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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

May 2, 2012

VIA EXPRESS MAIL

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company for Approval of Their Default Service Programs
Docket No. P-2011-2273650, Docket No. P-2011-2273668,
Docket No. P-2011-2273669 and Docket No. P-2011-2273670

Dear Secretary Chiavetta:

Enclosed for filing are an original and nine (9) copies of the **Initial Brief of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company ("Initial Brief")** in the above-referenced matter. Also enclosed is a disk containing the Initial Brief in a searchable PDF format.

As evidenced by the attached Certificate of Service, a copy of the Initial Brief has been served upon Administrative Law Judge Elizabeth H. Barnes and all parties. Pursuant to 52 Pa. Code § 1.11(2), the enclosed Initial Brief shall be deemed filed on the date shown on the express delivery receipt attached to the delivery envelope.

Kindly time-stamp the extra copy of the Initial Brief we have enclosed and return it to us in the postage-paid, return addressed envelope provided.

Morgan Lewis
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Should you have any questions, please contact me directly at 215.963.5234. Thank you.

Sincerely,

TP Gadsden

Thomas P. Gadsden

TPG/tp
Enclosures

c: Certificate of Service (w/encls.)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT PETITION OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN POWER COMPANY FOR APPROVAL OF THEIR DEFAULT SERVICE PROGRAMS	:	**DOCKET NOS. P-2011-2273650 P-2011-2273668 P-2011-2273669 P-2011-2273670**

INITIAL BRIEF OF
METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY AND
WEST PENN POWER COMPANY

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Before Administrative Law Judge
Elizabeth H. Barnes

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May 2, 2012

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I. INTRODUCTION AND PROCEDURAL HISTORY

This proceeding was initiated on November 17, 2011, when Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), Pennsylvania Power Company ("Penn Power") and West Penn Power Company ("West Penn") (collectively, or any combination of the foregoing, the "Companies") filed a Joint Petition ("Joint Petition") requesting that the Pennsylvania Public Utility Commission ("Commission" or the "PUC") approve their Default Service Programs for the period from June 1, 2013 to May 31, 2015 ("DSPs") and find that the DSPs satisfy the criteria set forth at 66 Pa.C.S § 2807(e)(3.7). The DSPs were designed to provide the Companies' default service customers access to an adequate, reliable generation supply at the least cost over time and to enable the Companies to recover their costs of furnishing that service. As described in the Joint Petition, the Companies' DSPs contain all of the elements required by the Commission's default service regulations (52 Pa. Code §§ 54.181 – 54.189) and its Policy Statement on Default Service (52 Pa. Code §§ 69.1801-69.1817), including implementation plans, procurement plans, contingency plans, rate design plans, and associated tariff pages. In addition, the DSPs contain certain competitive market enhancements that are described in subsequent sections of this brief. The DSPs proposed in the Joint Petition will begin upon the expiration of the Default Service Programs currently in effect for each Company, which expire on May 31, 2013.

Copies of the Joint Petition were served in accordance with 52 Pa. Code § 54.185(b). Additionally, on December 3, 2011, the *Pennsylvania Bulletin* published the Commission's notice setting a deadline for filing protests, complaints or petitions to intervene as of December 19, 2011 and scheduling a Prehearing Conference for December 22, 2011 before Administrative

Law Judge Elizabeth H. Barnes. Thereafter, the following intervenors were afforded active party status in this case:

Bureau of Investigation and Enforcement	("I&E")
Office of Consumer Advocate	("OCA")
Office of Small Business Advocate	("OSBA")
Anthracite Region Independent Power Producers Association	("ARRIPA")
Coalition for Affordable Utility Service and Energy Efficiency in Pennsylvania	("CAUSE-PA")
Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.	("Constellation")
Direct Energy Services, LLC	("Direct Energy")
Dominion Retail, Inc.	("Dominion")
Exelon Generation Company and Exelon Energy Company	("Exelon")
FirstEnergy Solutions Corp.	("FES")
Met-Ed Industrial Users Group	("MEIUG")
PECO Energy Company	("PECO")
Penelec Industrial Customer Alliance	("PICA")
Penn Power Users Group	("PPUG")
Pennsylvania State University	("Penn State")
Retail Energy Supply Association	("RESA")
Washington Gas & Energy Services, Inc.	("WGES")
West Penn Power Industrial Intervenors	("WPPII")
York County Solid Waste and Refuse Authority	("York County")

At the Prehearing Conference, a schedule was established for submitting written testimony, holding evidentiary hearings and filing briefs. *See* Amended Scheduling Order (December 29, 2011). Written direct, rebuttal and surrebuttal testimony was submitted by various parties on the dates established for each submission. Attached hereto as Appendix A is a list of written statements and accompanying exhibits, if any, submitted by witnesses appearing on behalf the Companies. A description of the Companies, an introduction of the witnesses testifying on their behalf and a summary of the principal components of their DSPs were provided in Companies' St. 1, the direct testimony of Richard A. D'Angelo. The parties to this case also engaged in extensive discovery. The Companies responded to 294 interrogatories, and other parties collectively responded to 149 interrogatories, with many containing multiple subparts.

Evidentiary hearings were held at the Commonwealth Keystone Building in Harrisburg on April 11 and 12, 2012. At the hearings, various witnesses were cross-examined and the testimony and exhibits of all parties were admitted into evidence. At the hearing held on April 12, a revised schedule was established for the submission of Initial (May 2, 2012) and Reply (May 16, 2012) Briefs (Tr. 354).

II. DEFAULT SERVICE PROCUREMENT AND IMPLEMENTATION PLANS

A. Procurement Groups

1. West Penn's Proposed Consolidation of Service Types 20 and 30.

In their DSPs, the Companies propose to procure default service supplies separately for each of three customer classes: a Residential Customer Class, a Commercial Customer Class, and an Industrial Customer Class. Each of these classes is comprised of specific rate schedules and tariffs. *See* Companies' St. 2, pp. 3-5 (listing applicable rate schedules and tariffs for each Customer Class); *see also* Companies' St. 3, p. 5 (discussing benefits of limiting number of procurement classes). The procurement classes recommended by the Companies for Met-Ed, Penelec, and Penn Power are identical to the procurement classes now in use by the Companies and previously approved by the Commission.[1] The only change proposed in this proceeding is to consolidate West Penn's current four customer classes into three customer classes, which will make West Penn consistent with the other Companies (Companies St. 2, p. 7).[2]

[1] *See* Order, *Joint Petition of Metropolitan Edison Co. and Pennsylvania Elec. Co. for Approval of Their Default Serv. Program*, Docket Nos. P-2009-2093053, P-2009-2093054 (Nov. 6, 2009) ("*Met-Ed/Penelec 2009 DSP Order*"), pp. 22-23; Order, *Petition of Pennsylvania Power Co. for Approval of Default Serv. Program for the Period from January 1, 2011 through May 31, 2013*, Docket No. P-2010-2157862 (Nov. 17, 2010) ("*Penn Power 2010 DSP Order*"), pp. 4-5.

[2] The four Service Type customer classes were established in West Penn's initial default service proceeding. *See* Order, *Petition of the West Penn Power Co. d/b/a Allegheny Power for Approval of its Retail Elec. Default*

For the Residential Customer Class, the rate schedules are those identified in each Company's tariff as applying to residential customers or based on residential service billing provisions, *e.g.*, non-profit senior citizen centers (Companies' St. 2, p. 6). For Met-Ed and Penelec, the Commercial Customer Class generally consists of customers that receive service at secondary voltage and did not have a registered demand equal to or greater than 400 kilowatts ("kW") in two consecutive months. For Penn Power, this class encompasses customers that receive service at secondary voltage. Customers in the Met-Ed and Penelec Industrial Customer Class are those which: (1) receive service at secondary voltage and have registered demands that equal or exceed 400 kW in two consecutive months; or (2) receive service at primary or transmission voltage. For Penn Power, customers in the Industrial Customer Class are those that receive service at primary or transmission voltage. For West Penn, this class consists generally of customers that: (1) receive service at secondary voltage and have billed demands that equal or exceed 500 kW; or (2) receive service at primary or transmission voltage (Companies' St. 2, pp. 6-7). As noted previously, the Companies are not proposing any changes to the composition of these customer classes.

Under West Penn's current DSP, there are four customer classes, which are denominated "Service Types." Service Type 10 is identical to West Penn's proposed Residential Customer Class, and Service Type 40 is identical to West Penn's proposed Industrial Customer Class. Service Type 20 consists of all rate schedules that would be included in the proposed Commercial Customer Class except those customers on Rate Schedule 30 that have billing

Serv. Program and Competitive Procurement Plan for Serv. at the Conclusion of the Restructuring Transition Period, Docket No. P-00072342 (July 25, 2008) ("*West Penn 2008 DSP Order*"), p. 10.

demands below 500 kW, which constitute a separate procurement group identified as Service Type 30. *See id.*

West Penn is proposing to consolidate Service Type 20 and Service Type 30 because the load profile and shopping rates of Service Type 20 and Service Type 30 customers are similar and because fewer than 600 customers (with a total load of less than 90 megawatts) remain in the Service Type 30 class. Combining the two procurement classes will reduce the costs and administrative burdens associated with separate procurement classes and achieve consistency across all of the Companies (*Id.*, p. 8; Companies' St. 2-R, p. 5). The only parties to oppose this consolidation are WPPII/MEIUG/PICA/PPUG, whose witness, Mr. Raia, testified on behalf of Sheetz, Inc. ("Sheetz")[3] Mr. Raia asserted generally – without any data or analysis – that the proposed consolidation "may" lead to "cross-subsidization" and higher wholesale supplier premiums for the combined customer class based on unspecified "billing and metering discrepancies," as well as "differing" load profiles (Raia St. 1, pp. 13-15).

In fact, contrary to Mr. Raia's assertion, the average hourly usage per day of all default service customers in Service Types 20 and 30 is quite similar (Companies' St. 2-R, pp. 3-4). In addition, the Companies presented detailed data showing that the weighted fixed prices for tranches of wholesale full-requirements supply for Service Types 20 and 30 to date are nearly equal, reflecting suppliers' similar bids for the two procurement classes. *See id.*, pp. 4-5. In short, there is no evidence to support Mr. Raia's contention that the consolidation of Service Types 20 and 30 will have any adverse effects on customers. The Commission should therefore

[3] The OSBA does not oppose consolidation of Service Types 20 and 30. *See* OSBA St. 1, p. 14.

approve the Companies' proposed procurement classes, including the consolidation of West Penn Service Types 20 and 30.

B. Residential And Commercial Class Default Service Procurement

1. Summary and Overview

For each of the Residential and Commercial Customer Classes, the Companies are proposing to procure full-requirements, load-following energy and energy-related services for the customers of Met-Ed, Penelec, Penn Power and West Penn who have not chosen an electric generation supplier ("EGS") or whose EGS fails to provide service. The load of each class will be divided into tranches, with each tranche constituting a fixed percentage of each Company's non-shopping load, and qualified suppliers will bid to serve tranches in simultaneous descending clock auctions ("DCAs") for all four Companies. Winning suppliers will enter into a standard supply master agreement ("SMA") and will be responsible for fulfilling all the obligations of a Load Serving Entity ("LSE") imposed by the PJM Interconnection LLC ("PJM"). As such, each winning supplier will be required to provide energy, capacity, transmission service (excluding Network Integration Transmission Service ("NITS"), Regional Transmission Expansion Plan charges ("RTEP"), any Transmission Enhancement Charges ("TEC"), Generation Deactivation charges, and unaccounted-for energy costs ("UFE")), all ancillary service costs, PJM administrative expenses and any other services or fees as required by PJM. In addition, as discussed in Section II.E, *infra*, suppliers will also be responsible for meeting the requirements of Pennsylvania's Alternative Energy Portfolio Standards Act ("AEPS") associated with their portion of default service load, except for 40% of the AEPS solar photovoltaic requirement, which will be supplied by the Companies (Companies' St. 4, pp. 3-4; Companies' St. 2-R, pp. 21-22).

Each residential and commercial class tranche will be comprised of a load-following full requirements product with a 90% fixed-price portion and a 10% variable-price spot portion. The fixed-price for the 90% fixed-price portion would be established through the Companies' DCAs. The 10% variable-price spot portion would be priced at the hourly PJM real-time zonal locational price for the applicable Company. Residential and commercial class suppliers will also receive a $20/MWh adder for the spot portion, which is designed to cover associated costs for capacity, ancillary services, and AEPS compliance (Companies' St. 4, pp. 6, 8; Companies' St. 3, p. 5).

All contracts will have the same 24-month term, expiring on May 31, 2015, and will be procured in November 2012 and January 2013 in order to bring time diversity and rate stability into the ultimate pricing for default service customers (Companies' St. 4, p. 6). A portion of the requirements of residential customers of Met-Ed, Penelec, and Penn Power will continue to be met through 48-month long-term block energy contracts procured during the Companies' prior default service proceedings, which all expire on May 31, 2015. *Id.*, pp. 7-8.

In considering and approving a default service provider's plan, the Commission is required to make specific findings that the plan "includes prudent steps necessary to negotiate favorable generation supply contracts...[and] includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis." 66 Pa.C.S. § 2807(e)(3.7). The Companies' plans satisfy each of these requirements. Full-requirements suppliers acquire the combination of energy, capacity, ancillary services, and transmission products needed to ensure adequate and reliable service to default service customers at a fixed price in the face of load and price uncertainty, and the Companies' DCAs result in the selection of those suppliers who can provide these products at the least cost over time (Companies' St. 6, pp. 9-10). The procurement length of twenty-four months is consistent with both the Public Utility Code's requirement for a "prudent mix" of default supply contracts and the Commission's guidance for default service plans for the June 1, 2013-May 31, 2015 period, which directs EDCs to limit or eliminate contracts that will extend past May 31, 2015. See *id.*, p. 8; Order, *Investigation of Pennsylvania's Retail Elec. Market: Recommendations Regarding Upcoming Default Serv. Plans*, Docket No. I-2011-2237952 (Dec. 16, 2011) ("*DSP Recommendations Order*"), pp. 20-21. The inclusion of a 10% portion subject to hourly PJM real-time zonal pricing exposes customers to the effects of spot purchases, and as noted, *supra*, a portion of the requirements of residential customers will continue to be met through long-term contracts (Companies' St. 6, pp. 8-10).

The Companies' procurement and implementation plans include detailed procurement schedules, bidding rules and associated documents, including form supplier contracts, contingency plans, plans for AEPS compliance, and a proposed independent evaluator to administer procurement protocols and ensure that any affiliate of the Companies does not receive an advantage in the procurements. In addition, the Companies' default service plans are compliant with the requirements of the PJM Interconnection, LLC ("PJM") (Companies' St. 4, pp. 11-13, 14-22; Companies' St. 3; Exs. RLS-2 and RLS-3; Companies' St. 5, pp. 5-17 and Ex. BAM-1; Companies' St. 1, pp. 16-18). Various issues were raised regarding the Companies' Residential and Commercial Class procurement plans and are discussed below.

2. Term of Contracts

The OCA, OSBA, and RESA agree with the Companies' proposal to primarily use full requirements contracts for procurement of default service supply, but each would replace some of the Companies' proposed two-year full requirements contracts with shorter-term (*e.g.*, one year or six-month) contracts. The OCA and the OSBA generally assert that two-year contracts are likely to include greater risk premiums than one-year contracts (OSBA St. 1, p. 16; OCA St. 1, p. 17); RESA, in turn, contends that use of two-year contracts should be reduced by half for the Residential Class to permit default service rates to adjust more frequently to wholesale market changes; and both the OSBA and RESA propose to eliminate two-year contracts entirely for the Commercial Class (RESA St. 1, pp. 14-16; RESA St. 1-R, p. 3; OSBA St. 1, pp. 16-17). The Companies addressed each of these arguments in rebuttal and/or rejoinder testimony, and explained why they should be rejected.

Risk Of Higher Supplier Risk Premiums. While the OCA and OSBA contend, as a theoretical matter, that two-year full requirements contracts will include higher supplier risk premiums than one-year contracts because of a longer contract term, the Companies provided detailed contract price data for one and two-year full requirements contracts from their prior procurements demonstrating that this was not necessarily true. As explained by the Companies' witnesses Stathis and Reitzes, products with one-year or shorter terms can be more expensive than contracts with longer duration. In fact, to the extent there was any difference in the risk premium included by suppliers in the Companies' one- and two-year contracts to date, the difference is not statistically significant (Companies' St. 4-R, pp. 3-4; *see also* Tr. 164-166, Companies' Ex. JDR-3). Moreover, increasing the amount of one-year contracts could actually undermine the inherent volatility protection of full requirements contracts and result in higher prices for customers if shorter-term contracts are procured during a time of high energy prices (Companies' St. 4-R, p. 4).

Mr. Kahal, on behalf of the OCA, also argues that suppliers could include a higher risk premium due to potential migration of customers as a result of the Companies' proposed Retail

Opt-In Auction, which will take place after the Companies' proposed full requirements contract procurements (OCA St. 1, p. 18). But, as explained by Dr. Reitzes, suppliers face a variety of uncertainties and ongoing volumetric risk with respect to the load they will serve over the course of a supply contract and can wait to make appropriate hedging decisions until after the Retail Opt-In Auction has occurred (Companies' St. 6-R, p. 5). While Mr. Kahal notes that default service supply auction results in Pennsylvania and elsewhere are typically approved by public utility commissions shortly after bidding so suppliers do not have to maintain open pricing positions (OCA St. 1-R, pp. 19-21), he does not explain why suppliers choosing to bid into the Companies' procurements with complete knowledge of the details of the upcoming Retail Opt-In Auction will be unable to fully consider risks associated with the auction and make hedging decisions prior to delivery. Indeed, as Dr. Reitzes shows, the premiums associated with full requirements contracts procured during other periods of uncertainty – including the end of rate caps in the Companies' service territory – have been quite small (Companies' St. 6-R, p. 14).

Potential Divergence from "Real Time" Market Prices. Ms. Williams, on behalf of RESA, contends that half of the two-year contracts the Companies propose to procure for the Residential Class should be replaced with one-year contracts because RESA generally believes that procurement plans should "approximate the real time market price as much as possible" and include a significant amount of spot market purchases (RESA St. 1, p. 14). As the Commission has previously observed, however, RESA's goals are inconsistent with the Public Utility Code's requirement that default service procurement be designed to achieve "least cost over time" and the objective of price stability:

> We disagree with RESA's overall recommendations as to the proper interpretation of the "least cost" standard as mandating that default service rates approximate, on a prospective basis, the

> market price of energy. Such an interpretation would signal retention of the "prevailing market price" standard that has been expressly replaced under Act 129. Moreover, this interpretation conflicts with the Act 129 objective of achieving price stability which dictates consideration of a range of energy products, not just those that necessarily reflect the market price of electricity at a given point in time. Price stability benefits are very important to some customer groups in that exposing them to significant price volatility through general reliance on short term pricing would be inconsistent with Act 129 objectives.

See Final Rulemaking Order, *Implementation of Act 129 of October 15, 2008: Default Serv. And Retail Elec. Markets*, Docket No. L-2009-2095604 (Order entered October 4, 2011), pp. 39-40. The Companies' proposed procurement plan for the Residential Class, with 90% fixed-price/10% spot-priced two-year contracts obtained at market prices through competitive procurements, is consistent with the short-term contract purchase provisions of Act 129 and will also provide both a degree of cost stability and exposure to spot-market pricing (Companies' St. 3, p. 6; Companies' St. 6, p. 8; Tr. 142). Furthermore, Ms. Williams' assertion that contract prices for the Companies' two-year contracts "will *always* diverge from current market prices" (RESA St. 1-SR, p. 3, emphasis in original) is not necessarily correct; there is, in fact, no certainty that current market prices one year after the Companies procure a two-year contract will be significantly different. Tr. 146-147.

Use Of Two-Year Contracts for the Commercial Class. OSBA witness Knecht, while characterizing the Companies' procurement plan as not "unreasonable," believes that it can be "improved upon" through the use of one-year and six-month contracts to reduce the theoretical premiums already addressed above (OSBA St. 1, p. 15).[4] RESA witness Williams makes the additional argument that the Commercial Class includes many "sophisticated buyers of goods

[4] OSBA witness Knecht also advocates one-year and six-month contracts for reasons relating to the timing of procurements within a "delivery year" and contract laddering, which the Companies address in Sections II.B.3.a and II.B.4.

and services and can appropriately adjust to the new opportunities provided by a more market responsive rate." RESA St. 1, p. 15. However, as Messrs. Stathis and Reitzes explained, the Companies' proposed plan is designed to not only procure contracts at market prices but also to achieve other default service goals of least cost over time and price stability for these customers. Moreover, two-year contracts for these customers will be familiar products for potential suppliers (Companies' St. 4, p. 8; Companies' St. 6, pp. 8-9). To the extent that "sophisticated buyers" wish to pursue the new opportunities that may be available from EGSs suggested by Ms. Williams, they remain entirely free to switch from default service.

3. Procurement Dates

a. Number of Procurements Per Delivery Year

OSBA witness Knecht (OSBA St. 1, p. 17) contends that the Companies' proposed procurement of two-year contracts for the Commercial Class in November 2012 and January 2013 does not comply with Section 69.1805 of the Commission's Default Service Policy Statement, which provides that default service contracts for both small and medium non-residential customers should be procured using "a minimum of two competitive bid solicitations per year to further reduce the risk of acquisition at the time of peak prices." 52 Pa. Code § 69.1805.

As a threshold matter, the Commission's Default Service Policy Statement does not constitute a rule, regulation, or other "binding norm" requiring semi-annual procurements of one-year contracts.[5] More importantly, while the Companies' proposed procurements of two-year contracts in November 2012 and January 2013, are not within the same *calendar* year (January

[5] *See, e.g., Order, Implementation of the Alternative Energy Portfolio Standards Act of 2004*, Docket No. M-00051865 (Dec. 5, 2006) (explaining that Commission is not establishing "binding norm" in issuing policy statements).

1-December 31), they are within the same PJM delivery year (June 1-May 31) and are thus compliant with Section 69.1805, as it is the PJM year with which default service programs are synchronized (Companies' St. 4, p. 5; see 52 Pa. Code § 54.185(d)(4)).[6]

b. Dates of Procurements Relative to Delivery Year

As discussed *supra*, the Companies have proposed to procure two-year contracts for the Residential and Commercial Classes in two separate procurements seven months and five months before delivery. Ms. Williams of RESA asserts that the Companies should procure their proposed two-year contracts closer to the June 1, 2013, delivery dates, *e.g.*, January and March 2013 instead of November 2012 and January 2013 on the ground that such procurements "will result in pricing that does not reflect the market price at the time of delivery." RESA St. 1, p. 15.[7]

The Companies disagree with RESA's alternative scheduling proposal for several reasons. As Mr. Stathis explained, the Companies seek to achieve multiple goals in procurement scheduling, including ensuring sufficient time diversity between procurements, allowing time to conduct any contingency procurements before supply must be delivered, and facilitating the ability of suppliers to effectively hedge potential congestion costs by participating in PJM's

6 As discussed in Section II.B.4 *infra*, Mr. Knecht's application of the calendar year instead of the PJM year appears to lead him to conclude that procurements for default service after June 1, 2015, would necessarily have to commence in early 2014. *See* OSBA St. 1-R, pp. 8-9. While the Companies have made no determination with respect to procurements for default service supply after June 1, 2015, interpretation of Section 69.1805 consistent with a PJM planning year requirement would clearly permit the scheduling of two procurements in late 2014 and early 2015 for June 2015 deliveries.

7 RESA, as well as the OCA (*see* OCA St. 1-R, p. 4) and the OSBA, (*see* OSBA St. 1, pp. 15-16), also propose procurements in 2014 for the portion of Residential or Commercial Class supply they believe should be obtained through shorter contracts. As discussed in Section II.B.2, *supra*, the Companies oppose reducing the term length of the proposed supply contracts for both the Residential and Commercial Classes and such additional procurements would be unnecessary under the Companies' programs.

Auction Revenue Rights ("ARRs") processes, all of which could be frustrated by the March 2013 procurement proposed by RESA (Companies' St. 4-R, pp. 6-7; Tr. 143-145).

With respect to ARRs, a March procurement would preclude suppliers from fully using ARRs associated with the load they will serve under PJM's rules. While the Companies could make ARR-related selections on behalf of suppliers and then allocate these instruments to winning suppliers on a pro rata share of load won in the auctions, it would be clearly preferable for winning suppliers to select their own hedges since they would most certainly know their own sourcing points for their power supply and could therefore tailor their ARR selections (and decisions regarding related Financial Transmission Rights, or "FTRs") accordingly. *See id.*

Furthermore, procurements that occur in advance of the delivery date for the power supplies may result in prices that are higher, lower, or equal to the price observed at or closer to the delivery date, and procurements by the Companies for the same full requirements product procured closer to delivery have resulted in higher, not lower, overall prices. Although Ms. Williams is concerned that two-year contracts and advance procurements inhibit opportunities for competitive retail suppliers, it is entirely possible that the prices from these procurements could end up higher than future forward and spot prices, creating opportunity for competitive retail suppliers to increase their customer base by offering prices that may be significantly lower than default service prices. *See id.*

4. Laddering of Contracts Beyond June 1, 2015

In accordance with the Commission's guidance, the Companies have designed their default service plans for the June 1, 2013-May 31, 2015 period so that all default supply contracts will terminate on May 31, 2015; *DSP Recommendations Order*, pp. 20-21. Witnesses for the OCA and the OSBA expressed concern regarding this approach, asserting that the

Companies should alter their procurement plans to procure additional one-year or six-month contracts and to ladder those contracts so that they extend past May 31, 2015. *See* OCA St. 1, p. 25 (proposing that 35% of contracts for the Residential Class extend beyond May 31, 2015); OSBA St. 1, pp. 15-16 (proposing that the Companies ladder one-year contracts, but suggesting that the Companies could procure only six-month contracts in late 2014 if the Commission determined that all contracts should expire on May 31, 2015).

The Commission should reject these proposals for several reasons. First, the Companies note that the proposed May 31, 2015 "hard stop" is entirely consistent with the Companies' current default service programs, in which all default service supply contracts (other than 50 MW long-term block contracts) will terminate on May 31, 2013. Moreover, while the Companies have not undertaken plans for default service supply after June 1, 2015, there is no reason that a future default service plan could not include similar multiple procurements to avoid a future "hard stop" in June 2015, as the Commission recommends. *See DSP Recommendations Order*, p. 21 (discussing example of conducting procurements nine months and three months before June 1, 2015 to mitigate adverse impacts from potentially unfavorable market conditions); Companies' St. 4, p. 3.

5. OCA's Proposal to Continue the Use of Block Purchase Components With Spot Transactions for Residential Customers

While the OCA supports the Companies' continued use of full requirements contracts, the OCA also proposes that all four Companies adopt the "block and spot" approach for the Residential Class which is currently in use by Met-Ed and Penelec in accordance with the settlement of their first default service case. *See Met-Ed/Penelec 2009 DSP Order*, pp. 23-25. Under this approach, all four Companies would be required to procure approximately 25% of their projected default service residential load through a combination of competitively procured block supply contracts and additional purchases of balancing spot-market energy in PJM's energy markets. In the event customer load declines, the Companies would need to sell the excess block energy to maintain the portion of residential customer load served by this mechanism at the 25% level. The OCA believes that its preferred block and spot approach would add product diversity to each Company's supply portfolio, and "has the potential" to lower overall supply costs (OCA St. 1, pp. 23-24).

As OCA witness Kahal acknowledges, this block and spot approach can result in additional costs for customers as a result of contractual commitments for block energy products which then must be sold back into the energy markets at a loss. *See id.* While Mr. Kahal believes that there is little risk of this actually occurring, the Companies introduced data demonstrating that the cost of the block and spot procurement strategy during the first eight months of Met-Ed and Penelec's current default service program generally exceeded the costs of those Companies' full requirements contracts. Indeed, Met-Ed and Penelec have both been required to purchase significant blocks of energy and then sell excess blocks of energy, as a result of low customer demand (in part due to increased shopping), into a depressed energy market. Because Met-Ed and Penelec have previously scheduled the purchased block energy in PJM and then are obligated to sell that energy into PJM's real-time markets, the Companies have incurred additional PJM charges that have increased costs to customers (Companies' St. 4-R, p. 4; Tr. 146-147).

The Companies' proposed use of full requirements contracts for default service supply without any block and spot component will eliminate these ongoing risks, while ensuring that customers continue to receive the benefits of a competitively procured, diverse portfolio of products designed to deliver "least cost over time." As explained by Dr. Reitzes, the use of a competitive procurement process for full requirements products is structured to induce aggressive bidding among suppliers who manage portfolios of energy, transmission and capacity products to meet the changing load obligations of customers at a fixed price (with a spot-priced component to expose customers in part to wholesale market pricing). While the OCA believes that the block and spot approach is necessary to add diversity, such diversity already exists because full requirements suppliers assemble a diverse mix of products to meet their contractual obligations (Companies' St. 6, pp. 9-12, 17).

The results to date of the Companies' full requirements procurements have demonstrated that the premiums full requirements suppliers may charge for managing the volumetric and pricing risks associated with varying customer load have been quite modest, with substantial participation by competing suppliers to offer the lowest price for customers (Companies' St. 6, pp. 12-16; Companies' St. 6-R, pp. 3-4). In light of the established benefits of full requirements contracts and the results of the Companies' procurements, the Commission should reject the OCA's proposal to continue (and expand) the use of the block and spot approach for default service supply.[8]

6. The OCA's Proposed "Hold Back" for the Retail Opt-In Auction

In addition to proposing that 25% of the Residential Class load be obtained through block and spot procurement, the OCA proposes to "hold back" 20% of the tranches of full requirements default service supply which the Companies seek to procure prior to June 1, 2013 until after the Retail Opt-in Auction (scheduled for March 2013) has been completed. Mr.

