do you think it is to be given more choices when deciding on an electricity supplier?

Very important	51%	**Important**	**89%**
Somewhat important	37		
Somewhat unimportant	4	**Unimportant**	**10**
Not at all important	6		
Not sure	1		

Nine in ten respondents (89%) think it is important to be given more choices when deciding on an electricity supplier, half of which (51%) say it is very important.

4. Right now, electricity customers who don't choose an alternative supplier are provided electricity by the local utility. Would you support or oppose allowing a company other than the utility company to provide that service if all of the consumer protections that exist today continued to apply?

Strongly support	46%	**Support**	**84%**
Somewhat support	38		
Somewhat oppose	4	**Oppose**	**10**
Strongly oppose	6		
Not sure	6		

A very large majority (84%) say they would support allowing a company other than the utility company to provide electricity to them as long as all the consumer protections that exist today continued to apply. In fact, 46% say they would strongly support allowing that to happen.

5. Direct Energy, a competitive electricity supplier headquartered in Pittsburgh, is proposing a plan it says will drive down rates by increasing competition. Would you support or oppose such a plan?

Strongly support	63%	**Support**	**91%**
Somewhat support	27		
Somewhat oppose	3	**Oppose**	**5**
Strongly oppose	2		
Not sure	4		

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Nine in ten (91%) respondents would support Direct energy's proposal to drive down electricity rates by increasing competition, nearly two thirds of which (63%) say they would strongly support it.

6. If you knew that part of the plan involves a competitive process, that you can choose not to participate in, in which electricity suppliers would win the right to provide service by bidding on customers, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

Much more likely	23%	**More likely**	**36%**
Somewhat more likely	13		
Somewhat less likely	6	**Less likely**	**12**
Much less likely	6		
No difference	44		
Not sure	8		

About a third of respondents (36%) say that knowing part of the plan involves a competitive bidding process in which electricity suppliers would win the right to provide them service, but in which they do not have to participate, makes them more likely to support the Direct Energy proposal. However, 44% say that knowing that information makes no difference in their decision.

7. If you knew that the utility company's response to outages and other service emergencies would remain unchanged would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

Much more likely	27%	**More likely**	**45%**
Somewhat more likely	18		
Somewhat less likely	2	**Less likely**	**3**
Much less likely	1		
No difference	51		
Not sure	1		

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Knowing that the utility company's response to outages and other service emergencies would remain unchanged under Direct Energy's proposal would make 45% of respondents more likely to support, 27% of which say it would make them much more likely to do so. However, half (51%) say that knowing that bit of information would make no difference to them.

8. If you knew that once you are selected by a new electricity supplier, you would be free to choose a different provider without paying any switching fees, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

Much more likely	50%	**More likely**	**75%**
Somewhat more likely	24		
Somewhat less likely	1	**Less likely**	**1**
Much less likely	<1		
No difference	23		
Not sure	1		

Three quarters (75%) would be more likely to support the Direct Energy proposal if they knew that once they are selected by a new electricity supplier they would be free to choose a different one without a switching fee. In fact half (50%) say that knowing that tidbit would make them much more likely to support the proposal. A quarter (23%) says that having that information would make no difference to them.

9. If you knew that you would receive a rebate check ranging from $150 to $500 from the electricity supplier who selected you as a customer, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

Much more likely	47%	**More likely**	**68%**
Somewhat more likely	22		
Somewhat less likely	2	**Less likely**	**4**
Much less likely	2		
No difference	25		
Not sure	2		

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Knowing that they would receive a rebate check of $150 to $500 from their new supplier would make two thirds (68% more likely to support Direct Energy's plan, nearly half of which (47%) say they would be much more likely to do so. A quarter (25%) say that knowing about the rebate would make no difference to them

10. In this current economic climate, do you agree or disagree that a $150-$500 rebate check would make a difference to you/your family?

Strongly agree	64%	**Agree**	**86%**
Somewhat agree	23		
Somewhat disagree	5	**Disagree**	**13**
Strongly disagree	8		
Not sure	1		

A very large majority (86%) agree that in this current economic climate, a $150-$500 rebate check would make a difference to them, nearly two thirds of which (64%) strongly agree.

11. In this current economic climate, do you agree or disagree that a $150-$500 per customer rebate check, totaling approximately $300 million to $1 billion for all customers would help stimulate spending in Pennsylvania?

