COMMONWEALTH OF PENNSYLVANIA

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July 9, 2012

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 Nos. P-2011-2273650; P-2011-2273668, P-2011-2273669, P-2011-2273670

Dear Secretary Chiavetta:

Enclosed please find the Office of Consumer Advocate's Reply Exceptions, in the above referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully Submitted,

Darryl A. Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures
cc: Hon. Elizabeth H. Barnes
Office of Special Assistants
Certificate of Service

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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

REPLY EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: July 9, 2012

TABLE OF CONTENTS

I. INTRODUCTION

On June 15, 2012, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Elizabeth H. Barnes in the Default Service Plan (DSP) proceeding of Metropolitan Edison Company (Met-Ed), Pennsylvania Electric Power Company (Penelec), Pennsylvania Power Company (Penn Power), and the West Penn Power Company (West Penn) (FirstEnergy or the Companies). Exceptions were filed on June 25, 2012. The OCA's positions in this proceeding are fully addressed in its Main Brief, Reply Brief, and Exceptions. The OCA files these Reply Exceptions to certain Exceptions filed by FirstEnergy, the Retail Energy Supply Association (RESA), FirstEnergy Solutions (FES) and Dominion Retail (Dominion).

II. REPLY EXCEPTIONS

A. The OCA's Reply As To Default Service Procurement Issues.

OCA Reply to FirstEnergy Exception 5: The Companies' Legacy Procurements Do Not Make Their Proposed Future Residential Default Service Procurement Prudent. (Companies' Exc. at 30-31; R.D. at 3; OCA M.B. at 17-24; OCA R.B. at 11-15)

In their Exceptions, the Companies argue that the ALJ was correct in finding that their residential default service procurement plan met Act 129's "prudent mix" requirement, but that the R.D. does not "furnish a complete picture of the Companies' procurement plan for fixed price service." Companies' Exc. at 30. The Companies propose to amend the ALJ's Finding of Fact No. 2, so that it makes note of the legacy 48 month block energy contracts that will supply power through May 31, 2015 for Met-Ed, Penelec, and Penn Power, as well as the ten year solar alternative energy credits. Companies' Exc. at 30-31.

The OCA recognizes that, except for West Penn Power, each Company's supply mix has a four year block of power procured for the existing default service plan. Indeed, the existence of this block supply provides a stabilizing effect for future default service rates, and is evidence that the proposed default service plan does not follow the same strategy for diversifying and layering of purchases that has worked well under the Companies' current plans. See, OCA Exc. at 19-21; see also, OCA M.B. at 22-24; see also, OCA R.B. at 11-15.

The OCA submits that the existence of prior block purchases, however, does not change the fact that the Companies' proposed residential procurement plan seeks to rely exclusively on the purchase of a single type of product – 24 month full requirements contracts that all start and end on the same dates – to serve their substantially unfilled residential default service load. The OCA fully addressed this issue in its Exceptions. See, OCA Exc. at 4-14. The OCA submits that, regardless of whether the Commission accepts the Companies Exception No. 5 on this point, it is not prudent to proceed with the residential procurement plan advocated by the Companies and recommended for adoption by the ALJ.

OCA Reply to RESA Exception 1: RESA's Arguments In Support Of Its Proposed Residential Procurement Plan Are Incorrect. (RESA Exc. at 4-15; R.D. at 7-13, 21-23, 25-26; OCA M.B. at 10-14, 22-24; OCA R.B. at 5-8, 11-15)

1. RESA's Arguments That Minimize The Importance Of Rate Stability Are Flawed And Must Be Rejected.

In its Exception 1, RESA argues that the Companies' residential procurement plan, recommended for adoption by the ALJ, is flawed. RESA Exc. at 6-10. RESA argues that the ALJ overstated the importance of price stability and thus erred by recommending that the Companies' procurement plan of 24-month full requirements contracts be adopted. RESA Exc. at 8. RESA's argument rests on the premise that the ALJ has inappropriately relied upon the Preamble to Act 129 and that the ALJ failed to take into consideration the Commission's ruling in Petition of Pike County Light & Power Company for Approval of its Default Service

Implementation Plan, at Docket No. P-2011-2252042, Opinion and Order dated May 24, 2012 (Pike). RESA Exc. at 6-10.