[8] For the same reasons, the Companies oppose the OCA's proposal that the Companies procure an additional four-year, 50 MW block of energy for each company. As Mr. Kahal notes in his discussion of the Companies' data on block procurements, the 50 MW block previously procured by the Companies appears to be particularly expensive (OCA St. 1-SR, p. 8).

Kahal, on behalf of the OCA, asserts that this approach will reduce uncertainty for full requirements suppliers that may be associated with the potential migration of a large number of customers to EGSs in the Opt-in Auction. In the event that the Opt-in Auction is undersubscribed, the tranches of supply that were "held back" would be offered to other full requirements suppliers; if those offers are not accepted, the Companies would procure energy using the OCA's block and spot approach to fill the "held back" tranches (OCA St. 1, pp. 30-34).

As explained in Section II.B.2 *supra*, suppliers are fully capable of properly assessing and mitigating any volumetric risk that may be associated with the Retail Opt-In Auction, and premiums for full requirements contracts have been small even in times of uncertainty regarding potential retail load migration. The OCA's proposal thus appears entirely unnecessary. As structured, however, the proposal presents significant additional risk for customers by increasing the amount of block and spot supply in each Company's portfolio in the event the Retail Opt-In Auction is substantially undersubscribed and current default service suppliers decline the opportunity to purchase additional tranches of supply. In that circumstance, under the OCA's plan, the Companies could be required to enter into new block energy contracts, which could compound the costs already incurred by customers if that block energy later had to be sold into the PJM markets. *See* Section II.B.5, *supra*. The Commission should therefore reject the OCA's "hold back" proposal.

7. Procurement Method – Descending Price Clock Auction

The Companies have proposed to use a DCA format for procurement of default service supply, with simultaneous auctions conducted for all four Companies in November 2012 and January 2013. Both auctions will offer tranches of Residential and Commercial Class supply, with the January 2013 auction offering the opportunity to also bid on tranches of spot-priced supply for the Industrial Class. *See* Companies' St. 4, p. 11.

Auctions to procure default service supply are expressly permitted under the Public Utility Code, 66 Pa.C.S. § 2807(e)(3.1), and DCAs have been used in numerous electricity procurements in Pennsylvania, New Jersey, Ohio, Illinois, and Massachusetts. *See* Companies' St. 5, p. 14. The auction format is non-discriminatory, open, fair, and designed to achieve competitive results, and Met-Ed, Penelec, and Penn Power have successfully conducted DCAs for default service supply under their current default service programs. *See id.*, pp. 17-18; Companies' St. 6, pp. 12-13.

Under the DCA approach, multiple products and/or multiple tranches are bid on simultaneously. Bidding takes place online using Web-based software in a series of bidding rounds, with pre-specified starting and ending times for each round. Prior to the start of each round, the announced price for each product is disclosed to bidders. At the end of each round, the bidding software (with oversight by the Independent Evaluator) determines which products are over-subscribed and which products are under-subscribed. A product is over-subscribed if suppliers bid to supply more tranches than the number of tranches needed of that product. Likewise, a product is under-subscribed if fewer tranches were bid on it than needed. If a product is over-subscribed, the announced price for that product will be reduced by a decrement for the next round. *See* Companies' St. 5, pp. 13-14.

If a product is not over-subscribed, its announced price will not change for the next round. The bidding process continues in this manner, with prices tending to tick down like a countdown clock. As prices change across the products, bidders are allowed to change the number of tranches they bid, subject to certain restrictions. In each round, a bidder simply specifies the number of tranches that it is willing and able to supply for each product at the announced price for each product. *See id.*

There is no pre-determined number of rounds before the close of the auction, which occurs after the first round in which no product is over-subscribed. The winning bidders are those bidders who bid tranches at a price no higher than the clearing price, which is the lowest price at which the tranche product is not under-subscribed. *See id.* No party contested the Companies' proposed use of the DCA for default supply procurement.[9]

8. Load Cap

As part of their respective procurement plans, the Companies have proposed to set a limit of 75% on the available tranches that any one supplier can win in their default service supply auctions (Companies' Ex. BAM-1, Section 4.2). RESA disagrees with the Companies' recommendation and contends that the load cap should be set at 50% (RESA St. 1, pp. 17-19).

The Commission carefully evaluated the proper load cap in Met-Ed and Penelec's first default service proceeding, where RESA also argued for a 50% load cap. As the Commission recognized in that proceeding:

> The level at which the load cap is set must balance supplier diversity and achieving the lowest price in the supply auctions. All other things being equal, supplier diversity would mitigate the impact on customers of a supplier's default. However, a load cap would also limit the amount of default generation supply that the lowest cost bidder can provide, which would necessarily increase the total average cost to serve default load.

[9] The OCA suggested that a sealed bid request for proposals ("RFP") process could be less expensive (OCA St. 1, pp. 16-17), but it did not quantify any savings. As the Companies' witness Miller explained, the OCA's assertion was not necessarily true, and many of the costs of procurement for default service supply are independent of the auction format (Companies' St. 6-R, pp. 2-3).

Met-Ed/Penelec 2009 DSP Order, p. 16. In light of these considerations, the Commission rejected RESA's 50% proposal and concluded that a 75% load cap appropriately balanced the interests of supplier diversity and obtaining the lowest cost bid for purposes of "least cost over time." *Id.*, p. 18.

In seeking to revisit this issue, RESA asserts that the load cap should be reduced in light of the 2011 merger of FirstEnergy Corp. and Allegheny Energy, Inc. RESA also argues that the Commission should have considered that FirstEnergy's Ohio affiliates – which also had a 75% load cap at the time of the *Met-Ed/Penelec 2009 DSP Order*, as the Commission noted then – had lower load caps years earlier. RESA's arguments are entirely without merit.

With respect to the FirstEnergy-Allegheny merger and the addition of West Penn as an affiliated EDC, the Companies' proposal not only continues a 75% load cap but imposes, **for the first time**, a load cap on default supply procurement for West Penn. Any benefits that may be derived from a load cap are thus being extended to West Penn customers. In addition, West Penn customers henceforth will benefit from the various provisions in the bidding rules and in the SMAs that require prospective bidders to undergo a creditworthiness evaluation and to provide financial guarantees in proportion to the number of tranches upon which they intend to bid (Companies' St. 3, pp. 8-10; Companies' St. 5, pp. 9-13). *Cf. Met-Ed/Penelec 2009 DSP Order*, p. 18 (concluding that the Companies' SMAs "go a long way" in addressing consequences of supplier default).

RESA's second argument is similarly inapposite. When the Commission approved the load cap for Met-Ed and Penelec, it noted that the ALJ in that proceeding had found: (1) that the Ohio FirstEnergy affiliates had a 75% load cap; and (2) that the Ohio companies had recently conducted a procurement **without any load cap at all**, and obtained significant participation.

See Met-Ed/Penelec 2009 DSP Order, p. 16. Presently, the Public Utilities Commission of Ohio enforces a load cap of 80% for the FirstEnergy Ohio companies. *See Re Ohio Edison Co.*, No. 10-388-EL-550, 2010 WL 3442143 (Ohio PUC Aug. 25, 2010) (discussing imposition of 80% load cap).

For the reasons set forth above, the Companies' proposed load cap of 75% is reasonable and should be adopted in this proceeding.

C. Industrial Class Hourly-Priced Default Service

1. Summary and Overview

The Companies have proposed to secure default service power supply for the Industrial Class utilizing Hourly Pricing Service ("HPS"). Supplier contracts for HPS will be for a 24-month term. The HPS is not a fixed-price service, but an hourly service that is priced to the PJM real-time hourly energy market for each Company. As with the Residential and Commercial Classes, suppliers will bid in a simultaneous DCA for the right to serve a percentage of each Company's HPS load, which will be divided into tranches. Customers on HPS will pay, and winning suppliers will receive: 1) the applicable PJM zonal real-time hourly locational marginal price; and 2) a fixed adder of $5/MWh to cover the costs of other supply components, including ancillary services, AEPS, and PJM administrative fees. *See* Companies' St. 4, pp. 8-9.

The Commission has previously approved this type of hourly-priced service for the default service industrial customers of each Company and no party to this proceeding opposed its continued use. *See Met-Ed/Penelec 2009 DSP Order*, pp. 25-26; *Penn Power 2010 DSP Order*, pp. 8-9; *West Penn 2008 DSP Order*, pp. 50-53.

D. Use Of Independent Evaluators

In accordance with Section 54.186(c)(3) of the Commission's regulations, the Companies have selected CRA International, Inc. ("CRA"), to serve as independent evaluator of the Companies' proposed default service procurements (Companies' St. 1, p. 9). CRA has extensive experience in managing procurements of default supply, including procurements using DCAs, and has prepared detailed bidding rules and procedures for the Companies' procurements (Companies' St. 5, pp. 2-3, 5-15, and Ex. BAM-1). The Companies have also selected CRA to serve as independent evaluator of the Companies' proposed Retail Opt-In Auction, which will also be conducted using a DCA, and CRA has prepared separate bidding rules and procedures for that procurement. *See id.*, pp. 18-25 and Exhibit BAM-2.

For procurements of solar photovoltaic alternative energy credits ("SPAECs") for compliance with the AEPS Act, the Companies have selected the Brattle Group to serve as independent evaluator. The Brattle Group has extensive experience in managing a variety of energy-related procurements through both requests for proposals ("RFPs") and DCAs, and has previously been approved by the Commission as the independent evaluator for SPAEC procurements conducted by Met-Ed, Penelec, and Penn Power (Companies' St. 6, p. 2). *See Met-Ed/Penelec 2009 DSP Order*, pp. 29-30. The Brattle Group has prepared bidding rules and procedures for the Companies' proposed SPAEC procurements, with updates from prior procurements to further encourage supplier participation (Companies' St. 6, pp. 20-36 and Exhibit JDR-1). The Companies have similarly selected the Brattle Group to serve as independent evaluator of the Companies' proposed Time-of-Use Competitive Bidding Process, which will also be conducted using a DCA, and the Brattle Group has prepared separate bidding rules and procedures for that procurement. *See id.*, pp. 41-44 and Exhibit JDR-2.

E. AEPS Requirements

1. Non-Solar Photovoltaic Requirements

The AEPS Act requires the Companies to obtain an increasing percentage of electricity sold to default service customers from certain alternative energy sources, such as wind, solar energy and biomass. Compliance is measured in alternative energy credits or "AECs," which are equal to one megawatt-hour of energy from approved "Tier I" or "Tier II" alternative energy sources. *See generally* 73 P.S. § 1648.1 *et seq.*; Companies' St. 4, pp. 14-15.

Under the Public Utility Code, a default service provider is required to use a competitive procurement process to fulfill its AEPS obligations. *See* 66 Pa.C.S. § 2807(e)(3.5). The Companies will satisfy this obligation by requiring winning default service suppliers in its competitive procurements also to be responsible for meeting all Tier I and Tier II requirements associated with the load they serve (except for 40% of the AEPS solar requirement, discussed *infra*). Companies' St. 4, pp. 15-16. The Companies' proposed SMAs include provisions requiring suppliers to transfer the necessary AECs to the Companies. *See* Companies' St. 3, p. 10.

The Companies will only accept AECs from Tier I and Tier II sources approved by the Commission's AEPS Program Administrator and generated through PJM Environmental Information Services Inc.'s Generation Attributes Tracking System ("GATS"), which the Commission has designated under the AEPS Act as the "registry" for issuance of AECs. It will be incumbent on each winning default service supplier to open and maintain, at its own expense, a GATS account in order to satisfy the AEPS Act requirements. This process is currently and successfully being used for compliance with the AEPS Act requirements by the Companies. *See* Companies' St. 4, p. 19.

2. Solar Photovoltaic Requirements

Under the current default service programs of Met-Ed, Penelec, and Penn Power, the solar AEPS requirements associated with the customer load of both default service customers and shopping customers are met with SPAECs obtained by those Companies through separate SPAEC-only procurements. West Penn, in turn, procures SPAECs sufficient to meet the AEPS requirements associated with its default service load, while EGSs remain obligated to obtain 100% of the SPAECs necessary to satisfy AEPS requirements associated with the load of their customers (Companies' St. 2, p. 29; Companies' St. 4-R, p. 12).

Consistent with commitments made by FirstEnergy Corp. and subsequently approved by the Commission as part of the FirstEnergy-Allegheny Energy merger proceedings, the Companies will now procure 40% of the SPAECs required to meet AEPS requirements for both default service and shopping customer load in each of their service territories through 2021 using ten-year contracts (Companies' St. 1, p. 26; Companies' St. 4, p. 17).[10] In order to implement this obligation through the term of the proposed default service programs, the Companies propose to conduct a series of SPAEC procurements based upon the same RFP model currently used by Met-Ed, Penelec, and Penn Power in accordance with the schedule set forth in Companies' Exhibit DWS-3 (Companies' St. 4, pp. 16-17). The Brattle Group, which served as the independent evaluator in prior SPAEC procurements by the Companies, will also administer these RFPs (Companies' St. 6, pp. 22-27). As explained by Dr. Reitzes, the SPAEC procurement is designed to achieve the "least cost over time." (Companies' St. 6, pp. 32-33).

[10] *See* Joint Petition for Partial Settlement, ¶ 25 (Docket Nos. A-2010-2176520 and A-2010-2176732) ("FE/Allegheny Merger Joint Settlement").

As in the Companies' prior SPAEC procurements, each supplier will be obligated to enter into a SPAEC Purchase and Sale Agreement, which describes the terms upon which the SPAECS will be supplied, the quantity of SPAECs to be delivered, the relevant purchase price of the SPAECs, credit requirements, and provisions that become effective in the event of default. The agreement also includes general provisions similar to those contained in the SMA, including provisions for indemnification, confidentiality, performance during a force majeure event, and assignment of the SPAEC PSA (Companies' St. 3, pp. 11-14).

In response to the Companies' SPAEC proposals, WPPII/MEIUG/PICA/PPUG witness Raia and MEIUG/PICA/PPUG witness Fried asserted that customers who have entered into multi-year supply contracts with EGSs could be adversely affected by the procurement of 40% of SPAECs by the Companies instead of 100% because they would have to monitor their EGSs to avoid overcharging, and could have difficulties standardizing their EGS contracts or may need to renegotiate contracts where they may be party to a fixed-price contract. At hearings, however, Mr. Fried conceded that he carefully reviews his EGS bills and did not believe determining whether his EGS had charged for the appropriate amount of SPAECs would be difficult. Tr. 283-284. Similarly, Mr. Raia acknowledged that he closely monitors his EGS bills, and that his company had managed contracts in territories with different rate treatments, including West Penn's service territory where EGSs were required to provide SPAECs. Tr. 298, 308. While both witnesses expressed concern that the Companies could change the percentage of SPAECs that would be purchased in the future, Mr. Stathis made clear that no such change could be undertaken without approval of the Commission. Tr. 147. In addition, Mr. Stathis explained that the Companies' proposed approach, in accordance with the approval of the merger by the Commission, strikes an appropriate balance between SPAECs obtained through long-term EDC contracts and SPAECs obtained by EGSs, which can apply their procurement and hedging experience and strategies to meet their AEPS obligations to the benefit of the overall SPAEC market (Companies' St. 4-SR, pp. 13-14).

RESA witness Williams acknowledged that the Companies' proposal was "workable," but advocated that the Companies continue procurement of 100% of SPAECs required for both shopping and default service customers to avoid "transition" issues that may also burden EGSs (RESA St. 1-R, pp. 13-14). However, Ms. Williams did not suggest that EGSs would seek to overcharge customers for SPAECs or that industrial customers entering into contracts with EGSs will be confused by a percentage allocation of responsibilities between EDCs and EGSs for AEPS solar compliance (Companies' St. 4-SR, pp. 4-5).[11] The Commission should therefore approve the Companies' proposal to procure 40% of the SPAEC procurements in accordance with the Companies' commitments approved by the Commission in the FirstEnergy-Allegheny Energy merger proceeding.

F. Contingency Plans

1. Full Requirements Products

The Companies have developed contingency plans to procure full requirements products for the following scenarios: (a) the Companies' competitive solicitations for full requirements load-following tranche products are not fully subscribed; or (b) a default by any of the winning suppliers prior to the start of the delivery period or at any time during the delivery period (Companies' St. 4, pp. 11-12).

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[11] As discussed with respect to Non-Market Based Transmission Service Charges, there is also ample time to address any "transition" issues associated with the Companies' SPAEC procurements. *See* Section IV.D.1., *infra*.

In the event that a scheduled solicitation is not fully subscribed during the initial proposed procurement date, the Companies will rebid the unfilled tranches from that solicitation in the next scheduled procurement. For any unfilled tranches still remaining, the Companies will purchase the necessary physical supply through PJM-administered markets and serve as LSEs for the affected default service customers. The Companies' procurements will be made at real-time zonal spot market prices, and the Companies will not enter into hedging transactions to attempt to mitigate the associated price or volume risks to serve these tranches. At the next quarterly rate adjustment, the Companies will include an estimate of these costs in the weighted cost of supply calculation and utilize the reconciliation process to recover differences between the estimated and actual costs that the Companies incur as a result of purchasing the necessary supply. *See id.*

This two-stage contingency plan, incorporating rebids in solicitations and purchasing supply from PJM-administered markets if rebids are unsuccessful, provides bidders an incentive to participate in the competitive solicitation. If bidders were to believe that a less than fully-subscribed competitive solicitation would lead to a separate negotiated agreement or a secondary market procurement in which the Companies, on behalf of their customers, would seek to acquire the remaining supplies, then the incentive to participate in the solicitation process and the incentive for bidders to present their best offer in the process would be diminished, which would likely result in higher final prices. *See id.* The Companies' proposed contingency plans are similar to those previously approved by the Commission for Met-Ed, Penelec, and Penn Power. *See Met-Ed/Penelec 2009 DSP Order*, pp. 30-32; *Penn Power 2010 DSP Order*, pp. 12-14.

2. AEPS Requirements

In the event a Company is required to serve as LSE for a portion of its default service supply requirements, that Company will procure AECs at market prices to satisfy the AEPS requirements for such load (Companies' St. 4, p. 12). If a default service supplier fails to acquire or deliver the necessary AECs under an SMA, the supplier will be identified by the Company and will be assessed any associated AEPS compliance penalties. *See id.*, p. 20.

If some SPAEC tranches remain unfilled or if a winning SPAEC supplier defaults before or during the delivery period, the affected Company will conduct short-term procurements at market prices to ensure compliance for all solar photovoltaic AEPS requirements until such time as the Commission approves an alternative mechanism. Additional costs incurred by a Company in implementing this contingency plan will be assessed against the defaulting SPAEC supplier. *See id.*, pp. 20-21.

The Companies' proposed AEPS contingency plans are similar to those previously approved by the Commission for Met-Ed, Penelec, and Penn Power. *See Met-Ed/Penelec 2009 DSP Order*, p. 32; *Penn Power 2010 DSP Order*, pp. 14-15.

G. Supplier Master Agreements

In accordance with the Commission's default service regulations (52 Pa. Code § 54.185(d)(6)), the proposed DSPs include forms of SMAs that the Companies will execute with wholesale suppliers that are successful bidders in the Companies' default service supply procurements. The Companies have submitted separate form SMAs for procuring default service supplies for the Residential and Commercial Classes and the Industrial Class (Companies' Exs. RLS-1 and RLS-2). When the procurement results are approved by the Commission, an appendix to the SMAs will be updated to reflect the names of the applicable Company and the winning supplier and specific information for the successful bid (*e.g.*, the amount to be supplied, the price, and, as to the Residential/Commercial SMA, whether the supply is for the Residential or Commercial Class) (Companies' St. 3, pp. 4-5).

The proposed SMAs are the same in all material respects as the SMAs now used for default supply procurements by Met-Ed, Penelec, and Penn Power. Accordingly, the proposed SMAs include detailed provisions that address when they start and end, breach and default, credit requirements, billing and payment, procedures for energy scheduling, and other responsibilities and obligations of the default service supplier and Company. The few differences from the currently effective SMAs remove certain provisions relating to Penn Power's transition to PJM and assure uniformity across the Companies (Companies' St. 3, pp. 7-8).

Constellation proposed that the credit provisions of the proposed SMAs should be relaxed and that payment to suppliers should be weekly instead of monthly (Constellation St. 1-SR, pp. 8-14). The OCA proposed that the confidentiality provisions in both the SMAs and the bidding rules should be revised to permit "appropriate reviewing parties," which it defines to include, in addition to itself, the Commission, the OSBA, and I&E, to have access in future proceedings to unspecified information (OCA St. 1-R, p. 47). The OSBA noted that the Companies have agreed to provide post-procurement information in accordance with the FE/Allegheny Merger Joint Settlement but proposed that the Independent Evaluator also be required to calculate risk premiums associated with those procurements. Each of these proposals is addressed below.

1. Unsecured Credit Thresholds

Mr. Fein, on behalf of Constellation, proposed two changes to the SMA credit provisions. First, he proposed that the amount of unsecured credit that the Companies should grant to suppliers before suppliers are required to post collateral should be increased from $75 million to $125 million, as permitted under West Penn's existing SMA (Constellation St. 1, pp. 10-11; Constellation Ex. 1SR-1, p. 2). Second, he proposed eliminating the SMA's Independent Credit Requirement ("ICR"). *Id.*, pp. 11-12.

Mr. Fein asserted that the Commission must accept Constellation's proposed changes to ensure that default service supply procured by the Companies meets the "least cost over time" standard and, as purported support for his position, referred to the Commission's decision in *Re: Petition of PPL Utilities Corporation for Approval of a Default Service Program and Procurement Plan for the Period January 1, 2011 through May 31, 2014*, Docket No. P-2008-2060309, Order entered June 30, 2009 ("*PPL Order*"). However, in the portion of that decision upon which Mr. Fein relied, the Commission was not addressing supplier credit requirements. Rather, it considered and rejected a so-called "One-Way" default termination payment provision proposed by PPL, which the Commission determined was not industry standard. *Id.* at 27.

Unlike the contract provisions addressed in the *PPL Order*, Constellation does not contend that unsecured credit amounts embodied in West Penn's currently effective SMAs, which he favors, are "industry standard." To the contrary, Mr. Fein suggested only that granting more unsecured credit to suppliers would allegedly make Met-Ed's, Penelec's and Penn Power's SMAs "more attractive to potential bidders" (Constellation St. 1-SR, p. 10). As Mr. Schreader explained, in light of the successful procurements to date by Met-Ed, Penelec, and Penn Power, it is more appropriate to extend the unsecured credit provisions set forth in the Met-Ed, Penelec and Penn Power SMAs to West Penn rather than the other way around (Companies' St. 3-R, pp. 2-3).

With respect to the ICR, Mr. Fein asserted that it should be eliminated because it represents "over-collateralization" and has been removed from the SMAs of some other EDCs in Pennsylvania, Maryland, Delaware and the District of Columbia. In fact, as Mr. Schreader also explained, the ICR does not represent excessive collateral at all. To the contrary, it protects customers from the risk of "intra-month" exposure following a supplier's default and also protects customers from the cost of associated components of default service supply that are not covered by the SMA's "mark-to-market" credit provisions (Companies' St. 3-R, pp. 3-4). Furthermore, the ICR is used in the statewide procurements of default service supply in New Jersey and has not precluded Constellation from participating successfully in those procurements.[12] The Commission should, therefore, reject Constellation's proposals to increase unsecured credit and eliminate the ICR in the Companies' SMAs.

2. Monthly Versus Weekly Settlements

Like his proposal to increase unsecured credit to suppliers, the weekly settlements Mr. Fein advocated are not an "industry standard" as he implicitly acknowledged by his assertion that weekly settlements are only "increasingly" finding acceptance in default supply agreements (Constellation St. 1-SR, p. 13). Moreover, Mr. Fein's reliance on the report of an independent advisor to the New Jersey Board of Public Utilities ("NJBPU") as support for his contention that weekly settlements will reduce costs for suppliers (Constellation St. 1-SR, pp. 13-14) is misplaced because the NJBPU subsequently rejected the advisor's recommendations.[13] The continuing monthly settlement requirement in New Jersey has also not prevented Constellation from submitting successful bids to provide default service supply in New Jersey.[14]

As explained by Mr. Valdes, moving from monthly to weekly settlements would effectively shift cash working capital costs from default suppliers to customers and force an increase in customer rates to cover those added costs (Companies' St. 2-R, p. 25). In addition,

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12 *See* Decision and Order, *In the Matter of the Provision of Basic Generation Serv. for the Period Beginning June 1, 2012*, Docket No. EO11040250 (Feb. 9, 2012) ("*NJBPU 2012 Order*") (approving DCA results and listing Constellation as winning supplier), p. 6.

13 *See* Decision and Order, *Re Provision of Basic Generation Serv.*, Docket No. EO09050351 (Dec. 10, 2009), p. 13.

14 *See NJBPU 2012 Order*, p. 6.

there is no reason to believe that all default service suppliers are actually settling their own underlying supply contracts on a weekly basis (Companies' St. 3-R, p. 5). Consequently, for all of the foregoing reasons, the Commission should not alter the monthly settlement process being used by the Companies and, therefore, should reject Constellation's proposed changes to the SMAs.

3. Confidentiality

As previously noted, the OCA proposed generally amending provisions in the Companies' SMAs and DCA Bidding Rules to allow what it refers to as "appropriate reviewing parties" access to unspecified "important information" relating to the Companies' procurements for use in future Commission proceedings (CA St. No. 1, p. 47). The OSBA also requested that the Independent Evaluator be required to calculate implied risk premiums in winning bid prices, with such information then generally released (OSBA St. No. 1, p. 27).

Both proposals should be rejected. The Commission has already approved the types of information that will be provided to OCA, OSBA, and BI&E relating to the Companies' procurements after June 1, 2013, subject to appropriate confidentiality agreements, and the provision of this information is reflected in the Companies' Bidding Rules. See Companies' St. 1, p. 25; Companies' St. 5, Ex. BAM-1 (p. 28); see also FE/Allegheny Merger Settlement, ¶ 53. The Commission should not now impose new requirements. In addition, the OSBA is able to undertake any risk premium analysis it believes should be conducted following the Companies' procurements; such expert analysis is outside the established role of the Independent Evaluator (Companies' St. 5, pp. 5-6).

III. RATE DESIGN AND COST RECOVERY

A. Residential And Commercial Classes: Price To Compare Default Service Rider

The Residential and Commercial Customer Class default service rates of all the Companies except West Penn are charged through a Price to Compare Default Service Rate ("PTC") Rider. The PTC Rider sets forth rates for default service that are incorporated in the applicable rate schedules that comprise the Residential and Commercial Classes. West Penn currently imposes a Generation Charge, an Energy Cost Adjustment Charge (essentially an "E" Factor adjustment) and a Transmission Service Charge for customers taking default service under Service Types 10, 20 and 30. Those three charges, plus any associated State Tax Adjustment Surcharge ("STAS"), constitute West Penn's Price to Compare (Companies' St. 2, p. 10). West Penn proposes to adopt a PTC Rider like those employed by Met-Ed, Penelec and Penn Power, including changes to the PTC Rider that those Companies are proposing in this case, which are explained below. *Id.*

Default service rates established pursuant to the PTC Rider consist of a single per-kWh energy charge, which changes quarterly. These rates currently recover: (1) generation costs, certain transmission costs and ancillary service costs; (2) supply management and administrative costs, as provided in 52 Pa. Code § 69.1808; and (3) applicable taxes. In addition, the default service rates include a quarterly reconciliation component, or "E factor," to recoup or refund, as applicable, under or over-collections from prior periods (Companies' St. 2, p. 9).

The Companies are proposing certain changes to the PTC Riders currently in effect for Met-Ed, Penelec and Penn Power and to be adopted by West Penn. These changes, which are reflected in the proposed PTC Riders set forth in the Companies' Exhibits REV-1 through REV-4, consist of the following:

1. The three-month periods used as the basis for recalculating default service rates are being advanced by one month, from the three months ending January 31, April 30, July 31 and October 31, to the three months ending December 31, March 31, June 30 and September 30. However, the effective dates of recalculated PTC Rider rates will remain March 1, June 1, September 1 and December 1. As a consequence, customers and EGSs will have additional time to consider and respond to each new set of quarterly default service rates (Companies' St. 2, pp. 10-11).

2. The seasonal weighting factors used to translate prices obtained in the default service auction into PTC rates, which are currently set forth in both the PTC Rider and in the Companies' SMAs, will be eliminated from the PTC Rider because it is not necessary, and could be a source of ambiguity, to have them in both locations (Companies' St. 2, p. 11). The Companies' proposed SMAs in this case continue to include the seasonal weighting factors. *Id.*

3. PJM's charges for NITS, RTEP, Expansion Costs, Generation Deactivation costs and unaccounted-for energy costs will no longer be recovered under the default service rates established pursuant to the PTC Rider, for reasons discussed in Section III.D., *infra*.

4. A Market Adjustment Charge ("MAC") and a cost of credit component are being added to the PTC Rider rates (Companies' Sts. 2 (p. 12) and 7 (p. 11)).

5. The time for filing PTC Rider rates with the Commission will be changed from ten days prior to the effective date of such rate changes to 30 days prior to the effective date (Companies' St. 2, p. 12).