Strongly agree	48%	**Agree**	**78%**
Somewhat agree	30		
Somewhat disagree	9	**Disagree**	**17**
Strongly disagree	8		
Not sure	6		

About three quarters (78%) agree that in this current economic climate, a $150-$500 rebate check, that would total approximately $300 million to $1 billion for all customers, would help stimulate spending in Pennsylvania, nearly half of which (48%) strongly agree.

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12. If you received a $150-$500 rebate check from the electricity supplier that selected you, and you were able to spend it on anything, which of the following things would you choose?

Save for a rainy day	54%
A shopping spree	7
Go out to a nice dinner with family and/or friends at a restaurant in Pennsylvania	6
Family trip to the Poconos or Hershey Park	4
Other*	26
Not sure	3

***(Number in parentheses denotes frequency of similar response)**
Pay bills/Debt (99); Home improvement projects (13); Spend on children/family (13); TV/appliance (8); Donate (6); Education/college (6); Taxes (4); New vehicle (3); Groceries (3); Investments (3); Gamble (3); Christmas (2); Sports (2); Luxury (2); Camping/Hunting/Fishing (2); Out-of-state travel (2); Combination of things (2); Gardening supplies, Wood, Normal day-to-day living

Half of respondents (54%) say they would save their rebate check for a rainy day.

13. Knowing what you now know, would you support or oppose Direct Energy's proposed plan to increase competition among electricity suppliers?

Strongly support	59%	**Support**	**89%**
Somewhat support	30		
Somewhat oppose	3	**Oppose**	7
Strongly oppose	4		
Not sure	5		

After taking the survey, and knowing what they now know, nine in ten respondents (89%) say they would support Direct Energy's proposal, 59% of which say they would strongly support it.

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Appendix B

Zogby International
Results from Pennsylvania Poll
(June 2, 2010)

IBOPE ZOGBY
international

Date: June 2, 2011

To: Ron Cerniglia
Direct Energy

From: Phil Vanno
IBOPE Zogby International

RE: **Results from Pennsylvania Poll**

Methodology

IBOPE Zogby International was commissioned by Direct Energy to conduct a telephone survey of energy customers in the PECO, PPL, and Duquesne Light territories of Eastern Pennsylvania and Metropolitan Pittsburgh.

The target sample is 800 interviews with approximately 32 questions asked from 5/24/11 to 5/31/11. Samples are randomly drawn from telephone lists of specific counties in Pennsylvania based on electricity supplier. IBOPE Zogby International surveys employ sampling strategies in which selection probabilities are proportional to population size within area codes and exchanges. Up to six calls are made to reach a sampled phone number. Cooperation rates are calculated using one of AAPOR's approved methodologies[1] and are comparable to other professional public-opinion surveys conducted using similar sampling strategies.[2] Weighting by age, education, gender, and race is used to adjust for non-response. The margin of error is +/- 3.5 percentage points. Margins of error are higher in sub-groups.

Narrative Summary*

*Not all numbers add up to 100 due to rounding

1. Who is your electric utility company?

PPL	51%
PECO	31
Duquesne Light	18

Half of those polled are customers of PPL (51%), while 31% use PECO, and 18% Duquesne Light.

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[1] See COOP4 (p.36) in Standard *Definitions: Final Dispositions of Case Codes and Outcome Rates of Surveys.* The American Association for Public Opinion Research, (revised 2008).

[2] *Cooperation Tracking Study: April 2003 Update*, Jane M. Sheppard and Shelly Haas. The Council for Marketing & Opinion Research (CMOR). Cincinnati, Ohio (2003).

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2. Have you switched to a competitive electricity supplier?

Yes	34%
No	66
Not sure	<1

A third (34%) say they have switched to a competitive electricity supplier, but two thirds (66%) have not done so.

3. Which of the following is the main reason you switched electricity suppliers? ***(Choose one)***

Lower price (savings)	88%
Environmental reasons (green power)	3
New supplier offered innovated products and services	2
Budget certainty	1
Don't like my utility company	--
Other*	4
Not sure	2

***(Number in parentheses denotes frequency of similar response)**
Family/friend recommended (2); No switching fee; Just moved; Went with coal

The vast majority of those who have switched say the main reason was to save money on lower price (88%).