The OCA wishes to state at the outset that it agrees with RESA that the Companies' procurement plan for residential customers should not be approved in this proceeding. See, OCA Exc. at 4-14. The Companies' prospective procurement proposal relies solely on 24 month, full requirements contracts that would all be procured only two months apart. As the OCA detailed in its Exceptions (pages 4-11), the Companies' over-reliance on two year full requirements contracts does not represent a prudent mix and must be rejected. In its place, the OCA recommends continuation of the procurement mix currently employed by Met-Ed, Penelec, and Penn Power. See, OCA Exc. at 11-14.

The OCA submits this Reply Exception, however, because it disagrees with RESA's characterization of the ALJ's analysis and the requirements of Act 129. In particular, the OCA submits that the ALJ's consideration of price stability as an important element of default service is consistent with Act 129, with the Commission's prior determinations on this issue and with the Commission's discussion in Pike. The Commission has recognized the General Assembly's intent to move away from a "prevailing market price" standard and to instead require each default service provider to procure a prudent mix of products to achieve least cost over time. Of critical importance, the Commission recognized that Act 129's standard must take into consideration price stability and service reliability. The Commission's recent Final Rulemaking Order on default service states:

> Finally, it should be noted that the "least cost over time" standard should not be confused with the notion that default prices will always equal the lowest cost price for power at any particular point in time. **In implementing default service standards, Act 129 requires that the Commission be concerned about rate stability as well as other considerations such as ensuring a "prudent mix" of supply and ensuring safe and reliable service.** *See* 66 Pa. C.S. §§ 2807(e)(3.2),

> (3.4) and (7). In our view, a default service plan that meets the "least cost over time" standard in Act 129 should not have, as its singular focus, achieving the absolute lowest cost over the default service plan time frame but, rather, a cost for power that is both adequate and reliable and also economical relative to other options.

Implementation of Act 129 of October 15, 2008: Default Service and Retail Electric Markets, Docket No. L-2009-2095604 (Final Rulemaking Order entered October 4, 2011) (Slip op. at 11-12)(Final Rulemaking Order) (emphasis added). As the Commission Order makes clear, default service providers must consider price stability and reliability when developing a procurement plan that meets the "least cost over time" standard. ALJ Barnes properly reflected this point in her R.D. at 7-13. Again, while the OCA submits that the ALJ was correct to consider price stability in her decision, the OCA respectfully submits that the Companies' plan does not represent a diverse, prudent mix of supplies that will ensure reasonable, stable service at least cost over time, including during the course of the plan and through the transition into the next plan. See, OCA Exc. at 4-14.

RESA also contends that the Commission addressed the need for price stability as set forth in the Preamble to Act 129 in the recent default service proceeding involving Pike County Light & Power Company (Pike), and that the R.D. does not reflect the Commission's latest findings on this issue. RESA Exc. at 7-8, citing Pike. RESA argues that the ALJ has incorrectly elevated the Preamble of Act 129 over the statutory requirements for default service, which the Commission found improper in Pike. RESA Exc. at 7-8. The OCA submits that the ALJ's discussion does not contain this error as RESA asserts.

The Preamble to Act 129 provides very specific guidance as to the purpose of Act 129 and the goals that have been set by the General Assembly for each default service provider to achieve. Specifically, the General Assembly declared:

(1) The health, safety and prosperity of all citizens of this Commonwealth are inherently dependent upon the availability of adequate, reliable, affordable, efficient and environmentally sustainable electric service at the least cost, *taking into account any benefits of price stability over time* and the impact on the environment.

(2) It is in the public interest to adopt energy efficiency and conservation measures *and to implement energy procurement requirements designed to ensure that electricity obtained reduces the possibility of electric price instability*, promotes economic growth and ensures affordable and available electric service to all residents.