6. Finally, minor changes to the text of the PTC Riders are proposed so that the PTC Rider can be used for all the Companies including West Penn. *Id.* As previously explained, West Penn proposes to adopt the same PTC Rider proposed by the other Companies in this case, which will make the default service rate design and cost recovery method uniform across all the Companies and, by so doing, satisfy a condition of the FE/Allegheny Merger Joint Settlement").[15]

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[15] Specifically, Paragraph 38 of the Commission-approved FE/Allegheny Merger Joint Settlement, (Docket Nos. A-2010-2176520 and A-2010-2176732) states:

> In their default service filings for the period beginning June 1, 2013, each post-merger FirstEnergy EDC will propose that the structure of the Price to Compare ("PTC") for each of the four post-merger EDCs will utilize the same PTC structure. Any PTC included on customer bills for the post-merger FirstEnergy

The design of the PTC Rider rates for the Residential and Commercial Classes is consistent with the Commission's default service regulations and the Public Utility Code. With respect to the Residential Class, the Commission's regulations at Section 54.187(c) state that default rates may not use a declining block structure. The Commission's regulations at Section 54.187(h) require that default rates charged to all rate classes with maximum registered peak loads of 25 kW or less (which includes the Residential Class) be adjusted no less frequently than quarterly, while Section 2807(e)(7) of the Public Utility Code provides that the residential rates should change no more frequently than quarterly. The Companies' proposed PTC Rider rates for the Residential Class comply with these requirements because they employ a flat per-kWh design and will change quarterly (Companies' St. 2, pp. 13-14).

With respect to the Commercial Class, the Commission's regulations provide that the default service rates for customers with a maximum registered peak load of up to 500 kW should be adjusted no less frequently than quarterly. However, the Commission's regulations also provide that default service providers may propose, for Commission approval, a different grouping of customers in order to avoid splitting existing customer and rate classes. Accordingly, when Met-Ed, Penelec and Penn Power proposed the Default Service Plans that are currently in effect for each, they sought approval of Commercial Classes that differed somewhat from the 500 kW threshold recommended in the Commission's regulations. The Commission-approved settlements in Met-Ed's and Penelec's prior proceeding defined the Commercial Class to generally include customers with peak monthly demands that do not exceed 400 kW, while the

EDCs will be calculated as a customer specific PTC for the current month of service.

Commission-approved settlement for Penn Power defined the class to include all customers served at secondary voltage on specified rate schedules that apply generally to commercial customers. The Commercial Class definitions approved as part of the existing Default Service Plans for Met-Ed, Penelec and Penn Power preserve their existing customer and rate classes. Consequently, in this case, those Companies believe that the continued use of their existing Commercial Class definitions and the concomitant quarterly adjustment procedures should be approved (Companies' St. 2, p. 14). Additionally, the Commercial Class proposed by West Penn consists of customers with billing demands that are less than 500 kW, and this delineation coincides with the principal recommendation set forth in the Commission's regulations (Companies' St. 2, p. 15). Finally, like the PTC Rider for the Residential Class, the Commercial Class PTC rates employ a flat per-kWh design and, therefore, are consistent with the Commission's regulation prohibiting a declining block structure (Companies' St. 2, p. 14).

Finally, the Companies have not proposed any restrictions on "switching" for customers that obtain default service under the PTC Rider. The Companies' proposed PTC Riders, like their current PTC Riders, do not require customers to remain on default service for a minimum term nor do they impose any restrictions on switching to an EGS or from an EGS to default service. However, switching may only occur on a meter reading date in accordance with the Companies' meter reading cycles and in conformance with the enrollment criteria stated in their respective supplier tariffs (Companies' St. 2, p. 15).

B. Industrial Class: Hourly Pricing Default Service Rider

The Industrial Class default service rates of all the Companies except West Penn are charged through an Hourly Pricing ("HP") Default Service Rider that is part of each Company's tariff. This Rider applies to the Industrial Class, but it may also be elected, on a voluntary basis, by qualifying commercial customers that have smart metering in place (Companies' St. 2, p. 15). West Penn currently has an Hourly-Priced Default Service Rider in its tariff to recover the cost of providing hourly-priced service to Service Type 40 customers. West Penn's Hourly-Priced Default Service Rider differs in certain material respects from the HP Default Service Rider used by Met-Ed, Penelec and Penn Power and, therefore, West Penn proposes to adopt an HP Default Service Rider like the one used by those Companies including the changes to that Rider that are proposed in this case (Companies' St. 2, pp. 15-16).

For Met-Ed's, Penelec's and Penn Power's Industrial Class and West Penn's Service Type 40, default service rates are currently based upon the PJM hourly locational marginal price ("LMP") for each Company's respective PJM-designated transmission zone plus associated costs, such as capacity, ancillary services, PJM administrative expenses and costs to comply with AEPS requirements that are incurred to provide hourly-priced service (Companies' St. 2, p. 9). The default service rates also include an "E" factor to reconcile costs and revenues. The principal components of the HP Default Service Rider are described in Companies' Statement No. 2 (pp. 17-18). The "E" factor component of the HP Default Service Rider will change quarterly to reconcile costs and revenues (Companies' St. 2, pp. 18-19).

Met-Ed, Penelec, and Penn Power propose to revise their HP Default Service Riders: (1) to add a cost of credit component; (2) to make minor textual changes so that the HP Default Service Rider can be used for all the Companies, including West Penn; and (3) to remove the provision for recovering in HP Default Service rates NITS charges and any direct transmission owner charges imposed by PJM as a result of a Company providing hourly pricing service, as discussed in greater detail in Section III.D., *infra* (Companies' St. 2, p. 16). These changes are set forth in the proposed HP Default Service Riders provided as Companies' Exhibits REV-5 through REV-7.

West Penn's current Hourly-Priced Default Service Rider provides an hourly-priced product based upon day-ahead LMPs, rather than the real-time LMPs offered by Met-Ed, Penelec and Penn Power, and prices capacity on a per-megawatt ("MW") day basis instead of the per-kWh basis employed in the HP Default Service Rider. With the Commission's approval, effective June 1, 2013, West Penn will adopt an HP Default Service Rider that employs the same kinds of charges, calculated in the same manner, set forth in the HP Default Service Riders of Met-Ed, Penelec, and Penn Power (Companies' St. 2, p. 17). By so doing, the rate design for hourly pricing service will be consistent across all Companies as required by the terms of the Merger Joint Settlement. West Penn's proposed HP Default Service Riders are set forth in the Companies' Exhibits REV-8 and REV-9.

The hourly-priced service to be offered under the HP Default Service Riders is consistent with the Commission's regulations at 52 Pa. Code § 54.187(i) and (j), other applicable provisions of those regulations, the Merger Joint Settlement and the Commission's prior approval of the Companies' customer class definitions and service offerings (Companies' St. 2, p. 21). Additionally, the Companies are not proposing any minimum terms or switching restrictions under their HP Default Service Riders. However, switching may only occur on a meter reading date in accordance with the Companies' meter reading cycles and in conformance with the enrollment criteria of the Companies' respective supplier tariffs. *Id.*

C. Market Adjustment Charge

1. Summary and Overview

The Companies are proposing to include a MAC in their PTC Riders. The MAC is a bypassable charge that would be imposed on non-shopping Residential and Commercial Customers at a rate of 5 mills ($0.005) per kWh and recovered as part of the Price to Compare. The MAC will compensate the Companies for the risks they bear and the value they provide as default service providers, which are not currently recognized anywhere in the rates charged for default service (Companies' St. 7, pp. 11-14), and constitute "reasonable costs" to furnish default service that EDCs are entitled to recover under 66 Pa.C.S § 2807(e)(3.9):

> The default service provider shall have the right to recover on a full and current basis, pursuant to a reconcilable automatic adjustment clause under section 1307 (relating to sliding scale of rates; adjustments), all reasonable costs incurred under this section and a commission-approved competitive procurement plan.

Other jurisdictions, including Maryland and New Jersey, have recognized that default service providers are not adequately compensated unless the prices they charge include an increment to reflect the value they provide and the risks they bear as the providers of last resort for non-shopping customers (Companies' St. 7, pp. 12, 14). Moreover, the Commission's assertion of authority under 52 Pa. Code § 54.183(c) to reassign the default service obligation to a default service provider other than an EDC implicitly acknowledges that some mechanism should exist to compensate a default service provider for the risks it assumes and the value it creates. Otherwise, it is impossible to envision why any alternative default service provider would be interested or willing to assume the responsibility now exercised by EDCs (Companies' St. 7-R, p. 6; Tr. 256-258).

Additionally, unless default service providers are properly compensated for the obligations they assume in that role, the price of default service is artificially depressed, which may impede the development of the competitive retail market. EGSs, which must charge prices that are adequate to cover their costs, including a reasonable margin, are at a decided disadvantage if they must "compete" against default service prices that do not properly compensate default service providers for assuming the substantial contractual and statutory obligations of serving as providers of last resort (Companies' Sts. 7 (pp. 14-15) and 7-R (pp. 7-8)). Therefore, the MAC also functions as an important competitive market enhancement. *Id.*

The Value Created And The Risks Borne By Default Service Providers. As default service providers, the Companies commit to significant contractual obligations under their SMAs to obtain default generation supplies on behalf of default service customers. Obviously, there is an inherent value to customers to have an entity assume liabilities of that magnitude on their behalf. The full extent of that value is not readily quantifiable. However, one significant component of the total value proposition was specifically identified and quantified by the Companies, namely, the value customers realize because the Companies are creditworthy counterparties (Companies' St. 7, p. 12). As a direct result of the Companies' commitment of available credit capacity to their SMAs, generation suppliers are willing to enter into SMAs that do not require the Companies to furnish collateral for the contract obligations they assume under those agreements. *Id.* If the Companies preserved their credit capacity instead of committing it to their contractual SMA obligations, suppliers would insist on imposing collateral requirements and, by so doing, increase the costs borne by customers. *Id.* The Companies have calculated that entering into SMAs that do not include collateral requirements provides a benefit to default service customers of between one and two mills ($0.001 – $0.002) per kWh (Companies' St. 7, pp. 12-13).

In addition, default generation suppliers are held responsible only for AEPS requirements as they exist at that time SMAs are executed. In this way, customers pay default generation supplier prices that exclude any element of the risk of future increases in the cost of AEPS compliance. *Id.* That value flows to customers only because the associated compliance risk falls on the Companies. The Companies are not currently compensated for creating that value or for assuming the associated risks. *Id.*

Of course, one of the largest components of the total value the Companies provide default service customers is that, as PJM-designated LSEs they must continuously stand ready to serve load, or to procure additional supply, if any supplier breaches its obligation under an SMA. The assurance of continued service at transparent market-based prices by entities that have sufficient creditworthiness to meet such an open-ended obligation has incalculable value to default service customers and to EGS customers that, for whatever reason, must return – or choose to return – to default service. No element of the existing default service pricing structure compensates EDCs for shouldering this obligation or providing the associated value to customers (Companies' St. 7, p. 13).

As explained above, for virtually every element of value created by the Companies, they bear an associated risk. However, there are a number of other, significant risks that EDCs face as default service providers. Not all of those risks are apparent because many are inchoate and would not surface until a major dislocation in the markets were to actually occur. Nonetheless, the Companies identified a number of major risk factors that clearly exist now and are not reflected in the price of default service. As explained by Dr. Reitzes (Companies' St. 6, pp. 36-

37), the obligations imposed on default service providers to support the competitive retail market create the risk of the Companies being unable to fully recover certain costs that are not included in their existing default service rates, including, among others:

- The need to maintain infrastructure and personnel to ensure generation supply in the event winning bidders in the default service auctions do not fulfill their obligations;
- Unanticipated cost increases under the program for purchasing receivables from EGSs at zero discount;
- Increases in uncollectible accounts expense associated with default service[16]; and
- The cost of providing incremental working capital to meet PJM collateral requirements if winning bidders in the default service supply auctions do not meet their supply obligations.

Approval Of Price Elements Comparable To The MAC In Other Jurisdictions. As previously noted, utility regulatory commissions in other jurisdictions have included charges like the MAC in default service rates. In Maryland, a specific return component is permitted as part of the price for service furnished to residential and small commercial customers (Companies' St. 7, p. 12). The issue of whether such a return component should be included in default service rates and in what manner was addressed in proceedings before the Maryland Public Service Commission which approved a comprehensive settlement that provided for the addition of a return component to default service prices. *Id.* New Jersey approved a "Retail Margin" of 5 mills per kWh to be included in the charges for basic generation service (the New Jersey

[16] This cost can be significant, as evidenced by Met-Ed, Penelec and Penn Power having incurred a shortfall in recovery of default service-related uncollectible accounts of approximately $3 million since the initiation of their existing Default Service Plans (Companies' St. 1-SR, p. 3).

equivalent of default service) furnished to customers with annual peak loads of 750 kW or above between 2004 and 2010 (Companies' St. 7, p. 12). And, the Public Utility Commission of Texas authorizes a 20% return to be added to the cost of wholesale energy costs in the prices charged by companies furnishing provider-of-last-resort service. *Id.*

Admittedly, each state operates under a somewhat different statutory scheme. Nonetheless, it is noteworthy that other regulatory commissions have found, as a factual matter, that default service is not fully compensated without reflecting an increment for the risks borne and the value provided by default service providers. Ample evidence has been produced in this case to show that the same holds true for EDCs in Pennsylvania.

Section 54.183(c) Of The Commission's Regulations And The Provision Of Default Service By Entities Other Than EDCs. Under 52 Pa. Code § 54.183(c), the Commission has asserted authority to reassign the role of default service provider to entities other than EDCs. If that authority is to have any real force, there must be entities willing to assume the obligations of furnishing default service. However, it is virtually inconceivable that any entity considered a valid candidate for that role would willingly undertake the obligation of serving as a default service provider without being compensated for shouldering the attendant risks. Stated simply, absent a return commensurate with the risk incurred, no rational market participant would step up to become an assigned default service provider and, therefore, it would be unlikely that Section 54.183(c) would have any practical application.

Clearly, the Commission did not adopt Section 54.183(c) with the expectation that, as a practical matter, it could never be exercised. Thus, Section 54.183(c) incorporates the implicit assumption that a default service provider can, and should, be compensated for the risks it bears and the value it provides by allowing it to recover an appropriate margin above its out-of-pocket expenses. If that is the case for non-EDC default service providers – and it clearly appears that it is – then there is no reason why EDCs serving in the same capacity should be denied compensation for the same "reasonable costs" of furnishing default service that alternative providers of that service are entitled to receive. Indeed, neither the Commission's regulations nor the Public Utility Code distinguishes between EDC and non-EDC default service providers in this regard. And, RESA's witness, when confronted with this issue, candidly stated that he was at a loss to discern any such distinction (Tr. 256-258).

The MAC As A Competitive Market Enhancement. The MAC is necessary to properly compensate the Companies for the risks they bear and the value they provide in discharging their obligations as default service providers. As such, the MAC levels the playing field for EGSs which, absent a MAC, would be competing against a default service price that excludes significant elements of EDCs' cost to furnish default service. In short, without the MAC, the "headroom" between default service prices and the prices EGSs are able to charge would be artificially reduced (Companies' St. 7, p. 11).

The attractiveness of EGS offers depends in large part on how their prices compare to the price of default service. As default service pricing rises relative to current forward market prices, competitive retail options become more attractive to consumers. In this context, a MAC that increases the Price to Compare modestly above forward wholesale energy prices in order to adequately compensate EDC providers of default service is likely to induce greater market penetration by EGSs in the residential and small commercial classes (Companies' St. 6, p. 37).

The Companies' witness, Dr. Reitzes, conducted detailed studies showing that the percentage of residential customers who choose competitive retail supply (i.e., the "shopping" percentage) increases in tandem with increases in the difference between the Price to Compare and wholesale energy prices (Companies' St. 6, p. 38). The results of that study were displayed graphically in Dr. Reitzes' direct testimony, and more detailed graphic presentations were provided in Appendix C to that testimony. *Id.* The study shows that higher shopping percentages are achieved among residential customers in utility service territories where there is a larger differential between the Price to Compare and wholesale market costs. The study's results are consistent with earlier comprehensive research that Dr. Reitzes presented in a peer-reviewed publication.[17] *Id.* In summary, the MAC will provide the important collateral benefit of promoting robust competition in the retail electricity market and, therefore, is a meaningful competitive market enhancement.

2. Positions Of Parties Opposed To The MAC

I&E, the OCA and the OSBA oppose the MAC, while, as discussed in subsequent sections, RESA and Dominion support modified versions of the proposed MAC. For the most part, the parties opposed to the MAC voice three principal objections: (1) that it is not permitted under 66 Pa.C.S § 2807(e)(3.9); (2) that it represents a "return" that, allegedly, is not justified because the Companies cannot identify any "investment" to which the "return" relates; and (3) it would not foster greater competition and EGSs would simply raise their prices. None of these arguments are valid.

The Contention That The MAC Is Not Permitted Under Section 2807(e)(3.9). Opponents of the MAC contend that it should not be approved because it does not represent a "reasonable cost" of furnishing default service entitled to recovery under 66 Pa.C.S § 2807(e)(3.9). However, each of these parties chose to ignore the evidence and simply pointed to

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[17] James D. Reitzes, Lisa V. Wood, J. Arnold Quinn, and Kelli L. Sheran, "Designing Standard-Offer Service to Facilitate Electric Retail Restructuring," *The Electricity Journal*, Vol. 15, No. 9 (Nov. 2002), pp. 34-51.

"reasonable cost" language of Section 2807(e)(3.9) while assuming the point they set out to prove. In fact, the MAC, even if characterized as a "return," reflects a "reasonable cost" that the Companies incur as default service providers and, therefore, are entitled to recover, for three reasons: (1) the Companies bear risks and provide value to customers in their role as default service providers for which they are not being compensated under the existing pricing structure for default service; (2) the right to a "return" commensurate with the risks default service providers bear and the value they create is implicit in the Commission's assertion of authority under 52 Pa. Code § 54.183(c) to reassign the default service obligation to an alternative default service provider; and (3) by failing to recognize such a reasonable return component in the Price to Compare, EGSs are forced to compete against an artificially depressed price (Companies' St. 7-R, pp. 5-6).

The Contention That The MAC Constitutes A "Return" For Which There Is Not A Corresponding "Investment." In general, the parties opposed to the MAC base their arguments on concepts derived from utility ratemaking. Those concepts, while acceptable for setting regulated utility rates under standard cost of service (i.e., rate base/rate of return) models, are not applicable to pricing default service, which represents only one of many options that customers can choose in the market for competitive electric service. While the Companies do not have an investment in generating facilities that furnish default service, they clearly have assumed a significant liability by contracting for generation to meet default customers' needs. The risks that attend the Companies' obligations, while different from those associated with the ownership of tangible assets, are, nonetheless, a significant form of investment for which the Companies should be compensated (Companies' St. 7-R, pp. 5-6).

Along the same lines, OCA witness Kahal alleged that the MAC would produce an "artificial increase" in the price of default service that is not warranted by "invested capital" (OCA St. 1, pp. 40-44). Mr. Kahal fundamentally misapprehended the basis for the Companies' MAC proposal, which, as previously discussed, is supported by significant "investment" that is not being recognized in the Companies' rates (Companies' St. 7-R, p. 11). Mr. Kahal's contentions are wrong for another important reason. He chose to ignore the substantial investment in goodwill that the Companies have made, which underlies their assigned role as default service providers.

As the Commission is aware, one of the challenges to fostering greater competition in the residential and small commercial market is customers' view that they receive greater value, relative to price, by purchasing default generation service from their incumbent EDCs. These customers' purchasing decisions reflect, in large part, the trust and brand loyalty that EDCs have built with customers over many years of providing reliable service. That trust and brand loyalty is the substance of the asset recognized and booked, under generally accepted accounting principles ("GAAP"), as "goodwill" (Company St. 7-R, p. 8).

In competitive markets for other goods and services, the added value that customers attach to a seller's "brand" supports a higher price. To capture the value-premium associated with a particular vendor's "brand," a customer pays a premium price. Premium pricing, however, leaves room for other vendors, who have not built up similar "brand equity," to compete effectively on the basis of price. Customers have to decide whether a premium price is justified by comparison to the products offered by other vendors. *Id.* As the Companies' witness Charles V. Fullem explained, the current pricing structure for default service not only fails to compensate the Companies for the risks they bear and the value they create, it also fails to properly account for the increment in price necessary to reflect the "brand equity" inherent in EDC-provided service (Companies' St. 7-R, p. 8).

There has been only marginal success from the significant efforts expended by EDCs and the Commission to educate customers that electric generation is a fungible commodity; no material "premium" should be attached to purchasing generation from their incumbent EDCs; and, therefore, price should be the most meaningful basis for choosing a generation supplier. The limited success achieved by education alone is understandable because customers respond to incentives. And, as default service is currently priced, the incentives are inconsistent with the consumer education message. If the "name brand" and the generic product are priced the same, customers will – all other things being equal – choose the name brand.

In contrast to how default service is priced, in unregulated markets name brands and other brands do not sell at the same price. *Id.* The "goodwill" associated with brand loyalty bears a premium price. Customers have to make a judgment about the price-to-value ratio of each product. In very large numbers, customers exercise their judgment to purchase the non-name brand, which is why so many competing vendors exist and can sell their products profitably in thousands of product markets across the country. *Id.* As Mr. Fullem explained (Companies' St. 7-R, p. 9), the existing structure of default service pricing ignores these basic economic principles:

> As things now stand, the pricing of default service does not reflect the straight-forward economics I described above. In the market for electric generation service, it is generally acknowledged that customers retain significant loyalty to the "brand" they associate with their incumbent utilities. However, the "name brand" is not priced to reflect the value-premium that customers attach to default service. In short, the price of default service is artificially depressed. As a consequence, regulation has removed from the generation market the incentives that operate in other competitive

> markets for customers to rationally assess price-to-value ratios for competing products. Under those circumstances, it is rational for customers to choose what they perceive to be the premium brand because they get the premium without paying for it.

Contrary to OCA witness Kahal's contention, the MAC, far from being an "artificial increase," is a reasonable way to assure that the price of default service offered by incumbent EDCs is not artificially depressed. The MAC allows the price of default service to reflect the value-premium that customers attach to purchases from their incumbent EDCs. If that increment is not reflected, then customers will rationally conclude that the price-to-value ratio favors default service. Depressing the price of default service by regulatory fiat, as currently occurs, not only fails to adequately compensate EDCs; it makes it very difficult for EGSs to compete on the basis of price while trying to build brand loyalty of their own (Companies' St. 7-R, pp. 9-10). As Mr. Fullem elaborated, OCA witness Kahal acknowledged the value inherent in EDC-provided default service, but ignored the investment that contributes to the creation of that value (Companies' St. 7-R, pp. 10-11):

> Mr. Kahal recognizes the value the Companies provide to customers through their provision of default service (OCA St. 1, p. 44). Nonetheless, he contends that none of that added value should be recognized in the price of default service because the Companies have "fail[ed] to identify any invested capital associated with that function" (OCA St. 1, p. 44). Mr. Kahal apparently is unwilling to acknowledge the existence of the asset that underlies the value-premium customers attach to EDC-provided default service. As I previously explained, that asset is "goodwill," which represents significant "invested capital" and, in fact, is recorded on corporate balance sheets as such pursuant to GAAP.

FirstEnergy Corp.'s investment in the Companies' goodwill is recorded on the Companies' books at approximately $1.2 billion. *Id.* That investment is not reflected in the Companies' delivery service rates, and the Companies are not proposing that it should be.

However, as explained earlier, default service is fundamentally different from regulated public utility service. Although traditional regulated service is priced under a standard cost of service (rate base/rate of return) model, default service is one of many products available to customers in the competitive market and, as such, must be priced under a different model. The increment of value that the MAC represents is the direct result of substantial underlying investments that generated the goodwill recorded on the Companies' balance sheets. Therefore, the Companies have a legitimate claim to retain the investment-backed increment of value that the MAC is designed to reflect. *Id.*

The Contention That The MAC Will Not Foster Competition And May Cause EGS Prices To Increase. OSBA witness Knecht and OCA witness Kahal argue that the proposed MAC would likely increase the prices EGSs charge to shopping customers because the retail markets are not "perfectly competitive." However, neither witness produced any evidence or empirical analysis that suggests the retail market is insufficiently "competitive" and, that any changes in customer demand resulting from the imposition of the MAC would increase the prices EGSs offer to shopping customers (Companies' St. 6-R, p. 11).

Many EGSs are actively marketing to customers in Pennsylvania, and there are no significant barriers limiting the ability of other EGSs to enter the market. *Id.* Moreover, there is no evidence that the marginal cost of supplying generation service to an additional customer increases with the number of customers that are being served, which is the fundamental – but flawed – assumption underlying the arguments of Messrs. Kahal and Knecht. *Id.* If the marginal cost of supply is not increasing with the volume of customers, then there is no valid, cost-based reason for EGSs' prices to increase as the number of customers they serve increases, as Dr. Reitzes pointed out. *Id.* Beyond that, the potential for an EGS to increase prices because more customers are shopping would be completely offset by the existence of multiple alternatives, including other EGSs' service offerings and the ability to "opt-in" to the service provided by the winner of the Retail Opt-In Auction. *Id.* Consequently, the contention that prices charged by EGSs to shopping customers would increase if a MAC were imposed has no basis in fact or in fundamental principles of economics.

3. RESA's Proposed Modification

RESA witness Kallaher supports the MAC in concept, agrees that the Companies bear risks and incur costs that are not compensated under the existing pricing structure for default service, and supports the Companies' retention of MAC proceeds to cover specifically identified costs (RESA St. 1, pp. 29-30). However, he opposes the Companies' retention of any portion of the MAC proceeds that might be characterized as a "reasonable return" and proposes that any MAC proceeds in excess of expenses actually incurred because of the risks identified by Dr. Reitzes (Companies' St. 6, pp. 36-37) be used for "improvements to the market structure in the EDC's service territory" (RESA St. 1, p. 31). Mr. Kallaher further proposes that any funds not used for the specific purposes he identified should be returned to customers. *Id.*

Mr. Kallaher's recommended modification to the Companies' MAC proposal should be rejected. His opposition to allowing the Companies to recover a "reasonable return" as part of the MAC is based on the same flawed reliance on utility cost of service ratemaking models that are not applicable to the default service function for the reasons discussed previously (Companies' St. 7-R, p. 12). Moreover, while acknowledging and accepting that the Companies bear risks and provide value in their role as default service providers, his proposal to exclude a "reasonable return" component in the Price to Compare would deny the Companies any compensation for assuming those risks and providing that value. *Id.*

4. Dominion's Proposed Modification

Dominion witness Butler also supports the MAC in concept. However, he recommends changes that would **increase** the charge to $0.01 per kWh until 50% of customers are shopping, would permit the Companies to retain only a small portion of the MAC proceeds, and would require the balance to be used to reduce administrative and competitive market enhancement costs the Companies propose to collect from all customers (Dominion St. 1, pp. 9-10).

Dominion's proposed revisions should not be adopted. However, if the Commission were to consider accepting Mr. Butler's proposal for a MAC of $0.01 per kWh, one-half of the proceeds should be retained by the Companies as reasonable compensation, for all of the reasons discussed previously, and the other half could be applied to reduce administrative and competitive market enhancement costs otherwise recoverable from all customers (Companies' St. 7-R, p. 13).

D. Default Service Support Rider

Met-Ed, Penelec and Penn Power currently have Default Service Support ("DSS") Riders in their respective tariffs that impose non-bypassable charges to recover the following four categories of costs:

1. The remaining balance of transmission costs that Met-Ed and Penelec were permitted to defer, amortize over ten years and recover pursuant to the Commission's Final Order in their 2006 transition base rate cases at Docket Nos. R-00061366 and R-00061367;

2. The final reconciliation of transmission costs and revenues, as of December 31, 2010, under the Companies' Transmission Service Charge ("TSC") Riders, which were also approved in their 2006 transition base rates cases[18];

[18] Met-Ed's and Penelec's TSC costs and revenues as of December 31, 2010 have been fully reconciled. In addition, the marginal transmission line loss charges that Met-Ed and Penelec recovered under their TSC Riders and that the Commission disallowed by its Order entered March 3, 2010 at Docket Nos. M-2008-2036188, *et al.* (the "TSC Order") will be fully refunded by May 31, 2013. Consequently, the DSS Riders

3. The generation-related portion of uncollectible accounts expense; and

4. Retail enhancement costs (Companies' St. 2, pp. 21-22).

Penn Power's DSS Rider currently recovers the following four categories of costs:

1. Uncollectible accounts expense associated with default service;

2. Midwest ISO ("MISO") Transmission Expansion fees, PJM integration fees, and MISO exit fees associated with Penn Power's move from MISO to PJM;

3. Customer education expenses; and

4. Beginning June 1, 2013, PJM RTEP costs, as approved in Penn Power's last Default Service Plan proceeding[19] (Companies' St. 2, p. 22).

Met-Ed and Penelec propose to continue to recover under their DSS Riders the amortization of the 2006 deferred transmission service charges, default service-related uncollectible accounts expense, and retail enhancement costs. However, Met-Ed and Penelec propose to revise their DSS Riders as follows:

1. To recover costs for customer education (excluding costs that are recovered under the Consumer Education Program Cost Recovery Rider);

2. To recover costs incurred for the proposed Retail Opt-In Aggregation Program and the proposed Standard Offer Customer Referral Program, under the Companies' primary proposal for cost recovery, which is discussed in Section IV, *infra*;

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proposed by Met-Ed and Penelec in this case will no longer contain a TSC reconciliation component. However, Met-Ed and Penelec are seeking further appellate review of the TSC Order. In addition, they have filed a Complaint in the United States District Court for the Eastern District of Pennsylvania challenging the TSC Order and seeking an order permitting them to recover PJM-imposed marginal transmission line loss charges. It is not known when a decision might be rendered in each case. Consequently, Met-Ed and Penelec reserve the right to recover through their DSS Riders or otherwise any previously-disallowed marginal transmission line loss charges, together with interest thereon, that they may hereafter be authorized to recover based on further appellate review or a decision of the United States District Court (Companies' St. 2, p. 23).

19 *Petition of Pennsylvania Power Company for Approval of Default Service Program for the Period from January 1, 2011 through May 31, 2013*, Docket No. P-2010-2157862 (Nov. 17, 2010) ("*Penn Power 2010 DSP Order*"), p. 20; Raia Cross-Examination Ex. 1, ¶ 47 at p. 20. *See also* Companies' St. 7, p. 9 (explaining the Commission's approval of DSS Rider recovery of RTEP costs for Penn Power).