4. Which of the following is the main reason you have not switched electricity suppliers? ***(Choose one)***

Not enough savings to make it worth my while	23%
I don't understand the whole process and don't want to be bothered	17
I am loyal to my current company and don't want them to lose business	15
It's simply too much of a hassle	11
I didn't know it was possible	9
I am afraid I would become a lower priority and would receive unreliable service	3
Other*	19
Not sure	2

***(Number in parentheses denotes frequency of similar response)**
Satisfied with current company/No reason to switch (18); Haven't had the time/gotten around to it (13); In the process of researching (12);Don't trust/think rates will increase after switch (7); No real reason/Just haven't (7); Have special rate/deal with current company (5); Just moved/Will be moving (4); More secure with established company/Question reliability (4); Work for current company/Own stock (3); Live in complex/co-op (2); I have no control over it (2); It's all the same (2); Have solar panels; Not possible; Switched to Dominion; On the fence; Pay bills for my dad and he doesn't want to switch

Of those who have not switched, most say it is because there is not enough savings to make it worth their while (23%), followed by not wanting to be bothered because they don't understand the process (17%), being loyal to their current utility company (15%), and felling it is too much of a hassle (11%). Nine percent say they didn't know it was possible to switch.

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5. How important do you think it is to be given more choices when deciding on an electricity supplier?

	Important			Unimportant			
	Very	Somewhat	**Total**	Somewhat	Not at all	**Total**	Not Sure
May 2011*	52	34	**86**	4	9	**13**	1
Sept. 2010**	51	37	**89**	4	6	**10**	1

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

A vast majority (86%) thinks it is important to be given more choices when deciding on an electricity supplier, half of which (52%) say it is very important. This is on par with the importance respondents assigned in the September poll (89%).

6. Right now, electricity customers who don't choose an alternative supplier are provided electricity by the local utility. Would you support or oppose allowing a company other than the utility company to provide that service if all of the consumer protections that exist today continued to apply?

	Support			Oppose			
	Strongly	Somewhat	**Total**	Somewhat	Strongly	**Total**	Not Sure
May 2011*	43	36	**78**	6	7	**13**	8
Sept. 2010**	46	38	**84**	4	6	**10**	6

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

About three quarters (78%) would support allowing a company other than the utility company to provide service if all consumer protections applied, with 43% strongly supporting. This is down slightly from the September poll (84%).

7. Direct Energy, a competitive electricity supplier headquartered in Pittsburgh, is proposing a plan it says will drive down rates by increasing competition. Would you support or oppose such a plan?

	Support			Oppose			
	Strongly	Somewhat	**Total**	Somewhat	Strongly	**Total**	Not Sure
May 2011*	52	27	**78**	6	6	**13**	9
Sept. 2010**	63	27	**91**	3	2	**5**	4

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

About three quarters (78%) would support the Direct Energy plan, with half (52%) saying they would strongly support it. This is down 13 percentage points from the September poll (91%).

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8. If you knew that part of the plan involves a competitive process, that you can choose not to participate in, in which electricity suppliers would win the right to provide service by bidding on customers, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

	More Likely			Less Likely				
	Much	Somewhat	**Total**	Somewhat	Much	**Total**	No difference	Not Sure
May 2011*	15	18	**33**	6	7	**13**	45	9
Sept. 2010**	23	13	**36**	6	6	**12**	44	8

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

Most respondents (45%) say that knowing the plan involves a competitive process that they can choose not to participate in, in which electricity suppliers would win the right to provide service by bidding on customers, makes no difference in their support of the Direct Energy plan. A third however (33%) say it would make them more likely to support. The results are nearly identical to the September poll responses.

9. If you knew that the utility company's response to outages and other service emergencies would remain unchanged would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

	More Likely			Less Likely				
	Much	Somewhat	**Total**	Somewhat	Much	**Total**	No difference	Not Sure
May 2011*	27	20	**47**	1	1	**3**	49	1
Sept. 2010**	27	18	**45**	2	1	**3**	51	1

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

Respondents are split over whether knowing that the utility company's response to outages and other service emergencies would remain unchanged would make them more likely to support the Direct Energy plan (47%) or would make no difference in their level of support or opposition (49%). This is about the same as what respondents said on the September poll

10. If you knew that once you are selected by a new electricity supplier, you would be free to choose a different provider without paying any switching fees, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

	More Likely			Less Likely				
	Much	Somewhat	**Total**	Somewhat	Much	**Total**	No difference	Not Sure
May 2011*	44	25	**69**	2	1	**3**	26	2
Sept. 2010**	50	24	**75**	1	<1	**1**	23	1

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

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Seven in ten (69%) say they would be more likely to support the Direct Energy plan if they knew that once selected by a new electricity supplier, they would be free to choose a different provider without paying any switching fees, but a quarter say it would make no difference in their decision. Slightly more respondents would have been more likely to support the plan in the September poll (75%).