See, Preamble to Act 129, 2008 Pa. Laws 129 (Emphasis added). While the rules of statutory construction dictate that the findings and declarations found in the Preamble of a statute do not take precedence over the specific statutory provisions contained in the law, the rules of statutory construction provide that the Preamble may be considered in the construction of a statute. Section 1924 states, "The title and preamble of a statute may be considered in the construction thereof." 1 Pa. C.S. §1924; see, Mt. Laurel Racing Ass'n v. Zoning Hearing Board, 458 A.2d 1043, 1046 (Pa. Commw. 1983) (stating that legislative intent is considered the polestar of statutory construction).

The OCA submits that RESA's discussion of the Commission's recent Pike Order overstates the scope of that decision. The Commission in Pike did not rule that price stability was not relevant to the reasonableness of Pike's default service plan. Rather, the Commission found that under the "unique" situation presented by Pike, it was appropriate to approve a plan based on a single spot-market based product. The OCA respectfully disagrees with the Commission's final Order in Pike, but notes that the conditions that led to the Commission's ruling in that case are not present here.

In making its determination in Pike, the Commission found that Pike should continue to procure all of its default supply on a spot market basis. Pike at 13-14, 29-31. The Commission concluded that procuring all power on the spot market was reasonable in order to avoid excessive costs due to Pike's small size and even smaller default service load. Pike at 13-14. Specifically, the Commission recognized the unique nature of Pike, as follows:

> We shall adopt the Company's proposal to continue the acquisition of default service supply entirely through the NYISO spot market for the following reasons. Pike serves only 4,700 customers and provides default service to approximately 1,300 or twenty-seven percent of these delivery service customers.

Pike at 13. The Commission then went on to acknowledge the importance of price stability, as follows:

> While ***we are concerned about price volatility and how it impacts a customer's bill***, as is the OCA, we support the Company's position that the cost of a financial hedge against spot market price volatility ***could be more costly*** to default service customers than a change in the spot market price of energy.

Pike at 14.

The Commission explicitly affirmed its consideration of price volatility in Pike, but chose not to implement measures that would add rate stability out of concern that those few customers on default service may see increased costs on a "per customer" basis. The OCA submits that the ALJ fully recognized the Commission's determination in Pike in the R.D. in this proceeding. The unique situation that led to the Commission decision approving a single spot market default service product for residential customers in Pike, however, is not present here. In the Pike proceeding, default service was being designed to serve an existing default service load of approximately 1,300 residential customers. Pike at 8. The Commission specifically noted that Pike represents a "unique case." Pike at 30. In this case, the Commission is considering default service to hundreds of thousands of FirstEnergy customers across Pennsylvania. The Pike situation bears little resemblance to the questions presented in this proceeding.

2. RESA's Arguments Regarding Market Responsive Pricing Must Be Rejected.

Using Pike as a foundation, RESA further argues in its Exceptions that, "the use of longer contracts with the longer procurement delivery windows guarantees that the default service rate at the time of delivery will not be reflective of the then-current market prices because it is based on the procurement bids." RESA Exc. at 9 (emphasis in original). As a result, RESA argues that the Companies should be required to move away from 24 month contracts to meet residential load. RESA Exc. at 9. Again, the OCA agrees that the Companies' reliance on 24 month contracts – all purchased at nearly the same time – is not reasonable. The OCA submits that these contracts can and should be a portion of the "prudent mix" of contracts approved by the Commission in this case, but that more diversity is needed.[1]

The Commission has previously rejected RESA's arguments that default service rates must always reflect then current market prices. The Commission has stated:

> 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.

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1 While the OCA agrees with RESA that the Companies have relied too heavily on 24 month contracts to meet their default service obligation, it is not for the same reasons. The OCA proposes that the Companies continue to utilize the same basic supply mix currently in place for Met-Ed, Penelec and Penn Power, that is a mix of one year and two year full requirements contracts, one year and four year block energy contracts, and spot market purchases. Under their current default service plans, the Companies have procured a mix of a variety of products that has worked well for both non-shopping and shopping customers alike. Since the expiration of Met-Ed and Penelec's rate caps in January 2011, for example, more and more customers have taken advantage of shopping opportunities. For the period of January 2011 to April 2012, Met-Ed and Penelec have seen the number of residential shopping customers increase from less than one percent to 20.0% and 23.3% respectively. The OCA submits that the current default service model has worked well and provides a solid foundation to further develop the retail market, while ensuring that non-shopping customers receive reasonable market-based generation default service. See, OCA M.B. at 9-33.