3. To include a Non-Market Based ("NMB") Services Transmission Charge to recover charges imposed by PJM for NITS, RTEP, Expansion Costs and Generation Deactivation costs, as discussed in greater detail in Sections III.D.1. and III.D.2, *infra*;

4. To include UFE costs on a non-bypassable basis, as discussed in Section III.D.3, *infra*; and

5. To make minor changes to the text of the DSS Rider so that it can be adopted by West Penn and be uniform across all the Companies.

Penn Power's proposed DSS Rider will continue to recover default service-related uncollectible accounts expenses; any FERC-approved charges imposed by MISO and PJM in connection with Penn Power's transfer from MISO to PJM (including MISO Transmission Expansion fees, PJM integration fees, and MISO exit fees); customer education costs; and, beginning June 1, 2013, RTEP costs (Companies' St. 2, p. 24). Penn Power proposes to revise its DSS Rider as follows:

1. To recover costs incurred for the proposed Retail Opt-In Aggregation Program and the proposed Standard Offer Customer Referral Program, under the Companies' primary proposal for cost recovery, which is discussed in Section IV, *infra*;

2. To include a NMB Services Transmission Charge to recover NITS, Expansion Costs and Generation Deactivation costs, in addition to RTEP costs that were previously approved for recovery under Penn Power's DSS Rider, consistent with the discussion in Sections III.D.1 and III.D.2, *infra*;

3. To include UFE costs on a non-bypassable basis as discussed in Section III.D.3, *infra*; and

4. To recover programming and implementation costs associated with competitive market enhancements approved by the Commission, including consultant fees and other costs to develop and implement the proposed Time-Of-Use Default Service Rider for the Residential Customer Class, which is discussed in Section III.F., *infra*; and

5. To make minor changes to the text of the DSS Rider so it can be adopted by West Penn and be uniform across all the Companies (Companies' St. 2, p. 24).

As previously noted, West Penn proposes to adopt a DSS Rider to its Tariff Nos. 37 and 39 to become effective on June 1, 2013. West Penn's DSS Rider will include an NMB Services Transmission Charge and will recover the cost of customer education (excluding costs being recovered under its Consumer Education Charge Rider); costs associated with the proposed Retail Opt-In Aggregation Program and the proposed Standard Offer Customer Referral Program (for Tariff No. 39) under the Companies' primary proposal for cost recovery discussed in Section IV, *infra;* and programming and implementation costs associated with competitive market enhancements approved by the Commission (including consultant fees and other costs to develop and implement the proposed Time-Of-Use Default Service Rider for the Residential Class), which is discussed Section III.F., *infra* (Companies' St. 2, p. 24).

The proposed DSS Riders will employ a flat per-kWh rate design for the Residential and Commercial Classes and a demand-based rate design for the Industrial Class. The demands of customers in the Industrial Class will be determined in the same way they are determined under their applicable distribution rate schedule or, as to Penn State, under West Penn's Tariff No. 37, which applies only to Penn State. This rate design is consistent with the current metering capabilities of the various customer classes. Under the DSS Riders, the rates will change annually, on June 1 of each year, unless the Commission directs or approves otherwise. Copies of the DSS Riders for each of the Companies are set forth in the Companies' Exhibits REV-22 through REV-26 (Companies' St. 2, p. 25).[20]

[20] Companies' Exhibits REV-22 through REV-26 reflect the revisions to each Company's DSP II made as part of their rebuttal case and replace the Companies' Exhibits REV-10 through REV-14 submitted with the Companies' direct testimony.

1. Non-Market Based Services Transmission Charges

As previously explained, NMB Services Transmission Charges consist of the charges PJM imposes for NITS, RTEP and Expansion Costs (Companies' Sts. 2, (p. 25) and 7 (p. 8)). Currently, for default service, these costs are embedded in the Companies' Price to Compare.[21] EGSs serving shopping customers, as LSEs, bear these costs. *Id.* In this case, the Companies propose to acquire all NMB transmission services on behalf of both their default service generation suppliers and EGSs serving load in their respective service areas; to remove the associated costs from their Price to Compare; and to recover NMB transmission service costs under the NMB Services Transmission Charge of their DSS Riders as a non-bypassable charge imposed on a competitively neutral basis on all shopping and non-shopping customers. *Id.* As previously explained, for Penn Power, the proposed change only needs to encompass NITS and Expansion Costs because the Commission previously approved Penn Power's recovery of RTEP costs under its DSS Rider.

All NMB transmission charges, like the RTEP component of NMB transmission charges approved for DSS Rider recovery in Penn Power's last Default Service Plan proceeding, are embedded, cost-of-service rates that are imposed on the basis of an EDC's **total** native load, regardless of the source of the generation used to serve that load (Company St. 7, p. 9). In other words, the way NMB transmission charges are imposed does not differentiate between EDC load served by default generation suppliers and load served by EGSs. Therefore, separating those charges between default service and shopping customers, as occurs under the existing cost-recovery mechanisms, is a distinction that does not reflect how the associated costs are actually

[21] Some components of NMB Services Transmission Charges are borne directly by default service generation suppliers while others are acquired by the Companies on behalf of their default service generation suppliers and added to the Price to Compare. *See* Companies' St. 7, p. 10.

incurred. Recovering NMB transmission charges on a competitively-neutral basis from all customers is a more appropriate way to recover such costs that conforms to how those costs are actually incurred. *Id.*

Additionally, default service generation suppliers and EGSs find it very difficult to financially "hedge" NMB transmission charges because of how those charges are calculated and imposed, namely, as embedded cost-of-service rates that reflect an EDC's total load. Consequently, as evidenced by their favorable responses to the Companies' proposal, default service generation suppliers and EGSs have a strong preference not to procure NMB transmission services. *Id.*

By allowing the Companies to provide NMB transmission services and to recover the associated costs from all customers through a reconcilable, non-bypassable charge, competitive neutrality will be maintained and all customers will benefit. More specifically, allowing the Companies to acquire NMB transmission services and recover the associated costs on a reconcilable basis will lower the risk profile for both default service generation suppliers that bid in the Companies' supply auctions and EGSs offering competitive products because, given the difficulty of financially hedging such costs, both default suppliers and EGSs need to include in their prices a premium for the uncertainty of these costs. *Id.*

Messrs. Fried and Raia, employees of Proctor & Gamble Paper Products Co. ("P&G") and Sheetz[22] respectively, were the only witnesses that opposed the Companies' proposal to

[22] Although Mr. Fried purported to submit testimony on behalf of MEIUG, PICA and PPUG and Mr. Raia purported to submit testimony on behalf of the same groups plus WPPII, cross-examination revealed that both witnesses could, in fact, only represent the interests of their respective employers (Tr. 285-286, 310-311).

acquire NMB transmission services and recover the associated costs under their DSS Riders.[23] RESA, Dominion, Exelon and Constellation – a group that reflects the views of both default service generation suppliers and EGSs that participated in this case – affirmatively support the Companies' proposal (Companies' St. 2, p. 6). Each of the principal arguments offered by the P&G and Sheetz witnesses in opposition to the Companies' proposal was discredited by the Companies in their rebuttal and rejoinder testimony (Companies' St. 2-R, pp. 5-14; Tr. 61-62), as explained below.

Customers Could Be "Double Charged." The principal thrust of Mr. Raia's and Mr. Fried's testimony is that the Companies' proposal to recover NMB Services Transmission Charges from all customers on a non-bypassable basis will raise their cost of delivery service while allegedly reducing the cost their EGSs incur to supply generation to the Companies' load zones. *See* Fried St. 1, p. 8. According to Messrs. Raia and Fried, this realignment raises the specter that their employers will be "double charged" because, under any existing EGS contracts that extend past June 1, 2013, the possibility exists that they could pay NMB transmission charges in both delivery rates (pursuant to the DSS Rider) and as part of the price of generation purchased from their competitive suppliers. *Id.* That assumption is wrong for several reasons.

First, some customers (and P&G and Sheetz may be among them) are billed transmission charges from their EGSs by means of a direct pass-through. That is, the contracts provide that the EGS may charge only for the transmission costs it actually incurs. Thus, if the EGS ceases to incur NMB transmission charges because the Companies' proposal is implemented, the EGS

[23] OSBA witness Knecht supported the Companies' proposal but recommended a one-year "transition" period before implementing that proposal to allow EGSs and their customers additional time to adjust their existing contracts to reflect a realignment of NMB transmission costs from EGSs to the Companies. *See* OSBA St. 3, p. 14. Mr. Knecht's recommendation is discussed, *infra*, in connection with a similar proposal by Mr. Raia.

would be contractually obligated to not bill those costs to its customers. Therefore, if Sheetz, P&G and similarly-billed EGS customers have such a provision in their EGS contracts, there would be no need to do anything to avoid even the possibility of "double billing" of NMB transmission charges (Companies' St. 2-R, pp. 9-10).

Second, even if direct pass-through billing were not the norm, EGSs have a great deal of flexibility to set prices and to establish pricing options, which is the hallmark of the competitive retail electric market. EGSs may offer elements of the service they furnish (such as energy, capacity, ancillary services, NMB transmission charges, etc.) at prices that are above market (because they can do so and to maximize their margins), below market (to increase their market share), or on a direct pass-through basis (to minimize their risk of under-recovery). Only EGSs are in a position to know for sure how their prices align with their costs. Regardless of the reasons for such variations, trying to assess any one component of EGS service in isolation will not accurately depict whether, or to what extent, an EGS's overall price conforms to the EGS's costs and profit expectations. Consequently, the assumption underlying Messrs. Raia's and Fried's position, namely, that each component of an EGS's price can be reconciled, on a dollar-for-dollar basis, to a specific cost, is an over-simplification and not necessarily correct (Companies' St. 2-R, p. 10). As a consequence, an EGS's contractual supply rate under a contract extending beyond June 1, 2013, may reflect market pricing even if the EGS does not "renegotiate" that price after ceasing to incur NMB transmission charges. Such a "renegotiation" could simply result in an EGS mitigating below-market pricing of other elements of service to compensate for any cost reduction occasioned by the removal of NMB transmission charges.

Third, the concern expressed by the P&G and Sheetz witnesses applies only with regard to contracts that extend beyond June 1, 2013, i.e., almost seventeen months from the date the

Companies filed the Joint Petition laying out their DSP II proposals. And, even as to contracts extending beyond June 1, 2013, if customers believe that the Companies' proposal might warrant a reduction in their EGS's contract prices, they have the flexibility to renegotiate that pricing. In fact, in this case, one EGS committed to voluntarily adjust its price to remove NMB transmission costs as of June 1, 2013 (Dominion St. 1-R, p. 11). Although Messrs. Fried and Raia acknowledge that the opportunity exists to renegotiate post-June 1, 2013 contracts – to the extent they have any – they contend that doing so might be burdensome. *See* Fried St. 1, p. 8. However, another proposal by the same witnesses totally belies this argument. Specifically, they also recommended that EGSs should be responsible for 100% of the solar AEPS requirements for the load they serve. Notably, Met-Ed, Penelec and Penn Power currently provide, and charge customers for, 100% of solar requirements (thereby relieving default service suppliers and EGSs of any responsibility to satisfy solar requirements). As a consequence, Messrs. Raia's and Fried's solar recommendation would also drive the need to change the prices charged under their employers' post-June 1, 2013 EGS contracts, if any and, therefore, require renegotiation and price adjustment (Companies' St. 2-R, p. 13).

Met-Ed's and Penelec's Proposal To Recover NITS Charges Under Their DSS Riders Was Not Implemented In Their Last Default Service Proceeding (Raia St. 1, p. 7). Mr. Raia contended that the Companies' proposal in this case should be rejected because Met-Ed's and Penelec's proposal to recover NITS charges in their first Default Service Proceeding was not implemented. In that case, Met-Ed's and Penelec's proposal was not rejected by the Commission. Rather, Met-Ed and Penelec withdrew their proposal to remove NITS charges from the Price to Compare and recover such costs under their DSS Riders in order to reach a broad consensus among many parties as part of the complete resolution of virtually all issues.[24] That settlement, like all settlements, required give and take on various positions by all the settling parties. The settlement must be viewed as a whole, which means it is improper and inaccurate to characterize the agreement reached by the parties as the equivalent of a rejection by the Commission of their NITS proposal. Nothing concerning the merits of the Companies' proposal in this case can or should be inferred from the fact that a similar proposal was not incorporated in the prior settlement (Companies' St. 2-R, p. 12).

Furthermore, Mr. Raia simply ignored the fact that the Commission approved Penn Power's proposal to recover RTEP costs – an important component of NMB transmission charges – on a non-bypassable basis under its DSS Rider (Companies' St. 7, p. 9; Raia Cross-Exam. Ex. No. 1). In so doing, the Commission validated both the legal and factual basis for an EDC to acquire such service on behalf of all suppliers and to recover the resulting costs from shopping and non-shopping customers on a competitively-neutral basis, just as the Companies have proposed in this case. And, the Commission's prior approval completely undercuts Mr. Raia's suggestion (Raia St. 1-S, p. 6) that the Companies' proposal is not consistent with the Commission's regulations on default service. In fact, in its final order approving the Joint Petition for Settlement of Penn Power's last Default Service Program proceeding, the Commission approved the consensus reached by the parties in that case that "[Penn Power's] affiliates, Metropolitan Edison Company and Pennsylvania Electric Company, will recover RTEP in a manner consistent with this Settlement." *Penn Power 2010 DSP Order*, p. 20.

[24] *Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of Their Default Service Programs*, Docket Nos. P-2009-2093053 and P-2009-209354 (August 1, 2009). A copy of the Joint Petition for Settlement in the 2009 case was placed in the record as part of OCA Cross-Examination Exhibit No. 1.

The Companies' Proposal Transfers "Risk" From EGSs To Their Customers (Raia St. 1, p. 7). Contrary to Mr. Raia's contention, the Companies' proposal would not transfer "risk" from EGSs to their customers. At the outset, for any customer that is charged transmission costs by its EGS through direct pass-through billing – which might include some or all of Sheetz's contracts – no "risk" would be transferred to it because it already bears that risk. Furthermore, even if such costs were not transferred to customers via pass-through billing, any EGS "risk" would arise from the possibility that its prices would be insufficient to recover all of the NMB transmission charges it incurs. EGSs compensate for this and similar risks through the risk premiums built into their prices. If the Companies' proposal were adopted, the principal reason for EGSs to impose such a risk premium would be removed. Thus any "risk" would be eliminated and not transferred to customers because NMB transmission charges would be recovered dollar-for-dollar on a competitively-neutral, non-bypassable basis without the need for such a "risk" premium (Companies' Sts. 2-R (p. 11-12)). This point was also acknowledged and validated by OSBA witness Knecht: "[T]he EGS is going to reflect that risk in a higher price because the EGS can't really hedge these particular kinds of costs" (Tr. 351).

The Companies' Proposal Prevents Sheetz From Standardizing Its Procurement Process (Raia St. 1, pp. 6-7). Mr. Raia contended that the Companies' proposal will prevent Sheetz from standardizing its procurement process with all of its EGSs in Pennsylvania. As previously explained, Mr. Raia simply ignored the fact that Penn Power will recover RTEP costs under its DSS Rider pursuant to the Commission's approval granted in the *Penn Power 2010 DSP Order*. For that reason, among others, there is no "standardization" with respect to recovery of NMB transmission charges under the status quo, as the OSBA's witness acknowledged (Tr. 352-353):

> It's not clear you have total standardization now, and it's not clear that either continuing the status quo or adopting the companies' proposal in this proceeding, which of them is better at creating uniformity across the Commonwealth. . . . But keep in mind, as I think the company went through this morning, there are some differences from utility to utility right now in how these costs are recovered.

Moreover, Mr. Raia confirmed that Sheetz conducts separate auctions for the load of its facilities located in each EDC service territory. Separate supply auctions provide more than enough flexibility to reflect the different products offered by EGSs in each EDC's territory, and there is no evidence that the Companies' proposal will add any incremental burden to that process (Companies' St. 2-R, p. 11). Additionally, Sheetz has facilities served by the Companies' affiliated electric utilities in Ohio (Ohio Edison Company, The Cleveland Electric Illuminating Company and Toledo Edison Company), where NMB transmission charges were removed from their equivalent of the Price to Compare effective June 1, 2011 (Companies' St. 2-R, pp. 9 and 11). Consequently, the Companies' proposal will not be a roadblock to contract "standardization." *Id.*

P&G's Overall Transmission Costs Might Increase Under The Companies' Proposal (Fried Sts. 1 (pp. 8-9) and 1-S (p. 4)). Mr. Fried contends that the Companies' proposal could adversely affect P&G's overall transmission costs because transmission charges would be based on average data across an entire customer class. To be clear, the Companies propose to allocate NMB Services Transmission Charges to the various customer classes based upon class demands and, therefore, the charge to the Industrial Customer Class, of which P&G is a part, is based upon demand. Because NMB Services Transmission Charges are imposed by PJM on a demand basis, the Companies' proposal for **allocating** such costs is consistent with the methodology PJM uses to allocate these transmission-related costs (Companies' St. 2-R, pp. 12-

13). However, these charges will be billed to individual customers in accordance with the rate structure proposed for the DSS Rider, which is based on the individual demand for each industrial customer (Tr. 62). Consequently, and contrary to Mr. Fried's contention, as an individual customer's demand decreases, the NMB Transmission Services Charge decreases as well; likewise, if the customer's demand increases, the NMB Transmission Services Charge increases. *Id.* For exactly the same reason, Mr. Fried is simply wrong to assert that the Companies' proposal would "mute the price signals upon which the market depends" (Fried St. 1, p. 9).

The Companies Should Develop A "Transition Plan" For Customers With EGS Contracts Extending Beyond June 1, 2013 (Raia St. 1, pp. 5-6). If any implementation issues exist – and none do, for the reasons discussed above – they are customer and EGS-specific and, therefore, should be negotiated between such customers and their EGSs with regard to the remaining terms of any existing contracts (Companies' St. 2-R, p. 7). Contrary to Mr. Raia's contentions, there is ample time to do this considering that the Joint Petition initiating this case was filed on November 17, 2011. MEIUG, PICA PPUG and WPPII all filed Petitions to Intervene in this case on December 19, 2011 – a little over a month after the case began – and, therefore, had actual notice of the Companies' proposal well before that date. Additionally, EGSs were aware of the Companies' proposal to implement an NMB Services Transmission Charge from the date the Companies' Joint Petition was filed because it was served on all EGSs licensed to furnish service in the Companies' service territories. Further, as required by the Commission-approved settlement of the FirstEnergy Corp./Allegheny Energy, Inc. merger proceeding, the Companies began holding regularly-scheduled monthly meetings with EGSs and will continue to do so for the foreseeable future. These meetings provided EGSs an opportunity to discuss the implications of the Companies' proposal to implement an NMB Services Transmission Charge, and no issues or concerns were raised to date.

Consequently, Sheetz, P&G and the other customers comprising MEIUG, PICA, PPUG and WPPII will have had over eighteen months to "transition" to NMB transmission charges being recovered in the Companies' DSS Riders. Even if the period for "transition" were not deemed to begin until a final Commission order on the Companies' proposed DSP IIs is issued in August 2012, there will be a nine-month interval from that date to the implementation of the Companies' proposal as of June 1, 2013.[25]

As previously discussed, the Companies' Ohio affiliates recover NMB transmission charges on a competitively neutral, non-bypassable basis. The Public Utilities Commission of Ohio approved that proposal on August 25, 2010, with an effective date of June 1, 2011. This occurred without widespread concern or complaints from customers or consumer advocates (Companies' St. 2-R, p. 9). And, the transition period in Ohio was from August 2010 to June 2011, which is the same length afforded by the Companies' proposal (i.e., from August 2012 to June 2013).

In summary, NMB transmission services should be acquired by the Companies on behalf of default service generation suppliers and EGSs serving load in the Companies' service areas and such costs should be removed from the Price to Compare and recovered through the DSS Rider on a competitively-neutral, non-bypassable basis. The objections to that proposal voiced by Messrs. Fried and Raia are not valid reasons for the Commission to withhold its approval.

[25] As previously explained, OSBA witness Knecht supports the Companies' proposal but called for a one-year transition plan. For the reasons discussed above, the Companies' proposal affords a built-in "transition" period of more than one year (measured from the filing of the Joint Petition) and nearly a year from the expected date of a Commission order (Companies' St. 2-R, p. 8).

Moreover, an additional transition period beyond the substantial lead time already provided under the existing implementation schedule is not needed and should not be required.

2. Generation Deactivation Charges

Exelon's witness, William Berg, recommended that the Companies revise their DSP II proposal such that they would be responsible for Generation Deactivation charges imposed by PJM and recover those charges from all customers on a non-bypassable basis under their respective DSS Riders (Exelon St. 1, p. 2). Mr. Berg explained that Generation Deactivation charges have the same characteristics as NMB transmission charges (i.e., they are uncertain, lack transparency, are volatile and cannot be hedged) and, therefore, the same rationale for recovering NMB transmission charges under the Companies' DSS Riders applies with equal force to Generation Deactivation charges (Exelon St. 1, p. 4).

Generation Deactivation charges compensate generation owners for the continued operation of one or more generating units beyond their planned deactivation date pending the completion of transmission upgrades that PJM determines are necessary to sustain system reliability (Companies' St. 2-R, p. 21). Thus, Generation Deactivation charges are similar in concept to RTEP charges, which are a component of NMB transmission charges. Since both RTEP and Generation Deactivation charges are allocated by PJM on a demand basis, are non-market-based, are impossible to hedge, and are assessed by PJM to preserve system reliability, the Companies agree that is reasonable to recover such costs in the NMB Services Transmission Charges the Companies propose to add to their DSS Riders. *Id.* The appropriate changes have been made to the Companies' DSS Riders to incorporate Mr. Berg's recommendation, as shown in the Companies' Exhibits REV-22 through REV-26.

3. Unaccounted-For Energy Costs

Dominion's witness, Mr. Butler, recommended that UFE be borne by the Companies and recovered on a non-bypassable basis in the DSS Riders (Dominion St. 1, p. 4). The Companies accepted Mr. Butler's recommendation in their rebuttal testimony (Companies' St. 2-R, p. 22).

UFE is the difference between an EDC's system load, determined from the summation of generation and net inflows and outflows over its transmission lines, compared to the summation of all customer loads (both shopping and non-shopping) plus line losses. Such differences, which can fluctuate between a charge and a credit, are attributable to four main factors: (1) the difference between customer class average line loss factors (which remain constant) and the actual loss factor (which varies hour by hour); (2) the difference between customer class load profiles and the actual load used by customers; (3) estimated bills; and (4) estimates used in submitting generation and transmission tie-line meter information in determining the zonal load. *Id.* Because UFE is allocated to all EGSs (wholesale and retail) on an energy basis, all retail customers are currently paying for UFE either through default service generation charges or EGS charges. *Id.* However, UFE is unpredictable, and cannot be hedged, which means that EGSs likely include a risk component in their prices in an attempt to compensate for this unmanageable risk (Dominion St. 1, p. 4; Companies' St. 2-R, p. 22). Therefore, to mitigate that risk, it is reasonable for EDCs to collect such charges on a non-bypassable basis from all customers. For the Companies, this would occur through their competitively-neutral, non-bypassable DSS Rider. Therefore, the Companies have revised their DSS Riders, as set forth in Companies' Exhibits REV-22 through REV-26, to reflect that change. To maintain consistency with other components of the DSS Rider, the UFE net costs will be collected from the Residential and Commercial Classes on an energy basis and from the Industrial Class on a demand basis. *Id.*

OCA witness Kahal opposed Mr. Butler's recommendation because he contends that UFE is a "cost of doing business" for EGSs and "[m]erely because an EGS faces risks in providing service does not mean that the risk should be transferred to all customers, including those that do not even take EGS service" (OCA St. 1R, p. 10). Contrary to Mr. Kahal's contention, Mr. Butler's proposal, which the Companies endorse, would not "transfer" a risk borne by EGSs to "all customers." As previously explained, UFE is a cost borne by EGSs and the providers of generation supply for default service load, and both are subject to the risk of under-recovery created by the variability of UFE costs (Companies' St. 2-SR, p. 2). Because UFE is unpredictable and cannot be hedged, both default service generation suppliers and EGSs likely include a risk premium in their prices in order to compensate for the unmanageable risk imposed by UFE. *Id.* Consequently, all customers, whether they shop for generation service or not, already bear the cost of UFE, as well as the premium to compensate for the risk of under-recovering those costs, either through the prices charged by EGSs or the default service rates that that reflect prices charged by wholesale providers of default generation supply. *Id.*

As Mr. Butler and the Companies propose, the cost of UFE would be removed from both EGSs and wholesale default generation suppliers and recovered from all customers (both shopping and non-shopping) on a competitively-neutral basis as a reconcilable component of the Companies' DSS Riders. By providing a mechanism for dollar-for-dollar recovery of UFE costs, EGSs and wholesale default generation suppliers would not need to impose a premium in their respective prices to compensate for bearing the risk of not fully recovering UFE costs. *Id.* Consequently, the "risk" of under-recovering UFE costs is not "transferred" to customers - they already bear the financial consequences of that risk. Rather, the risk of under-recovery is, in effect, eliminated by assuring dollar-for-dollar recovery. As a consequence, Mr. Butler's proposal would likely reduce generation costs for all customers. *Id.*

4. Economic Load Response Charges

Economic Load Response ("ELR") charges provide market-based compensation to demand-response resources when those resources can cost-effectively be used. Cost-effectiveness is determined by PJM on the basis of a net benefits test (Companies' St. 2-R, p. 23). As proposed by PJM, demand response resources are compensated at the LMP when the LMP is at or above a "net benefit" threshold price. ELR costs are then allocated to any area where the price that is paid to a demand response resource is at or above the threshold price. *Id.*

a. Constellation's Proposal Regarding ELR Charges Resulting From PJM ELR Payments

Constellation witness David I. Fein recommends that ELR charges incurred by wholesale default services generation suppliers be borne by the Companies be removed from the Price to Compare, and be recovered as part of the DSS Riders (Constellation St. 1, pp. 22-24). Mr. Fein contends that ELR charges, which have not yet been implemented, change the "market structure" in ways that are "unknown at this time" and "will be difficult for potential DS [default service] Suppliers to predict and manage" (Constellation St. 1, p. 24). For that reason, Mr. Fein believes that EDCs rather than default service generation suppliers should bear any costs that flow from the full implementation of ELR charges. *Id.*

b. The Companies Oppose Mr. Fein's Recommendation

The Companies oppose Mr. Fein's recommendation. Unlike Generation Deactivation charges and UFE costs, the proposed ELR charges are, in fact, market-based, as Mr. Fein's testimony confirms (Constellation St. 1, p. 23). The basis for the Companies' proposal for NMB transmission charges and their acceptance of similar treatment for Generation Deactivation and

UFE costs is that those costs are not market-based and cannot be hedged. Because the same is not true for ELR charges, they should remain the responsibility of generation suppliers (Companies' St. 2-R, p. 23). By their nature, demand response resources will ultimately help generation providers with peak-shaving during high-usage periods, thereby providing them benefits in terms of an improved overall load shape. *Id.*

Moreover, transferring responsibility for ELR charges to the EDC can only be accomplished for default service generation suppliers. Therefore, EGSs would have to retain responsibility for ELR charges. *Id.* In short, what Mr. Fein proposes cannot be done on a competitively neutral basis and cannot be done under the proposed structure of the DSS Rider. This will leave retail EGSs at a competitive disadvantage because they would continue to incur costs from which default service generation suppliers would be absolved. Therefore, for all the foregoing reasons, Constellation's request that ELR charges be collected through the non-bypassable DSS Riders should be rejected.

E. Solar Photovoltaic Requirements Charge Rider

Issues pertaining to the Solar Photovoltaic Requirements Charge Rider have been addressed in Section II.E.2., *supra*.

F. Time Of Use Rate Proposals For Penn Power And West Penn

1. Summary and Overview

Penn Power and West Penn have each proposed a new Residential Time of Use ("TOU") Default Service Rider ("TOU Rider"), as set forth in the Companies' Exhibits CVF-1 and CVF-2, respectively, to satisfy the requirement imposed by Section 2807(f)(5) of the Public Utility

Code that EDCs have in place a TOU rate[26] (Companies' St. 7, p. 19). The proposed Residential TOU Default Service Riders will be available to residential customers that have been provided a smart meter pursuant to Penn Power's and West Penn's respective Commission-approved Smart Meter Plans. *Id.* Customers who desire TOU pricing must enroll for service under the Residential TOU Default Service Rider. Enrollment will be available for up to 15,000 new customers per Company per year during an enrollment period running from April 1 through May 31 of each year. *Id.* After May 31 of each year, the Rider would be closed to new applicants until the following year.

The Residential TOU Default Service Rider reflects the Commission's recommendation in its final order at Docket No. I-2011-2237952 that "EDCs contemplate contracting with an EGS in order to satisfy their TOU requirement."[27] Accordingly, under their TOU proposal, a Commission-approved EGS would serve customers who elect service under the Residential TOU Default Service Riders (Companies' St. 7, p. 19).

As proposed by Penn Power and West Penn, the EGS that would serve TOU customers would be selected through an auction process to be held annually, as described in detail in Companies' Statement No. 6 (pp. 42-44). Through the auction, Penn Power and West Penn would solicit a twelve-month, fixed price, on-peak and off-peak product. (On-peak hours would match those of PJM (7:00 am to 11:00 pm weekdays), excluding Company-observed holidays, and all other hours would be off-peak.) (Companies' St. 7, p. 19). The results of the auction

[26] Met-Ed and Penelec have legacy, optional TOU rates available for residential customers, which are set forth in each Company's Rate Schedule RT – Residential Time-of-Day Service (Companies' St. 7, p. 17). No changes are proposed to Met-Ed's and Penelec's Rate Schedule RT in this case. The existing rates of Penn Power and West Penn that meet the criteria for a "Time-of-Use rate" or a "Real-time price" under 66 Pa.C.S. § 2806.1(m) are described in the Companies' Statement No. 7 at pp. 17-18.