11. If you knew that you would receive a rebate check ranging from $150 to $500 from the electricity supplier who selected you as a customer, would that make you more or less likely to support the Direct Energy proposal or would it make no difference to you?

	More Likely			Less Likely				
	Much	Somewhat	**Total**	Somewhat	Much	**Total**	No difference	Not Sure
May 2011*	43	20	**63**	2	4	**6**	28	4
Sept. 2010**	47	22	**68**	2	2	**4**	25	2

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

Nearly two thirds (63%) say they would be more likely to support the Direct Energy plan if they knew they would receive a rebate check ranging from $150 to $500 from the electricity supplier who selected them as a customer, while about a quarter (28%) say it would make no difference in their decision. The number of respondents to say this would make them more likely was slightly more in the September 2010 poll (68%).

12. In this current economic climate, do you agree or disagree that a $150-$500 rebate check would make a difference to you/your family?

	Agree			Disagree			
	Strongly	Somewhat	**Total**	Somewhat	Strongly	**Total**	Not Sure
May 2011*	61	24	**85**	6	7	**13**	2
Sept. 2010**	64	23	**86**	5	8	**13**	1

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

The vast majority (85%) agree that a $150-$500 rebate check would make a difference to them in this current economic climate, six in ten of which strongly agree (61%). The level of agreement in the September 2010 poll was nearly identical.

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*13. In this current economic climate, do you agree or disagree that a $150-$500 per customer rebate check, totaling approximately $600 million to $2 billion for all customers would help stimulate spending in Pennsylvania?****

	Agree			Disagree			
	Strongly	Somewhat	**Total**	Somewhat	Strongly	**Total**	Not Sure
May 2011*	45	33	**79**	7	11	**17**	4
Sept. 2010**	48	30	**78**	9	8	**17**	6

*PECO, PPL & Duquesne Light customers
**Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers
***Was asked as "$300 million to $1 billion" in Sept. 2010

A very large majority (79%) agrees that a $150-$500 per customer rebate check, totaling approximately $600 million to $2 billion for all customers would help stimulate spending in Pennsylvania, 45% of which strongly agree. The level of agreement was the same in the September poll, despite the projected totals being halved.

14. If you received a $150-$500 rebate check from the electricity supplier that selected you, and you were able to spend it on anything, which of the following things would you choose?

	May 2011*	Sept. 2010**
Save for a rainy day	56	54
A shopping spree	5	7
Go out to a nice dinner with family and/or friends at a restaurant in Pennsylvania	5	6
Family trip to a Pennsylvania destination	4	4
Other***	26	26
Not sure	3	3

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

***(Number in parentheses denotes frequency of similar response)**
Pay bills/put toward debt (113); Home improvements/buy things for home (21); Spend on/give to family (13); Food/Groceries (9); Donate/Charity (8); Take out-of-state trip (8); Spend on necessities/something important (4);Gas (3); Invest it (3); Not interested (2); New car; New house; Medicine; All of the above

A majority (56%) say they would save their $150-$500 rebate check for a rainy day, which is about the same amount that said so in the September poll.

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15. Knowing what you now know, would you support or oppose Direct Energy's proposed plan to increase competition among electricity suppliers?

	Support			Oppose			
	Strongly	Somewhat	**Total**	Somewhat	Strongly	**Total**	Not Sure
May 2011*	48	34	**82**	6	7	**12**	6
Sept. 2010**	59	30	**89**	3	4	**7**	5

*PECO, PPL & Duquesne Light customers
** Mainly Pennsylvania Electric Co., Allegheny Power, Metropolitan Edison, Penn Power, with other customers

The vast majority (82%) say that after taking the poll, they would support the Direct Energy plan, which is a slight increase from when they were asked at the beginning of the survey (78%), but down slightly from the September 2010 poll (89%).

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