Final Rulemaking Order at 39-40 (emphasis added). After citing the above passage, the ALJ in the present case concluded that:

> RESA's proposal to create a "market responsive" default service plan, without considering rate stability, is unreasonable.

R.D. at 22.[2]

The OCA submits that the ALJ was correct to consider rate stability in her deliberations, consistent with Act 129 and prior Commission precedent. As detailed in the OCA's Exceptions, however, the OCA submits that the ALJ's adoption of the Companies' proposed residential procurement plan should be rejected in favor of a broader mix of supplies that better meets all the goals of Act 129.

3. <u>The RESA Proposed Residential Procurement Plan, Like The Companies' Plan, Does Not Properly Ladder Contracts For Service Beyond The Proposed Two Year Plan</u>.

In its Exceptions, RESA advocates that the Companies' residential procurement plan be modified. Like the Companies' proposal, the RESA proposal would utilize full requirements purchases for the June 1, 2013 through May 31, 2015 period with no contracts extending beyond that period. Like the Companies' proposal, RESA proposes that 90% of the full requirements be set at a fixed-price, with the remaining 10% priced at spot market. RESA Exc. at 4. Unlike the

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2 The OCA further submits that RESA's argument against stable default service and in favor of relying on the retail marketers to provide rate stability does not reflect the requirements of Act 129. RESA Exc. at 12-15. RESA argues that, under its proposed modifications, the retail market will step in and meet all policy objectives of Act 129, including price stability. RESA Exc. at 13. Act 129, however, explicitly requires each default service provider, not electric generation suppliers, to meet the requirements and intent of Act 129. The default service provider must procure a prudent mix of spot market, short term, and long term contracts designed to achieve least cost over time. 66 Pa. C.S. §2807(e)(3.2-3.4). The policy goals of this Section of Act 129 must be met by the default service provider.

Further, Under RESA's rationale, because long term contracts would always have the potential to diverge from prevailing market prices, they would never be a reasonable choice. It is the obligation of the Default Service Provider to meet the goals of Act 129, and long-term contracts are to be considered as part of the prudent mix of supplies designed to achieve those goals. Had the General Assembly believed long term contracts (greater than 4 years and up to 20 years, 66 Pa. C.S §2807(e)(3.2)(iii)) to be inherently harmful to consumers and competitive markets, it would not have included them in the Act.

Companies' proposal, however, RESA recommends that the Companies procure both 12 month and 24 month contracts, rather than rely on procuring only 24-month full requirements contracts. RESA Exc. at 4-5.

Again, the OCA agrees with RESA that a greater variety of contracts should be procured in this plan. The OCA submits, however, that the RESA plan shares one of the same flaws as the Companies' proposal. That is, it would result in a "hard stop" on May 31, 2015. The OCA submits that it is not reasonable to replace 100% of power on June 1, 2015. The OCA fully addressed this issue in its Exceptions with regard to the Companies' proposal, which also includes a hard stop. See, OCA Exc. at 19-22; see also, OCA M.B. at 22-24; OCA R.B. at 11-15.

The OCA submits the supply plan should be laddered so that default service customers are never fully exposed to changing market conditions at a single point in time. The OCA submits that there is no justification to leave customers fully exposed to potential dramatic price spikes in the future. See, OCA St. 1-SR at 5. As explained above, the Companies' proposal should be rejected in favor of a more laddered approach that reduces the risk of an abrupt price spike at the end of the upcoming Plans. The OCA submits that the RESA proposal should not be adopted for the same reasons.