[27] *DSP Recommendations Order*, p. 47.

would be submitted to the Commission for approval, and the winning bidder would be required to execute a contract in the form set forth in the Companies' Exhibit CVF-3. *Id.* The winning bidder would provide service to all customers that enroll under the Residential TOU Default Service Rider for a term of up to twelve months that begins with the customer's June meter reading and ends with the customer's May meter reading. *Id.* Other components of the TOU program are summarized below.

Enrollment. *The window for customer enrollment would begin after each auction is* completed and would last two months. Penn Power and West Penn would send information on the TOU program by bill insert or a direct mailing to non-shopping residential customers that have been provided a smart meter pursuant to those Companies' approved Smart Meter Plans. The information provided would consist of the auction-determined TOU price and the terms and conditions of service. Customers would also receive a tear-off card printed with the return address of the winning bidder to be used for enrollment, as well as information on how to enroll with the winning bidder by telephone or internet if they prefer (Companies' St. 7, p. 20). Additionally, if a customer with an installed smart meter calls either Company during an enrollment period and expresses an interest in TOU rates, the customer would be referred to the EGS selected to provide TOU service. *Id.* The winning bidder in the TOU auction would be responsible for processing customer enrollments, which must adhere to each Company's meter reading schedule and the switching rules of its supplier tariff. *Id.*

Billing. Customers enrolled for service under the Residential TOU Default Service Rider would be billed by each EDC using rate-ready EDC consolidated billing (Companies' St. 7, pp. 20-21). Penn Power and West Penn are developing the capability to bill TOU rates for residential customers based on the on-peak and off-hours specified in the Residential TOU

Default Service Rider. This system will be multi-functional because, once it is completed, all EGSs will be able to offer residential customers a TOU rate using the on-peak and off-peak periods under the Residential TOU Default Service Rider and rate-ready EDC consolidated billing. *Id.* (EGSs that wish to offer different on-peak and off-peak periods will be able to do so using bill-ready EDC consolidated billing.)

Return To Default Service And Shopping. The terms of the Residential TOU Default Service Rider would not allow residential customers to return to standard default service until the next default service year (i.e. June 1 of the year following the year of enrollment) (Companies' St. 7, p. 21). However, like all other customers on default service, customers served under the Residential TOU Default Service Rider will have the opportunity to switch, without penalty, to any EGS, including the EGS that is serving as the supplier for Residential TOU Default Service Rider customers. *Id.*

Customer Options At The End Of The TOU Contract Year. At the end of each TOU contract year, an enrolled customer will not automatically revert to default service (Companies' St. 7, p. 22). Rather, the TOU supplier must inform customers of their right to select another EGS or return to default service before the end of the TOU contract year, in accordance with the notice requirements of 52 Pa. Code § 54.5(g)(1).[28] The TOU supplier will retain the customer unless the customer affirmatively elects a different EGS or affirmatively elects to return to

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[28] Section 54.5 of the Commission's regulations sets forth information an EGS must provide to its customers. Section 54.5(g)(1) provides that EGSs must supply a disclosure statement that includes the following warning:

> If you have a fixed term agreement with us and it is approaching the expiration date or whenever we propose to change our terms of service in any type of agreement, you will receive written notification from us in each of our last three bills for supply charges or in corresponding separate mailings that precede either the expiration date or the effective date of the proposed changes. We will explain your options to you in these three advance notifications.

standard default service. For customers that remain with the TOU supplier after the end of the contract year, that EGS may establish new TOU prices without Commission approval, as is the case at the conclusion of any other contract with an EGS. *Id.*

Notices To Customers At The End Of The Twelve-Month TOU Contract Period. At least sixty days before customers' agreements with their TOU suppliers expire, the Companies will notify all customers receiving service under their Residential TOU Default Service Riders that their contract with their current TOU supplier is ending (Companies' St. 7, p. 22). Such notice will also provide enrollment information to enable those customers, if they choose, to affirmatively re-enroll for service under the Residential TOU Default Service Rider for a subsequent twelve-month term. *Id.*

Competitive Market Enhancement. The proposed Residential TOU Default Service Riders are a reasonable means for Penn Power and West Penn to satisfy the requirement that they offer TOU rates to residential customers. They also reasonably implement the Commission's recommendation that EDCs consider "contracting with an EGS in order to satisfy their TOU requirement." Additionally, the Residential TOU Default Service Riders provide an important competitive market enhancement because Penn Power and West Penn will provide only standard or "plain vanilla" default service – thus, avoiding inadvertently competing with EGSs – and their obligation to furnish a TOU rate will be satisfied by the competitive selection of an EGS offering optional TOU service on their behalf[29] (Companies' St. 7, pp. 22-23). The TOU program will also enhance competition by placing enrolled customers in a direct contractual relationship with the EGS furnishing TOU service. *Id.* Although customers that enroll in the TOU program will

[29] The use of an annual competitive selection process also assures enrolled customers that they are obtaining TOU service from a least-cost provider each year (Companies' St. 7, p. 23).

be billed by the EDC (using EDC consolidated billing), TOU default service will be displayed as having been provided by the TOU supplier. *Id.* And, at the conclusion of the twelve-month TOU service period, customers enrolled in the TOU program will remain customers of the EGS unless they affirmatively elect default service or select an alternative EGS, which is entirely consistent with the options afforded all shopping customers. *Id.*

2. The OCA's Position

The OCA's witness Barbara R. Alexander (OCA St. 2, pp. 21-22)[30] recommends that Penn Power's and West Penn's proposed Residential TOU Default Service Riders not be implemented at this time and that the existing TOU rate options for both Companies be continued. As the purported basis for her recommendation, Ms. Alexander contends that the number of smart meters to be installed in the West Penn and Penn Power service areas during the period from June 2013 to May 2015 will be too small to sustain the cost-effective implementation of the Residential TOU Default Service Riders.

Ms. Alexander's position is wrong for several reasons. First, Ms. Alexander agreed that 15,000 installations would be enough to justify West Penn offering the program and that West Penn will, in fact, have more than 15,000 smart meters installed prior to the summer of 2013 (Companies' St. 7-R, p. 7). Second, recovering the costs of the TOU program from all residential customers under the DSS Rider makes it cost-effective for both EGSs and residential customers to participate in the proposed TOU program, contrary to Ms. Alexander's claim that the program cannot be implemented cost-effectively. *Id.*

[30] OCA witness Kahal echoed Ms. Alexander's recommendation that the Residential TOU Default Service Riders not be implemented but did not offer any additional arguments in support of that recommendation (OCA St. 1, p. 36).

Ms. Alexander also predicts that the proposed TOU program will be unsuccessful because she disagrees with the on-peak and off-peak periods that would be established under the Residential TOU Default Service Riders. Specifically, she claims that residential customers cannot be expected to shift enough usage from the on-peak period to off-peak period (which coincide with the on-peak and off-peak periods defined by PJM) to experience meaningful savings in their electric bills. However, Ms. Alexander's prognostication has no basis in fact. Until the TOU procurement process is implemented and the rate differential for on-peak and off-peak usage is developed from the results of that process, it is premature to make any judgment about how much load residential customers would need to shift in order to experience meaningful bill savings (Company St. 7-R, p. 16). Moreover, adopting the wholesale market's definition of on-peak and off-peak periods assures that EGSs bidding to provide TOU service will be able to appropriately hedge their TOU offering in the wholesale market. *Id.* The TOU auction will not generate much interest among EGSs if they do not have the opportunity to hedge that risk. *Id.*

Furthermore, contrary to Ms. Alexander's view, there is no reason to simply abandon the effort – which the Commission clearly favors – to use market forces to determine the pricing of TOU service (Company St. 6-R, p. 7). If the Penn Power/West Penn TOU proposal generates insufficient EGS interest in providing TOU service, then TOU customers could be served through administratively-determined rates, as is currently done in Penn Power's service territory. *Id.* For that reason, there is very limited downside to offering competitively supplied retail service to TOU customers as Penn Power and West Penn propose.

Ms. Alexander also suggested an alternative approach that would consist of simply soliciting offers from EGSs rather than using a competitive auction process to select a TOU supplier (OCA St. 2, p. 22). However, EGSs currently are able to offer TOU rates to any customer with a smart meter, and the Penn Power/West Penn proposal would not foreclose that opportunity. Moreover, Ms. Alexander ignored – or does not understand – that the proposed TOU auction will foster competition to supply a homogeneous TOU product with clearly defined on-peak and off-peak periods that provides an attractive option to customers in addition to TOU products that EGSs are always free to offer on their own (Companies' St. 6-R, pp. 7-8). More importantly, the TOU program will make it more attractive for EGSs to offer TOU service through their participation in the TOU auction, which will lower customer acquisition costs. *Id.*

Finally, Ms. Alexander's contention that, in lieu of the proposed TOU program, Penn Power and West Penn should simply maintain their existing TOU rates overlooks the fundamental terms of West Penn's existing Critical Peak Rebate ("CPR") program, which provide that the program will expire as of May 31, 2013 (Companies' St. 7-R, p. 14). Ms. Alexander is erroneously suggesting that West Penn could unilaterally continue this program through May 31, 2015 notwithstanding authority to the contrary. *Id.* A decision to continue West Penn's CPR program should only be made in a proceeding properly initiated for the purpose of evaluating whether to continue West Penn's existing, Commission-approved energy efficiency and conservation ("EE&C") programs, of which the CPR program is one. And, only within the context of such a proceeding could all interested parties assess whether the CPR program cost-effectively reduced usage during the top 100 hours of the summer of 2012, which is a threshold determination for the program's survival beyond May 31, 2013.[31] *Id.*

[31] West Penn's CPR program is funded through West Penn's EE&C Surcharge. As noted above, the CPR program is set to expire on May 31, 2013, at which point its source of funding will end as well (Companies' St. 7-R, p. 15). Although West Penn enrolled approximately 17,800 customers in its CPR program as of January 2012, which Ms. Alexander considers significant, that enrollment is still well short of the express goal set for the program of enrolling approximately 25,000 customers before the summer of 2012. *Id.* While actual

Consequently, Ms. Alexander's assumption that rejecting the Penn Power/West Penn TOU proposal assures the continuation of West Penn's CPR program is simply not correct. Therefore, her recommendations, which proceed from that flawed assumption, should be rejected.

3. RESA's Proposal

Although RESA's witness, Mr. Kallaher, found the Companies' proposal to be reasonable, he offered an alternative approach (RESA St. 2, p. 8) that would require each utility to survey EGSs, identify those that are offering or intend to offer a time-differentiated rate for at least twelve months, post information about conforming EGSs on a "clearing house website," and refer customers to that information when they inquire about TOU service. The utilities would also have to certify to the Commission that they complied with this protocol. Given the competitively sensitive information required to support such reporting requirements, Mr. Kallaher suggested that the data should be compiled and analyzed either by the Commission's Bureau of Conservation, Economic and Energy Planning ("CEEP")[32] or a consultant hired by the EDCs. *Id.*

While there are aspects of Mr. Kallaher's proposal that may merit further consideration by the Commission, there is simply not enough information available to determine if his recommendation is feasible or could be implemented a part of DSP II for Penn Power and West Penn (Companies' St. 7-R, p. 17). Moreover, there is a meaningful difference between the Penn Power/West Penn proposal, whereby EDCs would offer TOU service that is subcontracted to an EGS selected on the basis of a competitive procurement, and the RESA proposal, which

enrollment exhibits some customer interest, it is simply not known whether the program will meet the stated goal of reducing West Penn's peak usage during the top 100 hours during the upcoming summer, which is an important consideration for determining whether continuation of the CPR program will be approved. Id.

32 CEEP no longer exists. Its duties have been transferred to the Bureau of Technical Utility Services.

relegates the EDC to the role of administering a "clearing house" for EGS TOU rate offerings that conform to certain minimum standards. While the Commission might decide that RESA's recommendation, if properly implemented, would satisfy the requirement of 66 Pa.C.S § 2807(f)(5), that decision has not been made and, in fact, there is insufficient basis to do so at this time. Additionally, based on the Companies' review of information available from *www.PaPowerSwitch.com*, there are currently no EGSs offering time-differentiated products to customers of Met-Ed, Penelec, West Penn or Penn Power (Companies' St. 7-R, p. 17). As a result, serious concerns exist about the viability of RESA's recommendation. *Id.*

G. Reconciliation Of Default Service Costs And Revenues

1. Summary and Overview

Consistent with the Commission's default service regulations at 52 Pa. Code § 54.187(f) and its approval of the existing DSPs for Met-Ed, Penelec, Penn Power and West Penn, the Companies have incorporated a reconciliation component in the generation rates proposed in each DSP II (Companies' St. 1, p. 20). Reconciling adjustments will be made on a quarterly basis for the duration of each DSP II. The reconciliation feature is included in both their PTC Riders and HP Default Service Riders (Companies' St. 2, pp. 31-33).

Each month, costs to provide default service (as defined in the applicable riders) will be compared to default service revenues from retail customers (as also defined in the riders), and any resulting over or under collection will be recorded on each of the Companies' books. *Id.* The calculations will be done separately by Company and by customer class.

Each quarter, the cumulative over or under collection recorded on the Companies' books will be used to compute a new reconciliation charge, or "E" factor. The "E" factor will be calculated to refund or recover, as appropriate, the net over or under-collection per customer class, including carrying charges, on a per-kWh basis, over the prospective three-month rate application period. Carrying charges will be calculated at the interest rates specified in the default service regulations. *Id.*

The basic default service charges for the Residential and Commercial Classes will be adjusted on a quarterly basis. This will require the Companies to make quarterly compliance filings in order to have their proposed retail rates approved for billing purposes (Companies' St. 1, pp. 21-22). The new generation rates would include the latest "E" factor adjustment for each Company. As a result, default service rates would change four times per year. *Id.*

The Companies have not proposed any changes to their existing reconciliation mechanisms, which have been approved by the Commission and have worked well over the terms of their prior DSPs.

2. The OCA's Proposal

OCA witness Kahal recommends that costs and revenues under the PTC Rider continue to be reconciled on a quarterly basis, but that the net balance of each quarter's reconciliation be collected or refunded over a prospective twelve-month period instead of a prospective three-month period (OCA St. 1, pp. 49-50). Mr. Kahal assumes that refunding or recovering quarterly over or under-collections over a prospective twelve-month period "should contribute to . . . rate smoothing and less volatility" for the "E" factor component of the Price to Compare. *Id.* Mr. Kahal's proposal should be rejected because it contains three major flaws.

First, Mr. Kahal assumes that the net balance from each quarter alternates between an over-collection and under-collection, with the potential to achieve some offsetting effects over time. Notably, Mr. Kahal has not offered any empirical evidence to suggest that this assumption has any basis in fact. Moreover, if – as may well be the case – a customer class has a tendency to under-collect more often than over-collect, or vice-versa, the reconciliation rate will tend to compound and continually grow as either a charge or credit. Rather than "smoothing" the "E" factor component, Mr. Kahal's recommendation could increase the magnitude of each change and add to volatility (Companies' St. 2-R, p. 15).

Second, Mr. Kahal's proposal fails to recognize the larger amount of interest an over-collection or under-collection will accrue if the balance is refunded or collected over twelve months instead of three. By extending the period during which interest accrues, Mr. Kahal's proposal may, for that reason alone, add to the magnitude of each "E" factor change, not reduce it. *Id.*

Third, Mr. Kahal's proposal assumes that simply lengthening the reconciliation recovery period will produce less volatility in the default service generation rate. However, he failed to consider the greater impact that increased levels of shopping would exert on the "E" factor if his recommendation were accepted. Shopping percentages across the Companies have increased throughout 2011, and they continued to increase during the first two months of 2012 (Companies' St. 2-R, pp. 15-16). This trend is expected to continue throughout 2012 into 2013 and could accelerate as a result of the retail enhancements proposed by the Companies. This means that, in the future, there will likely be fewer and fewer customers remaining on default service. The smaller the remaining pool of default service customers, the larger the absolute (positive or negative) E-factor charge will have to become to refund or recoup any over or under-collection. Thus, a smaller base of customers would be subject to a reconciliation adjustment triggered over a year earlier when the default service customer base was much larger. The shrinking customer base would deter – not support – Mr. Kahal's stated goal of reducing volatility because a larger reconciliation balance would have to be distributed to a progressively smaller pool of default service customers, which would distort the Price to Compare and make it far less reflective of market pricing. *Id.*

Given the foregoing defects, Mr. Kahal's recommendation would not achieve his stated purpose of "smoothing" the Price to Compare and reducing "volatility" and, in fact, could promote the exact opposite effect. Accordingly, Mr. Kahal's recommendation should be rejected.

3. The OSBA's Proposal

OSBA witness Knecht expressed concerns about the magnitude and "stability" of the "E" factor, with specific reference to the Commercial Class (OSBA St. 1, pp. 19-26). Mr. Knecht offered several recommendations that he contends would moderate what he perceives to be "large default service variances" attributable to the "E" factor of the PTC Rider. Each recommendation is discussed separately below.

Use Of Unbilled Revenues To Reconcile Costs And Revenues. Mr. Knecht's primary recommendation is that Met-Ed, Penelec and Penn Power should add the "unbilled revenues" in each month of the quarterly reconciliation period to the billed revenues during that period. Mr. Knecht contends that using unbilled revenues in this fashion would better match revenues associated with service provided during the reconciliation period to the cost of purchased generation for that same period.[33] As alleged support for his proposal, Mr. Knecht offered the fact that West Penn uses "unbilled" revenue in its reconciliation calculations, which is the only EDC that does so (Companies' St. 2-R, p. 16).

[33] Mr. Knecht conceded that even his recommendation would produce a significant mismatch that would overstate revenue in the quarter his recommendation would be implemented. Accordingly, he also recommends that this mismatch, which is sure to occur, be resolved by amortizing it over a prospective twelve-month period (OSBA St. 1, p. 24).

At the outset, the variations in the "E" factor that Mr. Knecht purports to have observed are based on only fourteen months of data (January 2011 through February 2012) (OSBA Cross-Exam. Ex. 1, p. 6). The timing is significant because, for Met-Ed, Penelec and West Penn, this period constitutes the first fourteen months of their existing DSPs and, therefore, reflects the initiation of their respective default service rates following the expiration of generation rate caps. When market-based default service began as of January 1, 2011, these Companies immediately began to incur generation costs as of that date. Thus, the month of January 2011 contained a full month's worth of generation costs. However, because the Companies' respective market-based default service rates were implemented on a "service rendered" basis and because customers are billed on "cycles" that do not correspond to calendar months, customers were charged market-based default service rates for less than one month of service. (For example, a bill issued on January 20 might reflect a meter reading on January 15 and, therefore, the applicable market-based default service rate would apply for about half the billing month.) Thus, there was a built-in under-recovery as a result of the initial mismatch between costs and revenues.

The fact that the "ramp-up" period would create an under-recovery was known and anticipated. Met-Ed/Penelec and West Penn adopted different approaches to deal with the expected under-recovery. Met-Ed and Penelec, like all other EDCs except West Penn, calculated the under-recovery and proposed to amortize it over a prospective twelve-month period (Companies' St. 2-R, pp. 16-17; Tr. 122). The Companies' proposal was accepted and approved as part of their initial DSPs. West Penn, on the other hand, proposed to address the "ramp-up" by adopting a reconciliation method that added "unbilled" revenue to "billed" revenue. Thus, West Penn employed an accounting convention to try to mitigate the "ramp-up" effect by imputing "unbilled" revenues. West Penn's method did not eliminate the "ramp-up" problem, it just masked the effect by moving revenues that actually would not be billed until a subsequent month into the then-current month. In summary, Met-Ed/Penelec and West Penn used different methods to address the initial "ramp-up" effect; both methods were approved by the Commission in the Companies' respective DSPs currently in effect; and neither Met-Ed/Penelec nor West Penn is proposing any changes in this case.

At the outset, it is important to understand that the Met-Ed/Penelec method, described above, required those Companies to amortize the initial under-recovery over a prospective twelve-month period (March 2011 through February 2012). As a result, the "E" factor in effect during that period is incrementally higher because of that amortization. When this factor is considered, it is apparent that Mr. Knecht is proposing a solution to a problem that simply does not exist.

Mr. Knecht's recommendations are based on his review of historic "E" factors that include the "ramp-up" amortization. When the amortization is removed (which occurred automatically as of March 2012 when the amortization expired), the "E" factors decline by between $0.005 and $0.006 per kWh, as the Companies' witness, Mr. Valdes, explained (Tr. 122). In fact, if the amortization amount were removed from the historic "E" factors for the Commercial Class for Met-Ed and Penelec, the "E" factors would be minimal or, in some months, disappear. To illustrate, the Commercial Class "E" factors for Met-Ed between March 2011 and February 2012 ranged from a low of $0.00675 to a high of $0.01807 per kWh (OSBA Cross-Exam. Ex. 1, p. 6). Removing the amortization effect ($0.005 and $0.006 per kWh), Met-Ed's historic "E" factors range from lows of between $0.00175 and $0.00075 to highs of between $0.01307 and $0.01207. Penelec's Commercial Class "E" factors during the same period ranged from a low of $0.00582 to a high of $0.00971. Removing the amortization effect yields "E" factors ranging from lows of between $0.00082 and ($0.00018) to highs of between $0.00471 and $0.00371. In each instance, the "E" factors are minimal once the amortization is removed. These illustrations make it clear that Mr. Knecht failed to adequately consider how eliminating the amortization effect would automatically reduce the perceived "magnitude" and "variability" of the Met-Ed and Penelec "E" factors. They also show that Mr. Knecht, by trying to juxtapose the unadjusted "E" factors for those Companies to the comparable component of West Penn's default rates, was making an entirely inappropriate "apples to oranges" comparison.

There is a further error in Mr. Knecht's recommendation. As previously explained, the "ramp-up" effect ended in March 2012, when Met-Ed and Penelec achieved a "steady-state" that matches costs with billed revenues (Companies' St. 2-R, p. 17). Mr. Knecht's proposal would reverse Met-Ed's and Penelec's efforts to achieve a consistent steady-state condition by introducing a June 2013 over-collection variance that would have to be refunded to default service customers over a subsequent twelve-month period, as Mr. Knecht conceded would occur (OSBA St. 1, p. 24). The artificial over-collection and resulting amortization would decrease PTC Rider rates for reasons unrelated to the market price of electricity and, thereby, create a disincentive for customers to shop (Companies' St. 2-R, p. 17). Clearly, this is not an acceptable outcome and is yet another reason why the comparison of billed revenues to calendar month expenses for Met-Ed, Penelec and Penn Power should be maintained. That method has been used with the Commission's prior approval, and there is no valid reason to deviate from it.

Use Of Estimated Net Recoveries Through The Effective Date Of Each New "E" Factor. Mr. Knecht also recommends that the Companies estimate net recoveries of the reconciliation account balance up to the date that each new "E" factor goes into effect. Mr. Knecht illustrated this method by reference to an EDC under-collection balance of $10 million as of the end of March and an "E" factor designed to recover that $10 million balance beginning two months later (on June 1) (OSBA St. 1, p. 21). For purposes of his illustration, Mr. Knecht assumed that the rates in effect during April and May were designed to recover some or all of the $10 million under-collection, which means that, if estimates of the interim recovery are not reflected in the calculation, the June 1 charge will overstate the variance and a subsequent over-collection will occur. However, as Mr. Valdes explained (Companies' Statement No. 2-R, pp. 17-18), Mr. Knecht never said why he assumed the rates in effect during April and May would, in fact, be designed to recover some or all of the $10 million balance. Indeed, the exact opposite could just as readily occur, such that the $10 million balance would increase due to, for example, a change in loss factors or variances from spot market estimates used to calculate default service rates. *Id.* As a consequence, when all likely outcomes are considered, using estimated balances from estimated variables as Mr. Knecht proposes, could produce a net "E" factor estimate that is no more accurate than the Companies' existing method and could result in even greater "variability," contrary to the goal Mr. Knecht is trying to achieve.

Interest Rates On Over And Under-Recoveries. Mr. Knecht also recommended the use of a published rate, such as the monthly prime bank lending rate, to calculate interest on over and under-recoveries in order to reduce the alleged incentives for EDCs to understate default service rates (OSBA St. 1, pp. 24-25). The interest rate currently in effect for under-collections is based upon the statutory rate set forth at 41 P.S. § 202 (which is currently 6%), while the interest rate for over-collections is based upon the statutory rate plus 2%. Both of these interest rates are prescribed by the Commission's default service regulations at 52 Pa. Code § 54.187(f), and Mr. Knecht has not explained why any deviation from the prescribed rates would be appropriate or permissible. Furthermore, and contrary to Mr. Knecht's musings, if any "incentive" exists to try to "game" default service rates – and the Companies strenuously dispute that such "incentive" exists – it would arise from the regulations' asymmetrical interest provisions, which require an EDC to pay interest at a higher rate on over-collections than it recovers on under-collections (Companies' St. 2-R, p. 18). As long as asymmetrical interest is imposed, the real or perceived "incentive" to understate default service rates would remain regardless of whether under-collections accrue interest at the statutory rate or some other rate. *Id.* The Companies are not suggesting that they would act upon any incentive to under- or over-collect default service expenses. However, if the Commission believes that a real or perceived incentive to under-collect exists and should be eliminated, the only way to do so is to provide for symmetrical interest on over- and under-collections regardless of the interest rate used. *Id.*

As an alternative to his principal recommendations, Mr. Knecht suggested that the Commission could eliminate the "E" factor from the PTC Rider and require the Companies to adopt a "migration" rider that would impose on customers an obligation, or grant them an entitlement, to the "E" factor recoupment or refund balance for twelve months following their decision to switch to a competitive supplier (OSBA St. 1, p. 25).

A migration rider is not needed and should not be adopted. A migration rider might become an appropriate remedy if, because of extensive shopping, the number of default service customers in a particular class became very low and, therefore, the reconciliation balance became disproportionally high relative to the customer base (Companies' St. 2-R, p. 19). However, this is not currently the case. In addition, instituting a migration rider would create additional, unnecessary EDC programming costs and could be confusing to customers, whose bills would display an EDC-imposed generation reconciliation charge long after they switched to an EGS. *Id.*

Most importantly, and contrary to Mr. Knecht's contentions, the "E" factor is not the cause of rate instability. The "E" factor balance is driven by differences between revenues and expenses, and those differences are not caused solely – or even primarily – by differences between billed revenues and calendar month expenses. Those differences also depend, for example, upon the accuracy of the spot market estimate, which is inherent in the pricing of PTC Rider rates for the Residential and Commercial Classes under the current Met-Ed, Penelec, and Penn Power DSPs, as well as the line loss factor, which is the estimate of transformer and line losses caused by resistance in the transmission and distribution systems (Companies' St. 2-R, pp. 19-20). To illustrate, rates for a particular customer class may assume an average line loss factor of 7%, while the actual loss factor for a particular month might be 10%, which produces a 3% variance in revenues from that factor alone. *Id.* Variances between actual and estimated the spot market prices, while somewhat less substantial, are, nonetheless, a factor. *Id.* Notably, RESA, which represents multiple EGSs, agrees that the Companies' "E" factors "…have not to date skewed the PTC in [their] service territories as it has in other service territories" (RESA St. 1, p. 23). RESA also noted that a migration rider "would create additional price distortions," not reduce "variability" as Mr. Knecht assumes (RESA St. 1-R, p. 7).

As previously noted, a migration rider along the lines Mr. Knecht discussed would recover or refund any "E" factor balance over a rolling twelve-month period. Recouping or refunding over a twelve-month period under a migration rider suffers from the same defects of the twelve-month collection/refunding proposal offered by OCA witness Kahal, which were discussed previously.

H. Other Tariff Changes

Certain changes to West Penn's Tariff Nos. 37 and 39 have been proposed and are set forth in the pro forma tariffs and tariff provisions provided as Companies' Exhibits REV-4, REV-8, REV-9, REV-18 through REV-21, REV-25 and REV-26. These changes include revising existing definitions, adding new definitions and new riders, and moving certain customer charges to new locations within the tariffs in order to make West Penn's default service tariff provisions similar to those of Met-Ed, Penelec and Penn Power. With regard to Met-Ed, Penelec and Penn Power, the tariff changes being proposed, other than those associated with specific program changes discussed elsewhere, consist of: (1) some minor textual changes to establish uniformity among the Met-Ed, Penelec and Penn Power PTC, HP Default Service, DSS and SPVRC Riders, which are shown in Companies' Exhibits REV-1 through REV-3, REV-5 through REV-7, REV-15 through REV-17, and REV-22 through REV-24; and (2) a change that will add "Non-Market Based Services Transmission Charges" to the definition sections of the Companies' respective tariffs when their compliance filings are made (Companies' St. 2, pp. 35-36).

IV. COMPETITIVE MARKET ENHANCEMENTS

The DSPs initially filed by the Companies contained two major competitive market enhancements, specifically, a Retail Opt-In Aggregation Program and a Customer Referral Program (Companies' St. 7, pp. 23-32). On December 20, 2011, the Companies submitted direct testimony in support of the DSPs set forth in their Joint Petition. On March 2, 2012, the Commission entered its final order at Docket No. I-2011-2237952, which set forth various recommendations to improve competition in the retail electricity market.[34] Ordering Paragraph Nos. 9 and 12 of the *Intermediate Work Plan Final Order* provide as follows:

> 9. That Electric Distribution Companies shall implement a Standard Offer Customer Referral Program consistent with the guidance provided in this Final Order. The company should include a proposal for a Standard Offer Customer Referral Program in its upcoming default service plan filing, or should amend a plan that is currently pending Commission review to include such a proposal.
>
> * * *
>
> 12. That Electric Distribution Companies shall implement a Retail Opt-In Auction Program consistent with the guidance provided in this Final Order. The company should include a proposal for the auction in its upcoming default service plan filing, or should amend a plan that is currently pending Commission review to include such a proposal.

As initially proposed, the Companies' Customer Referral and the Retail Opt-in Auction Programs conformed generally to the structure and principal elements of the programs for which the Commission offered guidelines in the *Intermediate Work Plan Final Order*. Consequently, major changes in the Companies' proposals were not necessary (Companies' St. 7-R, p. 3). However, in the rebuttal testimony and exhibits that the Companies submitted on March 16, 2012, they made modest revisions to their proposals to reflect some elements of the Commission's recommendations.[35] *Id.* Nonetheless, as amended, the Companies' proposals depart slightly from the Commission's guidance for compelling reasons that are fully supported by the evidence the Companies presented in this case. For the reasons set forth herein, the

[34] *Investigation of Pennsylvania's Retail Elec. Market: Intermediate Work Plan*, Docket No. I-2011-2237952 (Mar. 2, 2012) (hereafter "*Intermediate Work Plan Final Order*").

[35] The Customer Referral Plan was revised to offer a product that will provide 7% off each Company's Price to Compare at the time of customer enrollment in lieu of an auction-determined discount (Companies' St. 7-R, p. 3). As a consequence of that change, this competitive market enhancement has been referred to as the "Standard Offer Customer Referral Plan" since the submission of the Companies' rebuttal testimony.

competitive market enhancements proposed by the Companies, as fine-tuned in their rebuttal testimony, should be approved without modification.

A. Retail Opt-In Aggregation Program

1. Summary and Overview

The Companies have proposed a Retail Opt-In Aggregation Program in substantially the form outlined in the *Intermediate Work Plan Final Order* (pp. 33-85). Under the proposed Retail Opt-In Aggregation Program, EGSs would bid in a Retail Opt-In Auction to provide competitive retail service to not more than 50% of each Company's residential default service customers at a price that is at least 5% below the applicable Price to Compare on the date of the auction (Companies' Sts. 7 (pp. 23-24) and 7-R (pp. 31-34)). The results of the auction would be submitted to the Commission for approval, and the winning bidders would be required to execute an Opt-In Aggregation Agreement in the form set forth in the Companies' Ex. CVF-10. The winning bidders would provide service under the terms of the Opt-In Aggregation Agreement to enrolled customers for a term of twelve months beginning with the customer's June meter reading and ending with the customer's May meter reading (Companies' Ex. CVF-10, p. 4). Other salient components of the Retail Opt-In Aggregation Program are summarized below.

Customer Notification and Opt-In. The Companies propose that the Retail Opt-In Auction be conducted after their proposed January 2013 default service supply procurement but not later than March 2013 (Companies' St. 7, p. 25). After the Retail Opt-In Auction has been conducted and the results approved by the Commission, each Company will notify its residential customers of the Retail Opt-In Aggregation Program by means of a first-class direct mailing containing the terms and conditions necessary for a customer to make an informed decision, including that the offer is available only for a 25-day period from the date of the mailing

(Companies' St. 7-R, p. 28). The direct mailing will include a tear-off card that can be returned directly to the EGS to which the customer has been assigned, or customers can opt-in electronically or by telephone (Companies' St. 7, p. 26). The winning EGSs would enroll customers using the same protocols and electronic transactions currently in place for enrolling customers in retail choice. *Id.* Because a 50% supplier participation load cap will apply to the Retail Opt-In Auction, there will be multiple winning bids. Consequently, the Companies will randomly generate separate mailing lists to provide each customer the opportunity to select one supplier. *Id.*

Return To Default Service And Shopping. At any time during the twelve-month term of retail opt-in service, a participating customer may leave the Retail Opt-In Aggregation Program either by contracting with a different EGS or electing to return to default service (Companies' St. 7, pp. 26-27). Under those circumstances, the EGS furnishing opt-in service would not be permitted to charge the customer an early termination fee. *Id.* However, customers that leave the program would not be permitted to return to the program. *Id.*

Customer Options At The End Of The Opt-In Contract Year. At the end of the program term, the opt-in EGS must provide the notices required by the Commission's regulations at 52 Pa.Code § 54.5(g)(1). After receiving the required notices, if a customer does not affirmatively choose to receive service from a different EGS or elect default service, the customer will remain with the EGS that previously provided service under the Retail Opt-In Aggregation Program (Companies' St. 7, p. 27). For customers that remain with the EGS that provided opt-in service, that EGS may set a different price at which it will offer service to those customers after furnishing the required notices. *Id.*

Recovery Of The Costs Of The Program. The Companies propose that the cost of the Retail Opt-In Aggregation Program be recovered from all customers as a nonbypassable component of their DSS Riders (Companies' St. 7, p. 27). However, the Companies have developed an alternative cost-recovery recommendation, discussed *infra*, in the event the Commission insists that the cost of the program be recovered from EGSs.

Various parties have recommended revisions to the Companies' proposed Retail Opt-In Aggregation Program or have raised issues about the program. The proposed revisions and other issues are discussed below.

2. Customer Eligibility

a. Small Commercial And Industrial Customers

On behalf of RESA, Mr. Kallaher recommended that small business customers (i.e., those with loads of up to 25 kW) or, in the alternative, customers in the "smallest commercial rate class," should also be eligible to participate in the Retail Opt-In Aggregation Program (RESA St. 2, pp. 15-17). Mr. Kallaher's recommendation should not be adopted. Customers in either of the loosely-defined categories suggested by Mr. Kallaher have widely-varying usage patterns, which make it very difficult to create homogeneous "tranches" for bidding purposes (Companies' St. 7, p. 19). In addition, some of the largest companies in the nation can be considered "small commercial" customers if electrical usage is a defining criterion. For example, telecommunication, wireless, cable and transit companies have tens of thousands of low-usage connections spread throughout the Companies' service territories. For these national accounts it is very likely that the opt-in mailing will reach an accounts payable clerk that is not the same person who would make an electric commodity purchasing decision. *Id.* In short, there would be a large cost and administrative burden to extend the program to a population of business customers that largely would have no interest in participating or, in the case of service locations for large national accounts, have already considered "shopping" and made a considered decision not to do it. *Id.*

Mr. Kallaher contended that extending eligibility to small business customers is a justified departure from the Commission's guidance because the Commission allegedly did not consider what he characterized as "low levels" of shopping by small commercial and industrial customers. Mr. Kallaher is wrong; the Commission considered small commercial and industrial shopping levels before issuing its guidance:

> The Commission recognizes the lack of shopping in the small C&I segment and, as such, requested comments on the inclusion of these customers in the Retail Opt-in Auctions. Parties were almost equally split between including and excluding small C&I customers. While the Commission agrees that shopping can be improved in this segment, it maintains its original proposal that small C&I customers should not be eligible to participate. Because there is no consistency across the EDCs in defining "small commercial," the Commission believes it would be inappropriate to include a segment of customers that may reflect a wide variation in electric load. The definitions vary across EDCs and, as such, do not produce comparable groups of customers when reviewing shopping offers and statistics.

Intermediate Work Plan Final Order, p. 42.

b. Shopping Customers

Mr. Kallaher also recommended that customers who are already shopping should be barred from participating in the Retail Opt-In Aggregation Program (RESA St. 2, p. 14). The Companies explained that, although their marketing, notifications and customer education efforts would be targeted at non-shopping residential customers, all residential customers would be eligible to participate in the Retail Opt-In Aggregation Program because it would be administratively very difficult to selectively exclude shopping customers from eligibility

(Companies' St. 7, pp. 23-24). The significant operational reasons for the Companies' decision to fashion the program as they did were explained by Mr. Fullem (Companies' St. 7-R, p. 19).

> The Companies' systems for enrolling customers have been built to implement their existing supplier tariffs. Under those tariffs, the Companies do not have the right to reject enrollments submitted by an EGS simply because the customer is already shopping with another EGS, and the Opt-in Aggregation Program should not function differently. The Companies process requests to switch customers from one EGS to another every day. Only one screen is in place that would block an EGS-to-EGS transfer once a switch request is received through an EDI 814 transaction. That process is triggered by the Company sending the customer an enrollment letter to verify its EGS selection. If the customer does not contact the Company to dispute the EGS selection, the service will be switched on the next scheduled meter read date (conversely a customer contact that affirmatively declines verification would block the switch). *The Companies' systems cannot be operated to reject an EGS-to-EGS enrollment arising from the Opt-In Aggregation Program and permit all other EGS-to-EGS enrollments, because they are the same transaction.*

(Emphasis added.)

The Commission considered recommendations like Mr. Kallaher's before issuing the following guidance on retail opt-in programs:

> While the Commission agrees with those parties who state that the intent of a Retail Opt-in Auction is to encourage shopping by those customers who, for whatever reason, have shown an aversion to shopping, it disagrees with the parties who believe customers that are currently shopping should be deemed ineligible for such auctions. The Commission maintains its original position that Retail Opt-in Auctions should be open to both residential default service and residential shopping customers. The Commission agrees with those parties that expressed discomfort in the possibility of EDCs rejecting shopping customer participation. The Commission believes that would cast a shadow over the auctions and appear to be discriminatory against those who have already entered into the retail electric market. Additionally, the Commission believes this will prevent shopping customers from returning to default service in order to participate, which may

> result in cancelled contracts and the imposition of early termination fees/penalties.

Intermediate Work Plan Final Order, p. 42.

3. Program Length

As previously noted, the Companies propose that service under the Retail Opt-In Aggregation Program should be for a term of twelve months. In the *Intermediate Work Plan Final Order* (p. 50), the Commission recommended a term of six billing cycles.[36] As Mr. Fullem explained, there is a sound basis for this modest deviation from the Commission's guidelines (Companies' St. 7-R, pp. 24-25). Specifically, Mr. Fullem analyzed EGS pricing for short-duration (less than one-year) products, which showed that such products are more likely to result in customers paying a material premium above the Price to Compare if they remained with the EGS after the initial term (Companies' St. 7-R, p. 25). In that regard, products with terms as short as six months exhibit the characteristics of short-term "teaser" rates, which neither the Companies nor the Commission has viewed favorably. Moreover, customers will perceive the Companies' involvement in the Retail Opt-In Aggregation Program as an implicit endorsement of participating EGSs and their products. As a result, the Companies risk having their reputations tarnished if customers were to conclude that the benefits of the program were merely a "tease" that did not provide meaningful savings and was functioned only as a gateway to higher prices (Companies' St. 7-R, p. 24). Consequently, the opt-in product should have a term of one year to assure a meaningful benefit to participating customers and validate their continued

[36] The Commission's guidelines recommend that customers be able to exit a retail opt-in program at any time without paying a termination or cancellation fee, but should not be permitted to re-enter the program after they have returned to default service or switched to an alternative supplier. *Intermediate Work Plan Final Order*, p. 50. The Companies' Retail Opt-In Aggregation Program conforms to this guideline (Companies' St. 7-R, p. 24).

participation in the competitive retail market, which is the ultimate goal of retail opt-in programs. *Id.*

Mr. Kahal and Ms. Alexander, on behalf of the OCA (OCA Sts. 1 (p. 33) and 2 (p. 11)), and Mr. Fein, on behalf of Constellation (Constellation St. 1, p. 31), recommended a term of twelve months for the Retail Opt-In Aggregation Program. Mr. Kallaher recommended a term of not more than twelve months (RESA St. 2-SR, p. 7). Accordingly, no parties oppose the Companies' proposed one-year term.

4. Timing Of Solicitation And Auction

The Commission's guidelines recommend that service under a retail opt-in program should begin on June 1, 2013 and also recommend that EDCs conduct the retail opt-in auction before customer enrollment occurs. *Intermediate Work Plan Final Order*, pp. 54-56. Nonetheless, Messrs. Kallaher (RESA St. 1, pp. 19-20), Butler (Dominion St. 1, p. 7) and Fein (Constellation St. 1, p. 31) recommended that the Companies' Retail Opt-In Auction be held after customer enrollment so that the total number of participating customers will be known before EGSs bid in the auction.

The proposed revisions to the timing of customer enrollment and the Retail Opt-In Auction should not be adopted. EGSs' desire to know the size of the auction pool must be balanced against potential customers' need for sufficient pricing information to make an informed decision to participate in the program. The appropriate balance can be struck only if customers are offered a specific rate and terms and conditions of service at the time of the opt-in solicitation (Companies' St. 7-R, p. 27). Customers cannot reasonably be expected to "shop" without knowing the price and terms of the product they hope to buy. *Id.*

EGSs, on the other hand, routinely make offers to customers without knowing the number of customers that will accept the offer, and sophisticated EGSs know how to estimate the number of customers likely to accept an offer. *Id.* Furthermore, any potentially adverse effects that might flow from bidders not knowing the number of customers in the aggregation group are minimized by the use of a tranche-style auction and the 50% customer participation cap the Companies have proposed. *Id.* In short, the EGSs' concerns can be managed and should not be used to block the primary goal of the program, which is to enhance customer shopping. *Id.* The Commission for its part expressed the following view on this issue:

> Upon review of each of the party's comments, the Commission will retain its initial decision to hold the EGS auction before the customer enrollment. We are cognizant of the concerns raised by some EGSs about uncertainty that may be manifested from this sequence; however, we believe that the proposal to hold enrollments before the product specifications are known will create customer confusion. One of the underlying goals of the Retail Opt-in Auctions is to assist uncertain customers in their shopping endeavors. As such, mitigating customer confusion is important to the Commission. The Commission is also concerned about a worst-case scenario in which the EGS auction does not fully subscribe all available tranches. Such a scenario could foster a negative perception toward the competitive retail markets if customers who expected auction service were not able to receive service or had to receive a different price and/or product.

Intermediate Work Plan Final Order, p. 54.

5. Timing For Providing Full Terms And Conditions To Customers

Ms. Alexander (OCA St. 2, p. 11) recommended that the Companies provide customers the complete terms and conditions of the EGS opt-in offer when they are first given the opportunity to participate in the Retail Opt-In Aggregation Program. The Companies' proposed Retail Opt-In Aggregation Program conforms to Ms. Alexander's proposal (Companies' St. 7-R, p. 28). Each Company will issue a direct mailing consisting of: (1) a Company letter; (2)

marketing material provided by the EGS that describes itself and its product, as well as necessary instructions for enrollment; and (3) the terms and conditions of service, as set forth in Appendix B to the Companies' Exhibit CVF-10. *Id.* In order for the EGS marketing material to contain as much customer information as possible, the Company will provide each EGS with a database of the customers included in their winning tranches as soon as possible after the Commission approves the results of the Retail Opt-In Auction. *Id.*

6. Customer Participation Cap

a. Summary and Overview

A customer participation cap limits the total number of customers that may participate in the Retail Opt-In Aggregation Program and thereby serves two purposes. First, it provides an outside limit on the number of customers that EGSs bidding in the Retail Opt-In Auction may be called upon to serve. Second, it limits the possible "migration risk" faced by generation suppliers that bid into an EDC's default service generation supply competitive procurements because they know the maximum number of customer that potentially could depart default service if all customers eligible for the Retail Opt-In Aggregation Program elected to participate. The Commission considered the issue of an appropriate customer participation cap during its retail market investigation and expressed the following opinion:

> While the Commission understands those parties' comments suggesting that the cap be lower than 50% in order to provide more meaningful certainty to the EGSs, the Commission does not want to impose a limit that may lead to the rejection of customers wishing to participate in the Retail Opt-in Auctions. However, the Commission believes that a lack of a cap would provide no estimate of customer participation to both wholesale and retail suppliers. We believe the 50% cap provides both a large customer participation pool, while providing some level of certainty to those EGSs opting to participate in the Retail Opt-in Auctions.

* * *

> We also disagree with the parties who stated that the customer participation cap may deter EGSs from participating in the Retail Opt-in Auctions. The Commission believes the 50% cap provides a large number of customers to be served by the EGSs in the auctions while still providing those same EGSs with some certainty as to the maximum number of customers they are expected to serve.

Intermediate Work Plan Final Order, pp. 59-60.

b. The Companies' Proposal

As initially proposed, the Companies' Retail Opt-In Aggregation Programs did not include a customer participation cap. However, after reviewing the *Intermediate Work Plan Final Order*, the Companies revised their proposals to limit customer participation to 50% of each Company's default service residential customer base as of the date of the Retail Opt-In Auction (Companies' St. 7-R, p. 29). The customer participation cap would be implemented by limiting the number of customers each winning EGS can enroll to 50% of the customers included in the tranches that they win in the Retail Opt-In Auction. *Id.* Specifically, for each 10,000-customer tranche an EGS wins in the auction, the EGS would be entitled to enroll 5,000 customers. *Id.* The Companies' proposed 50% customer participation cap is supported by RESA (RESA St. 2-SR, p. 14), Dominion (Dominion St. 1-SR, p. 4) and Constellation (Constellation St. 1, p. 32).

c. The OCA's Proposal

Ms. Alexander recommends that the Companies limit customer participation to 20% of their residential customers (OCA St. 2, p. 11). Reducing the participation cap to 20% as Ms. Alexander proposes could result in customer dissatisfaction and a negative view of shopping if significant numbers of residential customers are turned away from participating in the program (Companies' St. 7-R, p. 29; *see Intermediate Work Plan Final Order, supra*). Additionally, because the Commission is targeting significant increases in shopping as an outgrowth of retail opt-in programs, imposing a participation cap as low as 20% is clearly contrary to the Commission's goals. As previously explained, the Companies have revised their proposed Retail Opt-In Aggregation Program to limit customer participation to 50% of each EDC's default service customer base. Reducing the participation cap any further is not appropriate, and all recommendations to do so should be rejected.

7. Supplier Participation Load Cap

a. Summary and Overview

A supplier participation load cap limits the number of opt-in customers that any one EGS can win in the Retail Opt-In Auction. The Commission has expressed the view that supplier participation load caps must strike an appropriate balance so that the number of customers that can be "won" in the auction is large enough to provide the "necessary economies of scale" while, at the same time, "making it impossible for one supplier to capture the entire load." *Intermediate Work Plan Final Order*, p. 61. The appropriate balance of those considerations must be achieved so that "[the] cap would help to protect both the diversity of the market and obtain reasonable Retail Opt-in Auction prices." *Id.*

After carefully considering whether any supplier participation load cap should be imposed and, if so, at what level, the Commission recommended a cap of 50%[37]:

> The Commission recognizes that a supplier participation load cap that is lower than 50% increases the likelihood that a number of different EGSs will be able to win customer accounts. However, we also recognize that a cap lower than 50% may be detrimental to the balance the supplier load cap is intended to achieve. This

[37] The Commission also recommended the use of a tranche structure such that participating customer accounts would be grouped into tranches. *Intermediate Work Plan Final Order*, p. 63.

> balance is between ensuring a diverse array of EGSs are able to participate and to enjoy the potential benefits of the Retail Opt-in Auctions while providing for the lowest pricing possible to consumers. The Commission continues to believe that a 50% cap is appropriate in achieving this balance. A cap that is lower than 50%, such as the 25%-33% range proposed by multiple parties, may result in an increased price. Further, caps in the 25%-33%, in a worst-case scenario, may result in a situation in which not all of the tranches are fully subscribed. We agree that a cap higher than 50% increases the possibility that only a few EGSs participate and serve customers in the Retail Opt-in Auctions. As such, we maintain our proposed supplier participation cap of 50% of the participating customer accounts within the Retail Opt-in Auctions.

Intermediate Work Plan Final Order, p. 63. .

b. The Companies' Proposal

As initially proposed, the Companies' Retail Opt-In Aggregation Programs did not include a supplier participation load cap. The Companies have serious reservations about the imposition of any load cap. However, after reviewing the *Intermediate Work Plan Final Order*, the Companies modified their proposals to provide that no EGS would be able to win more than 50% of the available tranches in the Retail Opt-In Auction (Companies' St. 7-R, p. 30).

c. Dominion's Proposal

Mr. Butler recommended a supplier participation load cap that would not allow an EGS to win more than 25% of the auction load (Dominion St. 1, p. 7). Mr. Butler did not offer any evidence that the Commission did not already consider before recommending a 50% load cap. Accordingly, Dominion's recommendation should not be adopted. A 25% load cap would skew the balance the Commission tried to achieve and create an unacceptable risk that the Retail Opt-In Auction would produce prices too high to be justified by the modest additional "diversity" that a 25% cap might produce. And, because the goal of the Retail Opt-In Aggregation Program is to induce greater customer interest in shopping, achieving the lowest prices is important to the success of the program (Companies' St. 7-R, pp. 30-31; *Intermediate Work Plan Final Order, supra*).

d. RESA' Proposal

Mr. Kallaher recommended that the Retail Opt-In Auction include, in addition to the Companies' proposed load cap, a requirement of at least four winning bidders because, in his opinion, this requirement would "help EGSs that otherwise might not be able to participate in the market to do so" and, thus, provide winning bidders "a critical mass of customers in a service territory" (RESA St. 2-SR, pp. 14-15). Mr. Kallaher's recommendation should be rejected for at least two principal reasons.

First, Mr. Kallaher has not furnished good cause, supported by substantial evidence, to depart from the Commission's guidance, which implicitly disfavored requirements for a minimum number of winners like the one Mr. Kallaher recommended:

> The Commission will evaluate the results of each opt-in auction to analyze certain criteria, including participation levels. At that point, the Commission may make a decision on whether or not a possible lack of participation warrants rejection of the auction results.

Intermediate Work Plan Final Order, p. 64.

Second, if Mr. Kallaher intended the four-winning-bidders requirement to mean that each winner should have an equal or near-equal portion of the opt-in load, then his recommendation is simply a 25% load cap under a different name. In that case, his recommendation is inconsistent with a 50% load cap and should be rejected for that reason alone. If, on the other hand, any one of the four winning bidders could win any proportion of the load up to the 50% load cap, then Mr. Kallaher's recommendation does not assure any greater "critical mass" than the 50% load cap, as he was forced to concede when pressed on cross-examination (Tr. 244-245).

8. Composition Of The Product Offer

a. Discount From The Price To Compare

As initially proposed, the price for opt-in service under the Companies' Retail Opt-In Auction would have been established on the basis of a percentage discount from the Price to Compare, with the discount determined by a competitive auction process. Thus, assuming, for example, the auction-determined discount were 6% and the Price to Compare increased or decreased several times over the contract term, participating customers would pay 6% less than whatever the **prevailing** Price to Compare might be **at the time their service was rendered** (Companies' St. 7, p. 26).

The Companies' proposal was opposed by a number of parties. In addition, in the Commission's subsequently issued guidance on this aspect of retail opt-in programs, it considered proposals for both a "percentage off" product, like the one the Companies initially proposed, and a product with a fixed price over the term of the retail opt-program, and it recommended the latter:

> [W]e think a fixed-price product is the most reasonable monthly pricing option, and we agree with PECO that the price should be at least 5% off the default PTC at the time of the auction. While we hope for a larger discount to attract the most customers, we believe anything less than 5% will not attract the attention of the target customers. A fixed price will provide both the suppliers and the customers with price-certainty.

Intermediate Work Plan Final Order, p. 70.

After carefully considering the direct testimony of other parties and the Commission's guidance, the Companies revised the Retail Opt-In Aggregation Program to offer a price at least

5% below the Price to Compare at the time the Retail Opt-In Auction is conducted (Companies' St. 7-R, p. 31). Messrs. Kallaher and Butler each recommended a fixed-price product, as reflected in the Companies' proposal (RESA St. 2-SR, p. 10; Dominion St. 1-SR, p. 4). Mr. Fein recommended a fixed-price at least 10% below the Price to Compare at the time of the Retail Opt-In Auction (Constellation St. 1, p. 31). In her surrebuttal testimony, Ms. Alexander opposed the Companies' revised proposal and insisted that opt-in service be priced at a percentage off the Price to Compare (OCA St. 1-SR, p. 7).

Mr. Fein's recommendation of a fixed-price product at least 10% below the Price to Compare at the time of the auction should be rejected. The market should determine if a discount of that magnitude relative to the Price to Compare is achievable and can be sustained over the term of the program (Companies' St. 7-R, p. 25). Moreover, Mr. Fein did not provide any valid evidentiary basis for deviating so substantially from the Commission's guidance. *See Intermediate Work Plan Final Order, supra.*

The position Ms. Alexander staked out in her surrebuttal testimony is a significant reversal from of her direct testimony, where she advocated a "12-month fixed-price contract with a price that is lower than the price to compare that will result from the Default Service procurements" because "[i]t is unlikely that the price to compare will change significantly during this first 12-month period" (OCA St. 2, p. 11). Why she made this abrupt about-face cannot be discerned from her surrebuttal testimony, particularly since the Commission's guidance affirmed Ms. Alexander's initial position on this issue. As a consequence, Ms. Alexander's revised proposal suffers from the deficiencies the Commission identified in the *Intermediate Work Plan Final Order*:

> While the Commission understands that a percent-off the default PTC may be attractive from a customer's perspective because it guarantees that the price he or she is paying will never exceed the utility default price, we agree with Direct Energy that this is an unrealistic expectation from the supplier's perspective. As Direct Energy points out, the utility's default service rate is not fully reflective of the market because it is also impacted by the reconciliation process. Predicting market prices in advance is always challenging; we think that adding to this the vagaries of the reconciliation process is asking too much. This same problem afflicts FES and OCA's suggested model of adjusting an otherwise fixed price down to match or beat the default service rate. As such, we think a fixed-price product is the most reasonable monthly pricing option . . .

Intermediate Work Plan Final Order, p. 70.

b. "Bonus" Payments

The Companies carefully considered the Commission's guidance that would permit "bonus" payments of $50 to participating customers that remain with their opt-in EGS for at least three billing cycles. *Intermediate Work Plan Final Order*, p. 69. However, the Companies oppose including any "bonus" payments in the Retail Opt-In Aggregation Program, for several reasons.

First, the Commission's view that a "bonus" of $50 is an "attractive unique feature" is not supported by the reality of the competitive market, where the payment of "bonuses" of $50 or more is commonplace (Companies' St. 7-R, pp. 31-32). In fact, packaging a $50 "bonus" with a relatively short-term fixed rate, such as the six-billing-cycle term discussed in the *Intermediate Work Plan Final Order* (pp. 50 and 69), is not "unique," but rather is quite similar to a multitude of products already being offered by EGSs (Companies' St. 7-R, pp. 32-33).

Second, the product the Companies propose, namely, a fixed-price for a full twelve-month term, is different from products already being offered for a several reasons. The most significant difference – particularly for those leery of shopping who are trying to decide whether to opt into the program – is that it avoids what customers perceive to be "gimmicks" that come with a "catch," like an up-front "bonus." *Id.* In short, the Companies' proposal provides a clear, understandable choice that focuses customers' attention on what is important in shopping for electricity, namely, the price of competitive service and the term over which a favorable price is guaranteed to remain in place. The Companies' proposal meets these criteria by providing a fixed price and by keeping it unchanged for a full twelve months. *Id.*

Third, the payment of a "bonus" is not consistent with the goal of retail opt-in programs to create a rewarding shopping experience for participating customers and, in that way, assure them that participating in the competitive market provides long-term benefits and does contain traps for the unwary that could cause them to pay more than they would for default service (Companies' St. 7-R, pp. 33-34). As Mr. Fullem explained, requiring a "bonus" in addition to a price below the Price to Compare at the time of the Retail Opt-In Auction would create an unacceptable risk of attracting bidders who plan to use the opt-in product as a "loss leader" in order to take advantage of a perceived *status quo* bias so that they can charge above-market prices after the initial service period expires. *Id.* If that were to occur, then it can reasonably be expected that customers will eventually, but belatedly, figure out that they are paying more than the competitive market price for power. *Id.* As a result, the Retail Opt-In Aggregation Program not only would not achieve its goal of encouraging customers to participate in the competitive market, but could confirm pre-existing misperceptions that shopping poses an unacceptable risk that they could pay more than the Price to Compare. *Id.* The Company's concerns in this regard are well founded because, as Mr. Fullem explained, a careful analysis of current market conditions shows that a $50 bonus plus a fixed price of at least 5% below the Price to Compare is likely to be merely a "loss leader" and not a sustainable price (Companies' St. 7-R, pp. 33-34):

Q. Is there any evidence that a product consisting of a $50 bonus and a six-month fixed price 5% below the PTC would likely be a "loss leader" for EGSs that decide to offer it?

A. Yes. I have prepared a study that shows such is likely to be the case. The study is provided as Met-Ed/Penelec/Penn Power/West Penn Exhibit CVF-9. For purposes of the study, it was assumed that EGSs can offer a price 5% below the PTC and earn a margin of between 2% and 5%. The study shows that offering a product with a six-month term that is 5% less than the PTC, when coupled with a $50 bonus payment, would probably cause suppliers to lose between $22 and $43 dollars per customer enrolled in the Opt-In Aggregation Program over a six-month term. An EGS would need to charge a higher price to customers that remain with it at the end of the program to recover those losses.

Fourth, and finally, if customers have an unsatisfying experience in the Retail Opt-In Aggregation Program because they believe they were enticed to participate by short-term "gimmicks" that they perceive as a form of "bait and switch," the EDCs' reputations may be tarnished because of their involvement in the process that selected EGSs to participate in the program. *Id.*

For all of the foregoing reasons, the Companies' decision to exclude a "bonus" provision from their Retail Opt-In Aggregation Programs is a departure from the Commission's guidance that is fully justified by "good cause . . . supported by evidence produced during an EDC's default service proceeding." *Intermediate Work Plan Final Order*, pp. 6-7.

c. Provision Of Standard Contracts Specifying All Terms And Conditions

Under the Companies' proposed Retail Opt-In Aggregation Program, winning bidders in the Retail Opt-In Auction would be required to enter into an Opt-In Aggregation Agreement (Companies' Ex. CVF-10). Appendix B to that agreement is the Consumer Contract and Disclosure Statement that the winning EGSs would enter into with customers they serve under the program. RESA was the only party that took issue with the Companies' proposed Opt-In Aggregation Agreement and Consumer Contract and Disclosure Statement. Specifically, Mr. Kallaher contended that requiring participating EGSs to enter into the Opt-In Aggregation Agreement and comply with the Consumer Contract and Disclosure Statement would be an unnecessary intrusion upon the competitive market (RESA Sts. 2, pp. 24-25 and 2-SR, pp. 10-12).