B. The OCA's Reply As To The Creation Of A Market Adjustment Charge.

OCA Reply to FirstEnergy Exception 1: The ALJ Correctly Rejected The Creation Of A Market Adjustment Charge. (FE Exc. at 6-18; R.D. at 54-58; OCA M.B. at 36-47; OCA R.B. at 26-30)

1. Introduction.

FirstEnergy proposed to add a 0.5¢ per kWh charge to the Price-to-Compare for the residential and commercial classes that would serve to increase the default service rate. The

Companies alleged that the Market Adjustment Charge (MAC) would compensate the Companies for the obligation and risk of providing generation service for default service customers, and would enhance competition by creating "headroom" for EGSs to provide competitive offers. It is important to note that OCA witness Kahal concluded that the Companies' MAC proposal would increase default service customers' costs and FirstEnergy's profits by over $190 million over the two-year period of the Default Service Plan. See, OCA St. 1 at 39.[3]

In the Recommended Decision (R.D.) the ALJ rejected the Companies' MAC proposal, in part, as follows:

> I find the MAC qualifies as an impermissible return; it fails to qualify as a legitimate retail market enhancement tool; and is an inappropriate and unnecessary financial adder. Even the Companies' witness, Mr. Charles Fullem, acknowledged, "the MAC contains a return component that will be added to the weighted average cost of generation for default service customers in the residential and commercial classes and included in the reconciliation cost calculation."

R.D. at 56 (citations omitted). FirstEnergy, RESA and Dominion submitted Exceptions on this issue.[4] The OCA submits that the ALJ's decision on this issue is consistent with the law and sound public policy, and accordingly should be upheld.

In its Exception on this issue, FirstEnergy makes three arguments in support of its MAC proposal: (1) the Companies are being exposed to risks due to the provision of default service for which they are not being adequately compensated; (2) other jurisdictions have approved similar

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[3] The OCA notes that FirstEnergy witness Fullem, in response to Mr. Kahal, testified that the MAC would only produce about $140 million during the two-year period of the DSP. FirstEnergy St. 7-R at 11.

[4] The RESA and Dominion Exceptions as to the MAC will be addressed together in the next OCA Reply section.

mechanisms to the MAC; and (3) implementation of the MAC would spur retail competition. FirstEnergy (FE) Exceptions at 6-18. The ALJ properly rejected these arguments.

2. <u>The ALJ Correctly Held That The MAC Does Not Represent A Valid Cost Recovery Mechanism, But Is Rather An Impermissible Profit Adder</u>.

As to the Companies' first argument that the MAC is necessary in order to compensate FirstEnergy for risks or unrecovered costs of providing default service, the ALJ held that:

> The MAC is in conflict with the Public Utility Code in several respects, particularly since the Companies receive full recovery of all costs of providing default service on a dollar-for-dollar basis through an automatic adjustment surcharge. 66 Pa. C.S. Section 2807(e).

R.D. at 56 (citation in original). The ALJ correctly found that there is no legal, or for that matter policy basis for the MAC, as the Companies are already authorized by the Public Utility Code to recover all costs, on a dollar-for-dollar basis, of providing default service. As to any potential unrecovered costs, OCA witness Matt Kahal testified that FirstEnergy witness Dr. Reitzes discussed a series of potential costs that the Companies were at risk for non-recovery, but as Mr. Kahal went on to discuss:

> Dr. Reitzes lists these costs but provides no cost data, nor does he indicate whether such costs have ever been incurred by the FE Companies or any Pennsylvania EDC.
>
> The OCA requested information on these four asserted risk items including cost data, a detailed description of the cost items and potential lost earnings estimates for the FE Companies. (OCA II-18) The response did not provide any description, documentation or quantification. There is no indication that such costs have ever been incurred by Joint Petitioners, nor is there any available evidence that any of the listed items constitute a material risk of earnings loss.