As Mr. Fullem explained, the competitive selection of EGS opt-in service providers based on the lowest fixed price, which the Commission recommends and the Companies have proposed, requires that the Companies establish common terms and conditions of service so that the Retail Opt-In Auction can focus on price competition alone (Companies' St. 7-R, p. 35). Consequently, uniform terms and conditions of service are essential. In fact, Mr. Kallaher essentially conceded that point (RESA St. 2-SR, p. 10). He also conceded that whatever agreements are employed must conform to the terms of the Retail Opt-In Aggregation Program and must be "reviewed" – and, presumably, approved – by the Commission. *Id.* That being the case, Mr. Kallaher's objection to "reviewing" and approving the Companies' proposed agreements in this case served no purpose other than to kick the can down the road and, without justification, leave to some future, unspecified time the task of introducing, "reviewing" and approving uniform contract terms. There is no reason to delay that process. This proceeding is the appropriate forum to develop approved, uniform terms and conditions, which is precisely why the Companies submitted proposed forms for the Opt-In Aggregation Agreement and Consumer Contract and Disclosure Statement for the Commission's review and approval. Moreover, and most significantly, no party – including RESA – has provided a single specific objection to the terms and conditions set forth in the form agreement submitted by the

Companies. Accordingly, those agreements should be approved for use in the Retail Opt-In Aggregation Program.

9. RESA's Proposal To Test Various Marketing Channels Before Implementing The Retail Opt-In Aggregation Program

In rebuttal testimony, Mr. Kallaher proposed an elaborate testing method to be designed and implemented by a special "task force" that does not exist and that he believes the Commission should form specifically for that purpose (RESA St. 2-R, pp. 13-14). The "task force" would be charged with identifying the various marketing "channels" to be tested and determining the "statistically significant" samples of each EDC's customer base to be selected as subjects for testing each marketing "channel." *Id.* As conceived by Mr. Kallaher, the proportion of favorable responses by customers in each sample would allegedly provide usable information about the level of success that might be expected if that method were used for the full roll-out of the program. *Id.* Mr. Kallaher's proposal should be rejected for three reasons.

First, there simply is not enough time to conduct the testing Mr. Kallaher proposes and to implement the Retail Opt-In Aggregation Program by June 1, 2013, as the Commission has recommended in the *Intermediate Work Plan Final Order* (p. 46). The final order in this proceeding is scheduled to be issued in August 2012. Thus, there will only be about six months between the issuance of that order and the opt-in auction, which must be conducted no later than March 2013 to support customer enrollment beginning in June 2013 as the Companies have proposed. As Mr. Fullem demonstrated – without contradiction – if the pre-implementation testing, analysis and reporting that Mr. Kallaher's proposal entails were conducted, a final Commission order selecting the preferred marketing channels would likely not be issued before June 2013 at the earliest and, if a fully litigated proceeding were needed, could take until December 2013 (Companies' St. 7-SR, pp. 3-4). And, because the Companies would need approximately six months following the issuance of that order to implement the program, power could not start to flow to opt-in customers until January 2014 at the earliest and might not start until July 2014. *Id.* Obviously, even the shortest critical path through that timeline would not permit the Companies to implement the Retail Opt-In Aggregation Program by June 1, 2013.

Second, the testing method outlined by Mr. Kallaher would not provide meaningful information about the likely success of various approaches to marketing the Retail Opt-In Aggregation Program because Mr. Kallaher proposed testing only to ascertain the percentage of customers that sign up for an offer based on the marketing channel used (Companies' St. 7-SR, p. 5). As such, it would not assess customer responses at the appropriate point in time, namely, the end of the service period, when "testing" could determine the number of customers that either elected to return to default service, selected an EGS other than the one that furnished opt-in service, or remained with their opt-in EGS after the opt-in contract term expired. Only that kind of "testing" would produce meaningful information about which marketing strategies contribute to customer satisfaction and, alternatively, which ones foster customer perceptions that they were "slammed" or misled by the way they were induced to enroll in the program. *Id.* That said, a testing protocol that would produce that information would be difficult to impossible to complete in time to support a June 1, 2013 implementation date for the Retail Opt-In Aggregation Program.

Third, as cross-examination of Mr. Kallaher revealed (Tr. 248-251), the "testing" that Mr. Kallaher has proposed cannot be distinguished in any material respect from the concept of running a "pilot" program. In that regard, the Commission agrees with Mr. Fullem's assessment that there is insufficient time to conduct such a "pilot" and that the results of any "pilot" are unlikely to have any value:

> The Commission maintains its position that pilot programs should not be implemented for Retail Opt-in Auctions. Constructing a pilot for a 2012 implementation date is burdensome given the condensed timeframe in which it will have to be developed. Further, the value of a pilot program is likely minimal as the results of the pilot would be realized either after, or in close proximity to, the next default service plan filings, which will include proposed full-scale Retail Opt-in Auctions.

Intermediate Work Plan Final Order, p. 47.

10. Customer Options On Program Expiration And Notices To Customers Of Contract Expiration

The Commission addressed customer options upon the expiration of the opt-in contract term in its March 2, 2012 Order, concluding as follows:

> The Commission reiterates that the Retail Opt-in Auctions are opt-in. As such, customers will voluntarily make an affirmative choice to participate. At the time that customers make their choice to participate, they will be informed that the program term, including any prices, will conclude on a date certain.
>
> * * *
>
> We agree that an automatic return to EDC default service at the conclusion of the program defeats the entire purpose of the Retail Opt-in Auctions. As stated above, a customer will voluntarily enter into the retail marketplace through the auction process. . . . As the program approaches the end of the term, the customer will receive the required notices about the program's termination, any changes in the terms and conditions offered by the current EGS, his or her options upon the conclusion of the term and a timeline within which action must be taken.
>
> * * *
>
> For the reasons stated above, the Commission maintains its determination that, upon expiration of the Retail Opt-in Auction program term, a customer who makes no other choice – does not (1) renew the contract with the current EGS; (2) switch to a new EGS; or (3) return to EDC-provided default service – will remain on a month-to-month contract with his or her current EGS, without the risk of the imposition of termination penalties or fees.

Intermediate Work Plan Final Order, pp. 73-75.

In addition, the Commission considered the notices of contract expiration participating opt-in customers will receive and made the following observation:

> In addition, any EGS participating in the retail auction program must provide the notices mandated in our renewal notice guidelines. Those guidelines provide that each customer will receive two notices; an initial notice 52-90 days before the end of the program followed by a more detailed "options notice" at least 45 days before the program ends. The options notice will provide new terms and conditions, pricing, other options and a date by which the customer must take action.

Intermediate Work Plan Final Order, p. 73 (footnote omitted).

The Companies' proposed Retail Opt-In Aggregation Program is entirely consistent with the Commission's guidelines in terms of customer options upon expiration of their opt-in contract and the notices they will be provided (Companies' St. 7-R, p. 36). For the most part, this aspect of the program was not controversial. However, witnesses for the OCA and Constellation proposed modifications that, as explained below, are unwarranted and should be rejected.

Ms. Alexander proposed that participating customers receive three notices rather than two (OCA St. 2, pp. 11-12). As envisioned by Ms. Alexander, the first notice would come from the EDC ninety days before the end of the customer's opt-in contract term to alert the customer that the term was expiring and inform it of its options (i.e., select another EGS, select another offer from its opt-in EGS, or return to default service). The ninety-day notice would also advise the customer that it will get the same message at least two more times from its EGS. Thereafter, two follow-up notices would be provided by the EGSs. *Id.*

Ms. Alexander's proposed modification should be rejected because it cannot be implemented due to serious operational constraints (Companies' St. 7-R, p. 37). Specifically, the

Companies will not know, and have no reasonable way to know, if the participating customer previously converted to a contract or product from its opt-in EGS other than that offered under the Retail Opt-In Aggregation Program. *Id.* If the customer did so, then the notice Ms. Alexander proposes be sent by the EDCs would be erroneous and confusing. *Id.* Moreover, the additional notice Ms. Alexander recommends is unnecessary and would introduce an unwarranted distinction between customers that shop as part of retail opt-in programs and other shopping customers. As the Commission discussed in its guidance on retail opt-in programs, in order to participate in such a program, a customer must affirmatively select its EGS in the opt-in process and, as a consequence, there is no valid basis for treating such a customer differently from any other customer whose contract with an EGS is about to expire. *Intermediate Work Plan Final Order*, pp. 73-75.

Mr. Fein, on behalf of Constellation, advanced a recommendation pertaining only to the situation where a customer who participates in the Retail Opt-In Aggregation Program decides, during the term of the program, to switch to either another EGS or to another product offered by the opt-in EGS (Constellation St. 1, pp. 31-32). Mr. Fein contended that, if a customer elects such secondary service during the term of the program and is subsequently dropped by that EGS, then either: (1) the customer should be barred from returning to default service until after May 31, 2015; or (2) the customer should be assigned to a newly-created alternative service classification under which hourly pricing is the sole means of obtaining nominal "default service" from the EDC. *Id.*

Mr. Fein's recommendation should not be adopted because it would impose significant, unwarranted costs and administrative burdens on the Companies to track each customer's movements between or among EGSs (Companies' St. 7-R, p. 38). The Companies will not create a separate rate code for opt-in participants and, therefore, will not be tracking them separately. Consequently, the Companies will not have the functionality to implement Mr. Fein's proposal without costly modifications to its billing and computer systems. *Id.* Moreover, Mr. Fein's recommendation conflicts with the Commission's regulations at 52 Pa. Code § 54.188, which require EDCs to charge customers returning to default service the same rates, on the same terms and conditions, as other default service customers. *Id.* Finally, no other party supports this convoluted recommendation.

11. Structure Of The Retail Opt-In Auction – Descending Clock Auction

The Companies propose to conduct the Retail Opt-In Auction using a DCA process similar to the one used to procure default service supply. The Companies have selected CRA as the independent evaluator to administer the auction and, in that role, CRA has prepared detailed bidding rules and associated forms for use by participating EGSs as set forth in Companies' Exhibit BAM-3 (Companies' St. 5-R, p. 9). The Retail Opt-in Auction DCA is designed to provide a fair, transparent competitive bidding process that will facilitate the submission of the lowest-price bids for all the Companies. *See* Companies' St. 6, p. 23).

The structure of the Retail Opt-in Auction will follow the same procedures used in the Companies' default supply DCAs. The price being bid will be a fixed price, with the price starting in round 1 of bidding at 5% below the applicable Price to Compare at the time of the Auction, and with the price decreasing round-by-round until the auction closes with the winning bids being the lowest-price bids.

There will be four twelve-month products in the Retail Opt-In Auction, i.e., one for each of the Companies. Each product will be divided into an integer number of equal-sized blocks of non-shopping retail customers for each Company. Actual customers will be assigned randomly for each product after bidding in the Retail Opt-In Auction concludes (Companies' St. 6, pp. 18-23).

Messrs. Butler (Dominion St. 1, pp. 8) and Kallaher (RESA St. 2, p. 23) contended that a sealed-bid RFP could obtain equally competitive prices, would cost less than a DCA and would be less complicated, and Mr. Kahal (OCA St. 1, p. 16) also asserts that a sealed-bid could be conducted at smaller expense. However, Messrs. Butler, Kallaher and Kahal did not quantify the alleged savings they speculate might be achieved or explained why such savings should outweigh the value of using a DCA process that has been employed successfully in the past and for which the infrastructure already exists. Notably, Mr. Butler candidly admitted that his opinion was based on nothing more than his "perspective," i.e., not an empirical analysis of costs and benefits (Dominion St. 1-R, p. 6). However, as Dr. Miller explained (Companies' St. 5-R, pp. 4-7), a sealed bid is not necessarily less expensive than a DCA because many of the most substantial costs to procure products for regulated utilities (*e.g.*, marketing and promotion of the procurement, educating and qualifying bidders, responding to bidder requests for information) largely are independent of the bidding format. Also, a sealed-bid RFP would make it difficult for bidders to formulate their best bids because, without the ability to re-bid in response to different sets of prices, they would be forced to submit bids on each product not knowing what they are committing to or what they may win with respect to other products. Furthermore, and as previously noted, Messrs. Butler and Kallaher did not consider any of the benefits that will accrue from using the DCA to procure multiple products across four different Companies, including an active, real-time "price discovery" process that ensures the lowest prices and avoids possible large disparities in prices among Companies that could occur if a sealed bid RFP were used.[38] Therefore, the Commission should approve the Companies' use of a DCA for the Retail Opt-In Auction.

12. Recovery Of Costs

a. Recovery From All Customers Versus Recovery From EGSs

As discussed in Section IV.A.1, *supra*, the Companies proposed that the costs of the Retail Opt-In Aggregation Program be recovered from all customers as a non-bypassable component of their DSS Riders (Companies' St. 7, p. 27). This proposal was opposed by witnesses on behalf of the OCA, the OSBA and CAUSE-PA. For its part, the Commission, after a cursory review of the cost recovery issue in the context of its retail market investigation, offered the following guidance: "[H]aving the participating EGSs pay for the auction implementation is a prudent way to recover the auction costs, given that the participating EGSs are the entities reaping the possible customer acquisition benefits resulting from the auction." *Intermediate Work Plan Final Order*, p. 78.

The Companies have presented substantial evidence demonstrating that there is good cause to justify deviating from the Commission's recommendation because attempting to recover Retail Opt-In Aggregation Program costs from "participating EGSs" presents at least three significant risks of which the Commission was not aware and did not consider before issuing the *Intermediate Work Plan Final Order* (Companies' St. 7-R, pp. 39-40). The first is the risk that the EDCs' costs will not be recovered. *Id.* The Companies must incur substantial up-front costs to implement a Retail Opt-In Aggregation Program. If EGSs are to be responsible for program

[38] Mr. Kallaher suggested that an RFP format might be preferable to the DCA "in the event a customer shows an interest in how the rate is derived" (RESA St. 2, p. 23). However, there is no direct connection between the bidding format used and the ability to explain to customers how their rate is determined (Companies' St. 6-R, p. 8).

costs, then the Companies could not recover those costs if no EGSs elected to participate in the program. The risk of non-recovery would still be present if EGSs that chose to participate did not fulfill their obligation to pay their assigned costs. The second is the increased risk that assigning cost responsibility to *participating* EGSs could make them decide not to participate in the opt-in auction at all. *Id.* One important purpose of the Retail Opt-In Aggregation Program is to reduce EGSs' customer acquisition costs and, in that way, provide the means for participating EGSs to offer a discount relative to the Price to Compare. Saddling EGSs with the costs of implementing and administering the program would negate that important aspect of the program. The third is the risk that the Commission's recommended approach is likely to make the Retail Opt-In Aggregation Program far less attractive to residential customers because either the market clearing price received in the auction may not be favorable or the only EGSs that participate will be those that plan on leveraging a perceived *status quo* bias in order to charge above-market prices after the initial service period. *Id.* If the Commission wants the opt-in auction to be successful, the Companies should collect the cost of the auction from all residential customers through the DSS Riders, as they have proposed in this filing.

b. Recovery Through The MAC As Proposed By RESA

As previously explained, Mr. Kallaher recommended a modification to the Companies' proposed MAC that would fundamentally change the design and purpose of that charge from one that compensates the Companies for the risks they bear and the value they create in their role as EDCs to an alternative means of recovering the costs of market enhancements (RESA St. 1, pp. 29-30). Mr. Kallaher's recommendation should be rejected for all of the reasons previously discussed in Section III.C.3, *supra*. Additionally, RESA's proposal, contrary to RESA's stated goal, would not recover the cost of market enhancement from all customers because the MAC, unlike charges under the DSS Rider, is bypassable and, therefore, would be imposed only on default service customers. Thus, under RESA's proposal, customers who actually participate in the Retail Opt-In Aggregation Program would not contribute to the recovery of the costs of the program in which they are participating.

c. Form Of Recovery If EGSs Are To Be Responsible For The Cost Of The Retail Opt-In Aggregation Program

The Companies firmly believe that recovering the costs of the Retail Opt-In Aggregation Program from all customers under their respective DSS Riders is appropriate, and, therefore, that cost recovery method continues to be their primary proposal in this case. However, if the Commission were to direct that EGSs pay for the program, the best way to do so would be for the cost of the auction itself to be divided equally among participating EGS, with each EGS required to pay the Companies its share before the auction is held (Companies' St. 7-R, p. 40). Winning EGSs would then be responsible for all costs associated with the marketing and mailing of opt-in notices to the residential customers included in the tranches that they win. *Id.* The mailing of the opt-in material would be contingent upon payment being received from each EGS. *Id.*

Ms. Carol J. Biedrzycki, who appeared on behalf of CAUSE-PA, recommended recovering the costs of the Retail Opt-In Aggregation Program from all EGSs through a discount on the price the Companies pay to purchase EGSs' accounts receivables (CAUSE-PA St. 1, pp. 27-28). (Currently, under the Commission-approved terms of their purchase of receivables, the Companies pay the face value of the purchased receivable (i.e., a zero discount)). That recommendation should be rejected. Such an approach would not follow cost causation principles and, therefore, would result in potential cross-subsidization between competitors. Cross-subsidization could occur because an EGS that elected not to participate in the Retail Opt-

In Aggregation Program would still be obligated to pay for it, while the costs the winning bidders would pay would be less than the benefit they receive from participating in the program (Companies' St. 7-R, p. 40).

B. Standard Offer Customer Referral Program

1. Summary and Overview

Under the Customer Referral Program as initially proposed, the Companies would have conducted a Weekly Customer Referral Solicitation to select the lowest 12-month and 24-month fixed-price offers from EGSs that agreed to participate in the program and submitted offers in the solicitation (Companies' St. 7, p. 28). The Companies would advise residential customers that contacted them regarding a high bill complaint or a new service request that they had the ability to purchase power from an EGS at favorable prices and would offer to transfer those customers' calls to a member of the Customer Referral Plan Implementation Team. *Id.* At that stage, the Customer Referral Plan Implementation Team would: (1) explain customer choice; (2) advise the customer where to obtain additional information in order to assess various offers from EGSs; (3) tell the customer that he or she could be referred to an EGS with the lowest 12-month or 24-month fixed price products being offered that week; and (4) describe those offers. *Id.* If a customer expressed the desire to pursue one of the EGS offers, the Customer Referral Plan Implementation Team would transfer the call to the EGS making that offer. *Id.*

In its *Intermediate Work Plan Final Order* (pp. 31-32), the Commission stated as follows:

> Accordingly, to provide direction to each EDC who has not yet filed its default service plan, to EDCs with proposed plans pending Commission review and to other interested parties, we set forth the following guidelines for the Standard Offer Customer Referral Program:

- The Standard Offer Customer Referral Program should be voluntary for customers, i.e., "opt-in", as well as for participating EGSs.

- The standard offer will target/market residential default service customers; however, residential shopping customers will not be excluded if they specifically request to participate. At this time, CAP customers should be excluded from the Standard Offer Customer Referral Program and have deferred the details of addressing the provision of universal service within default service to the RMI's Universal Service subgroup.

- The standard offer should be comprised of a 7% reduction from the EDC's effective DS PTC. The 7% reduction is a constant price established against the PTC effective on the date the standard offer is made.

- The standard offer should be provided for a minimum of four months, but should not exceed 1 year. The standard offer and its term should be uniform within an EDC's service territory.

- Customers may choose to be assigned to an EGS of their choice or may choose a random assignment. The process by which an EGS is assigned either randomly or by customer choice, at the customer's discretion, will be specifically detailed in each EDC's plan proposal to ensure fairness and impartiality.

- The terms and conditions of the standard offer must be presented to customers before they decide to enter the program.

- The Standard Offer Customer Referral Program should be presented during customer contacts to the EDC call centers, other than calls for emergencies, terminations and the like. We would, however, permit that a customer be presented the standard offer during customer contacts to the EDC call center for high bill issues, only and explicitly after the customer's concerns were satisfied.

- Once a customer enrolls in the Standard Offer Customer Referral Program, the enrollment will be forwarded to the EGS for EDI processing.

- At the time of the first contact between the EGS and the customer, the customer will be reminded of the terms and conditions of the standard offer, including the date by which the customer must take action to exercise his or her options at the end of the term.

- There will be no termination penalty or fee imposed at any time during the effective period of the standard offer.

- All existing customer notification requirements apply, including notices and the timing of those notices relating to proposed changes in the terms and conditions of the EGS-customer relationship.

- At the conclusion of the standard offer period, absent affirmative customer action to enter into a new contract with the EGS, the customer's enrollment with a different EGS or the customer's return to default service, the customer will remain with the EGS on a month-to-month basis, and shall not be subject to any termination penalty or fee. However, this should not deter an EGS from offering longer, fixed-term prices.

As to program costs, we agree with the assertions of OCA and UGIES that the bulk of the costs, including the costs of maintaining the referral programs once they are put into place, should be the responsibility of the participating EGSs.

The Customer Referral Program initially proposed by the Companies departed from the Commission's subsequently issued guidelines in four respects:

1. **Customers In Customer Assistance Programs ("CAP customers"):** The Companies proposed that CAP customers should be eligible to participate (Companies' St. 7-R, p. 42).

2. **Pricing, Term And EGSs Selection Process:** The Companies proposed to offer 12-month and 24-month fixed products at prices below the Price to Compare determined by a Weekly Customer Referral Solicitation. *Id.*

3. **Presentation Of Terms And Conditions Of Service:** The Companies proposed that EGSs provide customers the terms and conditions of their service and enroll customers using existing practices and procedures. *Id.*

4. **Recovery Of Program Costs:** The Companies proposed that program costs be recovered from all customers through their respective DSS Riders. *Id.*

After reviewing the *Intermediate Work Plan Final Order*, the Companies proposed two modifications to the Customer Referral Program. First, they replaced the Weekly Customer

Referral Solicitation with an administratively-determined fixed price of 7% below the Price to Compare at the time of referral, as recommended in the Commission's guidance (Companies' St. 7-R, p. 43). To reflect this change, the Companies now refer to their program as the Standard Offer Customer Referral Program. Second, they eliminated the optional 12-month and 24-month terms of service and adopted a term of twelve months for service at the 7% discount, which also conforms to the Commission's guidance. *Id.* These modifications are reflected in the revised and redlined Customer Referral Program Agreement provided as Companies' Exhibit CVF-11 (Companies' St. 7-R, p. 43).

The Companies continue to propose that CAP customers should be eligible to participate in the Standard Offer Customer Referral Program, for the reasons discussed in Section IV.C., *infra*, and that the costs of the program should be recovered from all customers through their DSS Riders, for the reasons discussed in Section IV.B.4., *infra*. Additionally, the Companies continue to propose that EGSs, rather than the Companies, provide program participants the terms and conditions of service and enroll customers using the EGSs' existing systems and procedures because significant operational constraints preclude adopting the Commission's recommendation in this regard, as Mr. Fullem explained (Companies' St. 7-R, pp. 44-45):

> The Companies do not currently have the processes, personnel or systems in place to manage EGS customer enrollments. Augmenting its system to provide that kind of capability would be very costly and would needlessly duplicate the systems EGSs already have in place to fulfill this function. The processes built to support enrollments today are effective because EDI is designed to support the initiation from the EGS. The EDC does not have the information needed to complete the full enrollment and would need to make significant modifications and changes to support the reverse transaction. EGSs have been managing the notice of terms and conditions of service and provision of disclosure statements to customers, and there is no need for the EDCs to build costly, duplicative system functionality. Moreover, EGSs may lose

> valuable opportunities and interactions with customers if this process is adopted. Therefore, the Companies do not support having the EDC provide the terms and conditions and process the full enrollment for the EGSs.

In addition, requiring an EDC to present the terms and conditions of the standard offer is facially inconsistent with 52 Pa. Code §§ 57.172 and 57.173 because it would shift from the EGS to the EDC the liability for incorrectly changing a customer, which appears contrary to the terms of 52 Pa. Code § 57.177. In any event, no party has taken issue with the Companies' proposal to have EGSs provide the terms and conditions of service and enroll customers. Accordingly, good cause for that departure from the Commission's guidelines has been established.

2. Customer Eligibility

Apart from the issue of CAP customer participation that was pursued only by CAUSE-PA and is addressed *infra*, issues of customer eligibility were raised only by RESA, whose witness, Mr. Kallaher, recommended that the Standard Offer Customer Referral Program: (1) extend to commercial customers; and (2) bar any participation by shopping customers (RESA Sts. 2, p. 28 and 2-R, p. 26). RESA's proposal to extend the Standard Offer Customer Referral Program to commercial customers suffers from all of the same defects as its proposal to include small business customers in the Retail Opt-In Aggregation Program, which were discussed in Section IV.A.2.a., *supra*. Additionally, Mr. Kallaher did not furnish any good cause, supported by substantial evidence, to depart from the Commission's guidance that only residential customers should participate in standard offer customer referral programs. *Intermediate Work Plan Final Order*, p. 31. Similarly, Mr. Kallaher's recommendation that shopping customers be barred from the Standard Offer Customer Referral Program should be rejected for all of the same reasons his comparable proposal with regard to the Retail Opt-In Aggregation Program should be rejected, as discussed in Section IV.A.2.b., *supra*. Here again, Mr. Kallaher has not justified departing from the Commission's guidance, which provides that "[t]he standard offer will target/market residential default service customers; however, residential shopping customers will *not be excluded* if they specifically request to participate." *Intermediate Work Plan Final Order*, p. 31 (emphasis added).

3. Term Of The Standard Offer Product And Length Of The 7% Discount

Mr. Kallaher disagreed with the Companies' proposal that the Standard Offer Customer Referral Program should provide a 7% discount from the Price to Compare for a one-year service term (RESA St. 2-SR, p. 24). Mr. Kallaher contended that the Companies' proposal is inconsistent with the *Intermediate Work Plan Final Order* because "while the term of the contract can be 12 months, the discount should last for 4 months." *Id.* Mr. Kallaher simply misconstrued the Commission's Order, which unmistakably states that the 7% discount may be offered for a term between four months and one year in length:

> - *The standard offer should be comprised of a 7% reduction from the EDC's effective DS PTC.* The 7% reduction is a constant price established against the PTC effective on the date the standard offer is made.
> - *The standard offer should be provided for a minimum of four months, but should not exceed 1 year.* The standard offer and its term should be uniform within an EDC's service territory.

Intermediate Work Plan Final Order, p. 31.

Contrary to Mr. Kallaher's interpretation, the Commission's guidance did not create any distinction between the "term of the contract" and the standard offer "discount" such that the contract "term" could be up to a year in duration but the "discount" (i.e., the price) would have to terminate after four months. The Commission clearly recommended that the standard offer discount could be offered for up to one year. Accordingly, the Companies' proposal is consistent with the Commission's guidance.

4. Recovery Of Costs

a. Recovery From All Customers Versus Recovery From EGSs

The Commission had recommended that the costs of Standard Offer Customer Referral Programs, like the costs of Retail Opt-In Programs, "should be the responsibility of the participating EGSs." *Intermediate Work Plan Final Order*, p. 32. Recovering the costs of the Standard Offer Customer Referral Program from participating EGSs raises the same substantial risks identified in Section IV.A.12.a., *supra*, as the basis for the Companies' proposal to recover the cost of the Retail Opt-In Aggregation Program through their DSS Rider, namely, that EDCs might not recover their costs and EGSs would be discouraged from participating in the program. Those risk factors make it unreasonable to follow the Commission's guidelines on this issue for the reasons discussed in Section IV.A.12.a., *supra*. Accordingly, the Companies' departure from the Commission's guidelines in this instance is justified.

b. Recovery Through The MAC As Proposed By RESA

RESA's proposal with regard to recovery of Standard Offer Customer Referral Program costs through the MAC is identical to its proposal to recover other market enhancement costs through the MAC, and it should be rejected for the reasons discussed in Section IV.A.12.b., *supra*. Here again, RESA's proposal would not recover the cost of market enhancement from all customers because the MAC is bypassable and, therefore, customers who actually participate in the Standard Offer Customer Referral Program would contribute nothing to the recovery of the costs of the program in which they are participating.

c. Form Of Recovery If EGSs Are To Be Responsible For The Cost Of The Standard Offer Customer Referral Program

The Companies are firmly committed to recovering the costs of the Standard Offer Customer Referral Program from all customers through their respective DSS Riders, and, therefore, that cost recovery method should be approved in this case. However, if the Commission were to direct that EGSs pay for the program, the Companies would propose to modify the Standard Offer Customer Referral Program Agreement (Companies' Ex. CVF-11) as follows: (1) to require each participating EGS, not less than six months before the program starts, to make a $100,000 payment toward initial start-up costs; (2) to provide that, beginning June 1, 2012, the ongoing costs for the Standard Offer Customer Referral Program Implementation team be billed monthly to participating EGSs by dividing the monthly expenses by the number of participating EGSs; (3) to specify that ongoing costs will include a two-year (June 1, 2013 to May 31, 2015) amortization of start-up costs that exceed the $100,000 up-front payments received from participating EGSs; and (4) to provide that the program only move forward if a minimum of five EGSs execute the Standard Offer Customer Referral Program Agreement and make the initial payments so that the Companies will have some assurance that they will recover at least a portion of their start-up costs (Companies' St. 7-R, p. 46).

CAUSE-PA's proposal to recover the cost of market enhancements from participating EGSs through a discount off the price of purchased receivables should be rejected for the reasons discussed in Section IV.12.c., *supra*.

5. Constellation's Proposal To Require Customers To "Opt In" In Order To Be Eligible To Participate In the Standard Offer Customer Referral Program

Mr. Fein proposed that customers should be required to "opt in" to the Standard Offer Customer Referral Program by a fixed date before any calls they make to the Companies could trigger a call-center inquiry as to whether they are interested in a referral (Constellation St. 1, p. 33). As Mr. Fullem explained, if Mr. Fein's proposal were adopted few customers would likely respond to the request to "opt in" to the program (Companies' St. 7-R, p. 49). Requiring an opt-in process before the program is implemented will confuse customers, who at that stage are unlikely to know what they are being asked to do. *Id.* Of course, Mr. Fein's proposal would require the Companies to send a letter to all residential customers asking them to return a post card if they want future calls to the Companies to be eligible for the customer referral program. In addition to the flaws identified by Mr. Fullem, such mass mailings would needlessly increase program costs. *Id.*

6. The OCA's Proposal To "Sequence" The Implementation Of The Standard Offer Customer Referral Program

Ms. Alexander generally opposes the implementation of the Standard Offer Customer Referral Program because she contends it would be too complicated, cost too much to implement and would likely cause customer confusion (OCS St. 2, pp. 15-17). Therefore, she proposed that the program not be implemented, that the Commission evaluate the results of the Retail Opt-In Aggregation Program and, based on that assessment, decide whether or not further market enhancement along the lines of the Standard Offer Customer Referral Program should be pursued at some undetermined future date (OCA St. 2, p. 16).

At the outset, Ms. Alexander's criticism that the Standard Offer Customer Referral Program is too complicated and could induce customer confusion was directed at the Companies' initial proposal, which offered customers twelve-month and twenty-four month options and changed the price for each product weekly based on EGS solicitations (Companies' St. 7-R, p. 47). The Companies' revised proposal, which conforms to the Commission's guidelines, is a straight-forward fixed price for a one-year term at a discount of 7% from the

Price to Compare. Given the modifications the Companies are proposing regarding the product to be offered, Ms. Alexander's criticism is moot.

Ms. Alexander's contention that the program is too costly is a generic criticism that, like her recommendation to "sequence" the Standard Offer Customer Referral Program is, at its core, aimed at derailing or delaying the implementation of any customer referral program.[39] All of Ms. Alexander's recommendations, whether viewed as proposals to "sequence" the initiation of the Standard Offer Customer Referral Program relative to the Retail Opt-In Aggregation Program or, as is more likely the case, a veiled attempt to simply kill the program altogether, are contrary to the Commission's guidance, which recommends the adoption of a customer referral program to commence as of June 1, 2013: "As stated in the December 16 Order, it is expected that detailed implementation and logistical elements will be determined during the default service plan proceedings for each EDC." *Intermediate Work Plan Final Order*, p. 31.

7. RESA's Proposal To Allow The Standard Offer Customer Referral Program Displace The "New/Moving" Customer Referral Program

Mr. Kallaher has proposed that the "New/Moving" customer referral program be dropped and that the Companies focus their attention on implementing the Standard Offer Customer Referral Program, with the goal of doing so by the end of 2012 (RESA St. 2-R, pp. 22-23).[40]

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[39] Mr. Fullem provided a detailed quantification that showed the Companies' costs to implement the program are not unique to them and are the lowest that could reasonably be expected for a program of this kind (Companies' St. 7-R, pp. 47-48).

[40] The Commission recommended that all EDCs implement a "New/Moving" customer referral program by the end of the fourth quarter of 2012 (Companies' St. 7-SR, pp. 9-10). Under the program outlined by the Commission, residential and small commercial customers that call an EDC to initiate service or to transfer service within an EDC's service territory would be provided information about the competitive marketplace so that they would not harbor the erroneous assumption that EDC-provided default service is their first (or only) option for generation supply. *Id.* If such a customer knows which EGS he or she wants to select, then the EDC should have processes in place to transfer the caller to his or her chosen EGS. If a customer does not select a specific EGS, he or she should be referred to *www.PAPowerSwitch.com*. The Retail Markets Investigation ("RMI") Universal Service working group has been charged with determining whether CAP

The Companies agree that the "New/Moving" customer referral program as envisioned by the Commission should not be implemented (Companies' St. 7-SR, pp. 9-12). Although the Companies currently offer information on retail shopping to customers when they call to initiate service or to change their service location, the Companies estimate that the earliest they could implement any proposed modifications to their existing program would be December 2012. *Id.* That date is just six months prior to the start of the DSPs proposed in this case, which will begin on June 1, 2013 and, if approved as proposed, will include a Standard Offer Customer Referral Program. The resources required to develop the processes, scripts, programming, and training guides to implement the "New/Moving" customer referral program are the same resources needed to develop the Standard Offer Customer Referral Program. *Id.* In addition, training call center representatives in the new protocols associated with the "New/Moving" customer referral program would be time consuming and expensive. *Id.*

For the foregoing reasons, the Companies agree with Mr. Kallaher that it is not cost-effective for them to incur the expenses associated with a "New/Moving" customer referral program that will be used for only six months. *Id.* Although Mr. Kallaher is wrong to assume that a Standard Offer Customer Referral Program could be implemented in 2012, he is correct that the Companies should focus their efforts on properly implementing the Customer Referral Program they propose to put into effect in June 2013. *Id.*

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customers should be included in the "New/Moving" customer referral program. *Id.* The Commission's Office of Competitive Markets Oversight ("OCMO"), in conjunction with the Commission's Office of Communications, has been tasked with establishing a working group to develop appropriate call center scripts. *Id.* The Companies' "New/Moving" customer referral program, if implemented, would be replaced by the Standard Offer Customer Referral Program beginning in June of 2013. *Id.*

C. Low-Income Customers' Participation In Market Enhancement Programs

In its *Intermediate Work Plan Final Order*, the Commission addressed the participation of CAP customers in market enhancement programs. With regard to retail opt-in programs, the Commission noted that some EDCs permit CAP customers to shop, while others do not. *Intermediate Work Plan Final Order*, p. 43. As a consequence, the Commission declined to offer specific guidance on CAP customer participation in those programs and directed that the issue be addressed in each EDC's next default service proceeding:

> Because CAP customer participation in electric competition currently varies from EDC to EDC, the Commission finds it difficult to make a statewide pronouncement regarding these customers' inclusion or exclusion in the auctions at this time. The Commission notes that a Universal Service subgroup has been formed under the auspices of the Investigation and it is expected that those subgroup participants will discuss the issues surrounding CAP customer shopping at length and provide recommendations for future RMI initiatives, such as the long-term work plan anticipated to be released in the spring of 2012. However, the Commission believes it cannot make a determination, at this time, regarding the eligibility of such customers to participate in the Retail Opt-in Auctions. As such, the Commission believes the ability of CAP customer participation should be determined within each EDC's default service proceeding, through which the EDCs are presenting proposed Retail Opt-in Auction models. We also note that we do see significant merit and agree with the comments provided by AARP/PULP/CLS, Constellation, OCA, PCADV and PEMC that CAP customers should not be subject to harm, i.e., loss of benefits, if they are deemed eligible to participate in the auctions.

Intermediate Work Plan Final Order, p. 43.

Unlike the consideration it gave CAP customer participation in the context of retail opt-in programs, the Commission did not discuss the issue in the portion of the *Intermediate Work Plan Final Order* that addressed Standard Offer Customer Referral Programs. Nonetheless, its guidance on such programs included the following recommendation:

> At this time, CAP customers should be excluded from the Standard Offer Customer Referral Program and have deferred the details of addressing the provision of universal service within default service to the RMI's Universal Service subgroup.

Intermediate Work Plan Final Order, p. 31.

As previously explained, the Companies have proposed that CAP customers be eligible to participate in both the Retail Opt-In Aggregation Program and the Standard Offer Customer Referral Program. Because the Companies' Standard Offer Customer Referral Program differs from the Commission's guidance in this respect, Mr. Fullem provided several significant reasons, including operational constraints, that justify the Companies' proposal. And, those reasons are equally applicable to the Companies' Retail Opt-In Aggregation Program (Companies' St. 7-R, pp. 42-43):

> CAP customers should be permitted to participate in the Companies' Customer Referral Program for four principal reasons. First, CAP customers are permitted to shop pursuant to the terms of the Companies' existing, Commission-approved retail tariffs. Second, the Companies have no right to reject a CAP customer enrollment by an EGS under the terms of the Companies' Commission-approved supplier tariffs. Third, under the terms of the Companies' Commission-approved Universal Service Programs, funding for CAP customers is portable and CAP benefits cannot be reduced because a customer switches to an EGS. Fourth, there is no evidence to suggest that CAP customers are more likely to make bad shopping decisions than any other group of residential customers.

1. CAUSE-PA's Proposal

CAUSE-PA's final position on low-income participation in all market enhancement programs was presented in the surrebuttal testimony of its witness, Ms. Biedrzycki. As evidenced by the summary of her conclusions, Ms. Biedrzycki urges the Commission to "just say no" to **any** "shopping" by CAP customers:

- The Companies should modify their tariffs to require CAP customers to remain with the EDCs on default service;
- CAP customers should be excluded from participation in the Retail Opt-In Auction and Customer Referral Program.

CAUSE-PA St. 1-SR, p, 21.

At the outset, there is no basis for Ms. Biedrzycki's proposal to bar CAP customers from shopping. Nothing in the *Intermediate Work Plan Final Order* suggests that the Commission believes such an outcome is appropriate or desirable. Moreover, Ms. Biedrzycki's recommendation that the Commission bar CAP customers from participating in any market enhancement programs is grounded on her fundamental perception that "shopping" is **always** deleterious to CAP customers because, as she views the market structure in Pennsylvania, default service is "stable," "predictable," and "least cost," while all of the options available in the competitive market, including those offered under the Companies' proposed market enhancements, are "volatile," "constantly changing" and present CAP customers with "pricing risk" (Tr. 320-326; CAUSE-PA St. 1-SR, pp. 7-8).

Ms. Biedrzycki's perception of the competitive market is based almost entirely on her experience in Texas, which, as she conceded, operates under a much different statutory model than Pennsylvania (Tr. 336-338, 340-341). In fact, Ms. Biedrzycki eventually conceded that she had "no idea" how Pennsylvania's Price to Compare is calculated but, even based on her limited knowledge, it was clear that the Companies' Price to Compare for residential customers changes quarterly, i.e., would be less "stable" and more "volatile" than the fixed-price products to be offered in the Retail Opt-In Aggregation Program and the Standard Offer Customer Referral Program (Tr. 324). In addition, Ms. Biedrzycki misunderstood the concept of "least cost to customers" embodied in Section 2807(e)(3.4) and, therefore, erroneously assumed that because the statutory mandate exists, default service is always more likely to produce a favorable price for customers than the options available in the competitive market (Tr. 325-326).

As a result of her misperceptions and flawed assumptions, Ms. Biedrzycki contended that CAP customers should not be allowed to participate in either of the Companies' proposed market enhancement programs because there is no assurance that they will not suffer "harm." *E.g.*, CAUSE-PA St. 1-SR, p. 11. In fact, she made the sweeping assertion that only by restricting CAP customers to default service could the Commission assure compliance with the "no harm" standard she alleges it adopted in the *Intermediate Work Plan Final Order*. *Id.* However, Ms. Biedrzycki has misconstrued the Commission's guidance. The Commission made clear that the "harm" it expects EDCs to avoid if CAP customers are allowed to participate in market enhancement programs is "loss of benefits" as a result of that participation. *Intermediate Work Plan Final Order*, p. 43; Tr. 338-339). The Companies' proposed market enhancement programs clearly satisfy that standard because the CAP benefits the Companies provide are "portable" and, therefore, cannot be lost if a customer shops (Companies' St. 7-R, p. 43).

As evidenced by her surrebuttal testimony and responses to questioning on cross-examination (CAUSE-PA St. 1-SR; Tr. 327-333), Ms. Biedrzycki's concept of the "harm" from which CAP customers should be insulated is much different from the Commission's pronouncement on that issue. In fact, Ms. Biedrzycki considers CAP customers "harmed" if, at any point in the term of a competitive contract, they would pay more than the Price to Compare, regardless of whether shopping could provide an overall net benefit (CAUSE-PA St. 1-SR, p. 11; Tr. 330-333). Not only is Ms. Biedrzycki's alleged standard inconsistent with Commission guidance, it is impossible to satisfy because, as Ms. Biedrzycki seemed to suggest, CAP customers should always be provided an administratively-determined price that, at any point in time, represents the lower of the Price to Compare or the "market determined" price available from a competitive supplier (Tr. 335-336).

Finally, and most importantly, Ms. Biedrzycki simply misunderstood, or chose to ignore, the fact that the Companies' market enhancement programs, as revised in their rebuttal case, provide one-year fixed-prices that will be below the Price to Compare.[41] As a consequence, the market enhancement programs will provide a benefit to customers that select them. And, if a CAP customer determines that the price offered is reasonable at the time of enrollment, that price cannot become unreasonable over the life of program because it is fixed for the term of the customer's participation. Ms. Biedrzycki claims that, because the Price to Compare might, at some point in future, become lower than the fixed price provided by market enhancement programs, a CAP customer could, thereby be "harmed." Obviously, that is not the case. Furthermore, each of the market enhancement programs permits customers to choose another EGS offer or to return to default service during the term of the contracts without switching fee or other penalties.

For all of the foregoing reasons, CAUSE-PA's recommendation to bar CAP customer participation in the market enhancement programs should be rejected.

2. The OCA's Proposal

As previously explained, the OCA has proposed, in effect, that the Standard Offer Customer Referral Program should be indefinitely postponed or not implemented at all. As a consequence, the issue of CAP participation in that program, from the perspective of the OCA's

[41] As to the Retail Opt-In Aggregation Program, the fixed price must be at least 5% below the Price to Compare at the time of the Retail Opt-In Auction. As to the Standard Offer Customer Referral Program, the fixed price must be 7% below the Price to Compare at the time of referral.

recommendations in this case, is essentially moot. As to CAP participation in the Retail Opt-In Aggregation Program, Ms. Alexander has opined that "[i]t would appear unreasonable to allow CAP customers to participate in the opt-in auction unless they will benefit in the form of lower bills compared to the PTC during the entire auction term" (OCA St. 2-SR, p. 12). Ms. Alexander's position is indistinguishable from Ms. Biedrzycki's, which was discussed in Section IV.C.1, *supra*, and should be rejected for all of the same reasons as CAUSE-PA's recommendation.

V. OPERATIONAL ISSUES

Mr. Fein identified certain system enhancements, all of which relate to West Penn's use of the Companies' computer enterprise system, that Constellation would like to see the Companies adopt (Constellation St. 1, pp. 18-20). Mr. Kallaher recommended that the Companies investigate implementing a secure, web-based system to provide EGSs with electronic access to key customer usage and account data, subject to appropriate customer authorization (RESA St. 2, pp. 31-33).

The seven specific items Mr. Fein identified are more appropriately addressed with the Companies' retail choice ombudsman or in the regularly-scheduled monthly meetings that are held between the Companies and EGSs, and not in this proceeding (Companies' St. 2-R, p. 27). Additionally, those items are more accurately categorized as merger integration considerations and not system enhancements because they are unrelated to any specific DSP. *Id.* Nonetheless, Mr. Valdes addressed each item discussed by Mr. Fein, as follows (Companies' St. 2-R, pp. 27-29).

Item 1: *When will new account attribute values such as rate class, load profile, etc. be communicated to EGSs?* The Companies have already communicated to EGSs via e-mail on March 1, 2012, the new customer attributes other than the new customer account number, which has not yet been fully established in the computer enterprise system. Further, on April 1, 2012, when West Penn will be integrated into the computer enterprise system, the Companies will follow up with an electronic data interchange ("EDI") 814 transaction to the EGSs to restate the new customer attributes including the new customer account number.

Item 2: *What steps will the Companies take to ensure that West Penn cancellations/re-bills are processed in a timely fashion?* The Companies are currently developing the internal processes to ensure West Penn's cancellations and re-bills are processed in a timely fashion.

Item 3: *Will an EGS be able to submit EDI 810s with Purpose Code 17 and 18 to re-issue an invoice sent to West Penn prior to the conversion to the Companies computer enterprise system?* The reissuance of an invoice sent to West Penn prior to its conversion to the Companies' computer enterprise system is a manual process. Since there is not a functional cross-reference to West Penn's old computer enterprise system due to system incompatibility, the EGS can submit the invoice reissuance to the Companies via e-mail.

Item 4: *We understand that under the new computer enterprise system, an EGS will be able to determine whether an account is an interval-metered account only through EDI 814 and 867 transactions, and will not know this information initially during the historical usage request. What steps will the Companies take to ensure that EGSs can continue to identify an account as an interval-metered account sooner in time?* The premise for this question is incorrect. An EGS will not be able to determine whether an account is an interval-metered account through EDI 814 and 867 transactions because such an identifying criterion is not available in the listed transactions. Instead, EGSs can identify an account as an interval-metered more quickly from the eligible customer list, which contains an interval-meter flag.

Item 5: *Will the practice of more than three business day turnaround and the e-mail process for enrollment confirmation be applied to West Penn after the migration into the Companies' computer enterprise system?* Contrary to the assumption embedded in the question, the Companies already send an EDI 814 enrollment response within three business days. The only reason an EDI 814 enrollment response would not be sent is because of an exception (i.e., something is incorrect with the customer account). The portion of the question regarding the e-mail process for confirmation is moot based upon my response concerning the three business-day turnaround.

Item 6: *Do the Companies expect to increase the size of their supplier support staff in order to continue to support timely responses to EGS inquiries and needs, post-integration?* The Companies have recently expanded their supplier support staff in anticipation of the increased workload. Additionally, the supplier support staff is continually monitored to determine if changes in procedures or staffing is warranted.

Item 7: *When the Companies cancel and re-bill usage transactions, will the Companies automatically cancel EGS charges associated with the original usage transactions?* No, an EDI 810 transaction must be sent to cancel EGS charges. EGS charges are not automatically canceled. This is not a change in policy and is unrelated to the integration of West Penn into the Companies' computer enterprise system.

Mr. Fein did not follow up on any of the preceding items in his surrebuttal testimony. Therefore, it appears that all of Constellation's concerns have been adequately addressed. Moreover, as previously noted, any further interaction should properly take place between Constellation and the Companies' retail choice ombudsman or in the regularly-scheduled monthly meetings between the Companies and EGSs.

RESA's recommendation that the Companies investigate implementing a secure, web-based system to provide EGSs with electronic access to key customer usage and account data should be addressed in one of the working groups being conducted as part of the Commission's Retail Market Investigation at Docket No. I-2011-2237952. More specifically, in accordance with the *Intermediate Work Plan Final Order* (pp. 96-99), this issue falls under the purview of the working group tasked to address EGS access to customer-specific bills and the language contained in letters of authorization ("LOA") that grant EGSs permission to receive customer account information. As the Commission explained in its *Intermediate Work Plan Final Order*

(p. 98), until the working group completes its mission, the current practices in each EDC's service territory should be maintained. That working group is the proper forum to investigate whether to implement a secure, web-based system to provide EGSs with electronic access to key customer usage and account data (and any LOA impacts associated with such a proposal) because the recommendation raises a global issue for all default service providers. However, if the Commission nonetheless were to order the Companies to implement such an operational change as part of their proposed DSPs, then they must be afforded the opportunity to recover the implementation costs through their DSS Riders or from all EGSs through the imposition of a charge under each Company's respective supplier tariff (Companies' St. 2-R, p. 29).

VI. AFFILIATED INTEREST APPROVAL

Section 2807(e)(3.1)(III)(B) of the Public Utility Code, 66 Pa.C.S. § 2807(e)(3.1)(III)(B), provides that any agreement between affiliated parties is subject to Commission review and approval under Chapter 21 of the Public Utility Code, 66 Pa.C.S Chapter 21. Accordingly, the Companies request that the Commission approve the proposed pro forma SMAs and the EGS agreements associated with their proposed Retail Opt-In Aggregation Program, Standard Offer Customer Referral Program and TOU Rate as affiliated interest agreements pursuant to 66 Pa.C.S. § 2102. The Commission's regulations and Policy Statement on default service permit affiliates of default service providers to participate in competitive procurements for default service supplies. Consequently, it is possible that the Companies' affiliate, FES, may participate in one or more of the Companies' proposed procurements. In the event FES is a winning bidder, it will need to execute the SMA and/or other agreements in the same timeframe as any other supplier or EGS. As a result, advance approval of the pro forma SMAs and agreements, previously identified, as affiliated interest agreements is necessary and appropriate. The

Commission granted similar approvals of Met-Ed's, Penelec's and Penn Power's existing SMAs as part of its approval of their existing default service programs.

VII. OTHER ISSUES

A. Call Center Performance Standards

As Mr. Fullem explained, if the Standard Offer Customer Referral Program is implemented, the length of calls to the Companies' call center will inevitably be increased (Companies' St. 7, p. 32). Because each call will be longer, the number of calls that can be handled and resolved within a given time period will likely be reduced, and wait times are likely to increase. *Id.* Therefore, the Companies request that all customer telephone calls regarding high bill complaints and new service requests be excluded from the data to which the Commission applies its metrics for measuring the percentage of calls answered within thirty seconds. *Id.*

B. Uncollectible Accounts Rate Adjustment

Under the terms of the DSS Riders currently in effect for Met-Ed, Penelec and Penn Power, which were approved by the Commission in those Companies' last default service program proceedings, each Company was permitted to adjust its Default Service Related Uncollectible Accounts Expense Charge in it next default service proceeding with the resulting change to become effective at the start of that default service program (Companies' St. 1-SR, pp. 3-5). Accordingly, Met-Ed, Penelec and Penn Power filed updated rates to recover uncollectible accounts expense for the provision of default service billed through their DSS Riders to become effective on June 1, 2013, as set forth in the Companies' Exhibit RAD-5. The basis for calculating the updated rates is set forth and discussed by Mr. D'Angelo in the Companies'

Statement No. 1-SR. Met-Ed, Penelec and Penn Power request that their updated rates be approved by the Commission. No party has opposed the Companies' request.

VIII. CONCLUSION

For the reasons set forth above, the Commission should approve the Companies' DSPs to become effective on June 1, 2013. In addition, the Commission should: (1) make the findings required by 66 Pa.C.S § 2807(e)(3.7); (2) grant the affiliated interest approvals requested herein; and (3) grant such other approvals as may be needed to fully implement the DSPs, including the competitive market enhancements set forth therein.

Respectfully submitted,

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May 2, 2012

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

JOINT PETITION
OF

METROPOLITAN EDISON COMPANY
DOCKET NO. P-2011-2273650

PENNSYLVANIA ELECTRIC COMPANY
DOCKET NO. P-2011-2273668

PENNSYLVANIA POWER COMPANY
DOCKET NO. P-2011-2273669

WEST PENN POWER COMPANY
DOCKET NO. P-2011-2273670

FOR
APPROVAL OF THEIR
DEFAULT SERVICE PROGRAMS

TESTIMONY AND EXHIBIT LIST

Statement No. 1, Direct Testimony of Richard A. D'Angelo

- Exhibit RAD-1 — Projection of Default Service Program Solar Photovoltaic Requirements Administrative Costs
- Exhibit RAD-2 — Projection of Default Service Program Incremental Administrative Costs

Statement No. 1-R, Rebuttal Testimony of Richard A. D'Angelo

- Exhibit RAD-3 Projection of Penelec Default Service Program Incremental Administrative Costs

Statement No. 1-SR, Surrebuttal Testimony of Richard A. D'Angelo

- Exhibit RAD-4 Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company Net Shortfall of Generation Related Uncollectibles
- Exhibit RAD-5 Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company Default Service Uncollectible Accounts Expense

Statement No. 2, Direct Testimony of Raymond E. Valdes

- Exhibit REV-1 Metropolitan Edison Company Price to Compare Default Service Rate Rider
- Exhibit REV-2 Pennsylvania Electric Company Price to Compare Default Service Rate Rider
- Exhibit REV-3 Pennsylvania Power Company Price to Compare Default Service Rate Rider
- Exhibit REV-4 West Penn Power Company Tariff No. 39 Price to Compare Default Service Rate Rider
- Exhibit REV-5 Metropolitan Edison Company Hourly Pricing Default Service Rider
- Exhibit REV-6 Pennsylvania Electric Company Hourly Pricing Default Service Rider
- Exhibit REV-7 Pennsylvania Power Company Hourly Pricing Default Service Rider

- Exhibit REV-8 West Penn Power Company Tariff No. 39 Hourly Pricing Default Service Rider
- Exhibit REV-9 West Penn Power Company Tariff No. 37 Hourly Pricing Default Service Rider
- Exhibit REV-10 Metropolitan Edison Company Default Service Support Rider
- Exhibit REV-11 Pennsylvania Electric Company Default Service Support Rider
- Exhibit REV-12 Pennsylvania Power Company Default Service Support Rider
- Exhibit REV-13 West Penn Power Company Tariff No. 39 Default Service Support Rider
- Exhibit REV-14 West Penn Power Company Tariff No. 37 Default Service Support Rider
- Exhibit REV-15 Metropolitan Edison Company Solar Photovoltaic Requirements Charge Rider
- Exhibit REV-16 Pennsylvania Electric Company Solar Photovoltaic Requirements Charge Rider
- Exhibit REV-17 Pennsylvania Power Company Solar Photovoltaic Requirements Charge Rider
- Exhibit REV-18 West Penn Power Company Tariff No. 39 Solar Photovoltaic Requirements Charge Rider
- Exhibit REV-19 West Penn Power Company Tariff No. 37 Solar Photovoltaic Requirements Charge Rider
- Exhibit REV-20 West Penn Power Company Tariff No. 39 - Miscellaneous Revisions
- Exhibit REV-21 West Penn Power Company Tariff No. 37 - Miscellaneous Revisions

Statement No. 2-R, Rebuttal Testimony of Raymond E. Valdes

- Exhibit REV-22 — Metropolitan Edison Company Default Service Support Rider
- Exhibit REV-23 — Pennsylvania Electric Company Default Service Support Rider
- Exhibit REV-24 — Pennsylvania Power Company Default Service Support Rider
- Exhibit REV-25 — West Penn Power Tariff No. 39 Default Service Support Rider
- Exhibit REV-26 — West Penn Power Tariff No. 37 Default Service Support Rider
- Exhibit REV-27 — Metropolitan Edison Company Price Cash Working Capital – Residential

Statement No. 2-SR, Surrebuttal Testimony of Raymond E. Valdes

Statement No. 3, Direct Testimony of Richard L. Schreader

- Exhibit RLS-1 — Companies' Default Service Supplier Master Agreement for Residential Customer Class / Commercial Customer Class (with blackline)
- Exhibit RLS-2 — Companies' Default Service Supplier Master Agreement for Industrial Customer Class – Hourly Pricing Service (with blackline)
- Exhibit RLS-3 — Companies' Solar Photovoltaic Alternative Energy Credit Purchase and Sale Agreement
- Exhibit RLS-4 — Calculations Of Additional Costs For Spot-Priced Components

Statement No. 3-R, Rebuttal Testimony of Richard L. Schreader

Statement No. 4, Direct Testimony of Dean W. Stathis

- Exhibit DWS-1 Default Service Supply Schedules
- Exhibit DWS-2 Overview of Alternative Energy Portfolio Standard Percentage Requirements
- Exhibit DWS-3 Solar Photovoltaic Alternative Energy Credits (SPAEC) - Procurement Schedule

Statement No. 4-R, Rebuttal Testimony of Dean W. Stathis

- Exhibit DWS-4 April 2012 to March 2013 Forward Average Power Prices
- Exhibit DWS-5 Eight Month Comparison of Residential Block and Spot Plus Market Cost vs. Full Requirements Products – June 2011 to January 2012
- Exhibit DWS-6 Interrogatory Response (RESA-I-1)

Statement No. 4-SR, Surrebuttal Testimony of Dean W. Stathis

Statement No. 5, Direct Testimony of Dr. Bradley A. Miller

- Exhibit BAM-1 Bidding Rules to Procure Default Service Products
- Exhibit BAM-2 Bidding Rules for Retail Opt-In Auction

Statement No. 5-R, Rebuttal Testimony of Dr. Bradley A. Miller

- Exhibit BAM-3 Bidding Rules for the Retail Opt-In Auction
- Exhibit BAM-4 Bidding Rules for the Retail Opt-In Auction (Redline)

Statement No. 6, Direct Testimony of James D. Reitzes

- Exhibit JDR-1 Solar Photovoltaic Alternative Energy Credits Request for Proposals Rules
- Exhibit JDR-2 Full-Requirements Retail Supply Obligation for Time-of-Use Customers Competitive Bidding Process Rules

Statement No. 6-R, Rebuttal Testimony of James D. Reitzes

Statement No. 7, Direct Testimony of Charles V. Fullem

- Exhibit CVF-1 Pennsylvania Power Company Time-of-Use Default Service Rider
- Exhibit CVF-2 West Penn Power Company Time-of-Use Default Service Rider
- Exhibit CVF-3 Time-Of-Use Aggregation Agreement
- Exhibit CVF-4 Customer Opt-In Aggregation Agreement
- Exhibit CVF-5 Customer Referral Aggregation Agreement
- Exhibit CVF-6 Customer Referral Program Terms & Conditions

Statement No. 7-R, Rebuttal Testimony of Charles V. Fullem

- Exhibit CVF-7 Comparison of EGS Variable Charges
- Exhibit CVF-8 Copy Of IDT Energy Offer
- Exhibit CVF-9 EGS Margin Comparison
- Exhibit CVF-10 Customer Opt-In Aggregation Agreement – Residential Customer Class Full Requirements
- Exhibit CVF-11 Customer Referral Program Agreement – Residential Customer Class Full Requirement

Statement No. 7-SR, Surrebuttal Testimony of Charles V. Fullem

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT PETITION OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN POWER COMPANY FOR APPROVAL OF THEIR DEFAULT SERVICE PROGRAMS	:	**DOCKET NOS.**	**P-2011-2273650** **P-2011-2273668** **P-2011-2273669** **P-2011-2273670**

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Initial Brief of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company** upon the following persons, in the matter specified below, in accordance with the requirements of 52 Pa. Code § 1.54:

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