OCA St. 1 at 41-42. Mr. Kahal testified further as to whether the financial markets perceive the Companies as bearing additional risk through the provision of default service, in relevant part as follows:

> The FE Companies have not identified any such investor concern. OCA II-13 asked for credit rating reports, securities analysts' reports and Joint Petitioners' management presentations that identified default service risks. The Joint Petitioners' response stated that they were not aware of any such reports. Based on my experience, I concur with this response. I have seen no evidence that the financial community perceives any material business risk resulting from the provision of default service. Again, there is no documented support for Dr. Reitzes' position that there is material risk associated with default service that warrants a profit adder of any size.

OCA St. 1 at 42. As OCA witness Kahal testified, and the ALJ concluded, the substantial evidence produced in this matter shows that the MAC proposal is not justified by any unrecovered costs[5], but rather is an unjustified profit adder. R.D. at 56.

Pennsylvania law does not permit a profit on the provision of reconcilable default service.[6] The Public Utility Code provides, in relevant part:

> 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.

66 Pa. C.S. § 2807(e)(3.9); see also OCA M.B. at 37-47. A plain reading of the statute indicates that the default service provider has a right to "recover" all reasonable costs "incurred." ALJ Susan D. Colwell succinctly captured the cost recovery structure of default service in a recent decision, stating "A default service provider is entitled to full recovery of its costs because it is not permitted to make a profit on the cost of the commodity." Petition of PPL Electric Utilities

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5 FirstEnergy did allege that it suffered a loss of $3 million relating to increased uncollectible accounts expense related to the provision of default service. See, e.g., FE Exc. at pg. 8, fn 5. What the Companies fail to explain, however, is that FirstEnergy voluntarily agreed in settlement proceedings to the treatment of the uncollectible accounts expense that the Companies are now complaining of. A complete discussion on this topic is included in the OCA's Main Brief at 42-44. Moreover, the Companies did not explain why default service customers should pay an estimated $190 million in higher costs over a two-year period to cover a $3 million increase in expenses.

6 At page 10 of its Exceptions, FirstEnergy again makes clear that it is not seeking to recover costs, but is rather seeking to make a profit on the provision of default service. FE Exc. at 10. The Companies' speculations as to the effect of Section 54.183(c) (the provision where an alternative default service provider could be appointed instead of the EDC) of the Commission's Regulations, however, are without merit. It is clear that Pennsylvania law does not allow a profit margin to be included in the provision of reconcilable default service.

Corp. for Approval to Implement a Reconciliation Rider for Default Supply Service, Docket No. P-2011-2256365 (Recommended Decision of Administrative Law Judge Susan Colwell, issued April 4, 2012 at 35). The Courts of Pennsylvania have also plainly addressed the issue of cost recovery by a public utility for "costs" that a utility does not incur. The Supreme Court of Pennsylvania has held that:

> Although the Commission is vested with broad discretion in determining what expenses incurred by a utility may be charged to the ratepayers, the Commission has no authority to permit, in the rate-making process, the inclusion of *hypothetical expenses not actually incurred*. When it does so, as it did in this case, it is an error of law subject to reversal on appeal.

Barasch v. PA PUC, et al., 493 A.2d 653, at 655 (Pa. 1985) (emphasis added). On this same issue of illusory costs, the Commonwealth Court of Pennsylvania has held that:

> However, a utility may pass along to its customers only those expenses or costs it actually incurs. Any other approach would permit the utility, by charging higher rates than necessary, to gain a profit from its customers under the guise of recovering operating expenses.

Cohen v. PA PUC, et al., 468 A.2d 1143, at 1150 (Pa. Commw. Ct. 1983) (internal citations omitted); See also, Barasch v. PA PUC, 532 A.2d 325, at 336 (Pa. 1987); Popowsky v. PA PUC, 695 A.2d 448, at 455 (Pa. Commw. Ct. 1997). The Public Utility Code, prior Commission decisions and the Courts of Pennsylvania have made clear that the creation of a profit through the recovery of hypothetical costs is impermissible.

As to its continued arguments attempting to justify the Companies' desire to extract a profit from the provision of default service, FirstEnergy contends that it is entitled to be compensated for its "goodwill." FE Exc. at 14-18. As OCA witness Kahal explained, however, goodwill has no bearing on setting utility rates. Mr. Kahal testified:

> The central point is that the goodwill asset on the parent's balance sheet has nothing whatsoever to do with the provision of default service and was not an investment undertaken or cost incurred so that these four EDCs could supply

> default service. In other words, the goodwill accounting entry would be precisely the same dollar amount whether or not the FE Companies provided any default service and is not a resource used to provide default service.
>
> Mr. Fullem correctly concedes that it is not proper to include any goodwill in setting the EDC delivery service rates. It is equally true that it should have no bearing on default service rates, and it clearly is not a reasonable cost incurred by the EDCs in connection with providing default service.

OCA St. 1-SR at 14. Consistent with the OCA's position on this issue, the ALJ concluded as follows on the issue of goodwill:

> Finally, the Companies allude to the fact that they should be able to extract a premium price for default service based on "goodwill". FE St. 7-R at 9-11. However, "goodwill" is not considered as part of a ratemaking process. *Des Moines Gas Company v. City of Des Moines*, 238 U.S. 153 (1915). The Supreme Court held that good will has no place in the fixing of valuation for the purpose of rate-making. *Id.* at 165 (*citing Willcox v. Consolidated Gas Co.,* 212 U.S. 19, 52 (1909). The Commission has also made similar holdings in *Application of PPL for Approval of Restructuring Plan*, Docket No. R-00973952 at 64-65 (Order entered April 1, 1998) and *Application of Shenango Valley Water Co.*, Docket No. A-21275F0002 at 10 (Order entered July 12, 1994).

R.D. at 57 (citations in original). The OCA submits that as there is no basis for the MAC as a cost recovery mechanism, as it is more correctly a wholly unjustified profit adder to the provision of default service, the ALJ's decision on this issue is in accord with the law and should be upheld.

3. <u>FirstEnergy's Attempted Comparisons To Other Jurisdictions Regulatory Schemes As Support For The MAC Are Without Merit</u>.

In its Exceptions, FirstEnergy alleges that other states include a return component as part of the provision of default service, and accordingly this Commission should consider following suit. FE Exc. at 9. The ALJ soundly rejected this argument. R.D. at 57-58. The OCA submits that the ALJ's ruling on this issue is correct for several reasons.

First, for all the reasons discussed above, Pennsylvania law does not allow for a profit on default service. This issue is not one to be decided based on non-precedential evidence from other jurisdictions, as it is an issue that has already been viewed and decided in this jurisdiction. Second, as the Companies readily admit, "each state operates under a somewhat different statutory scheme." FE Exc. at 9. OCA witness Kahal testified on this issue, as follows:

> Mr. Fullem points to Texas and Maryland as examples where a profit adder is included. I am not familiar with the development of such a charge in Texas, but I am in Maryland. Several years ago, the Maryland Public Service Commission approved a comprehensive settlement for default service that includes a 1.5 mill per Kwh adder for residential default service. This adder was developed as a negotiated figure but in compliance with the State's statutory requirement that default service provide the EDC with a return.
>
> The Joint Petitioners were not able to identify any other jurisdiction or utility that includes a profit adder for residential default service. (Response to OCA III-24) Moreover, FE utilities in other jurisdictions have ***not*** proposed either the inclusion of a residential profit adder, or in the case of Maryland an increase in the 1.5 mill adder. In fact, in Maryland, FE proposed eliminating the profit adder for a period of time in connection with its Allegheny Energy merger.

OCA St. 1 at 38-39 (emphasis in original). As Mr. Kahal testified, there are undoubtedly different statutory provisions that are in place in other states. The ALJ correctly reflected in the R.D. that the comparisons presented by FirstEnergy find no support in Pennsylvania law, in relevant part as follows:

> Although utility regulatory commissions in other jurisdictions may have included charges like the MAC in default service rates, we have different regulatory schemes than Maryland, New Jersey and Texas and our Public Utility Code does not allow for a return recovery as depicted in the proposed MAC. We have a reconciliation process to address risk of providing default service, and the Companies have not proposed waiving their right to reconciliation in exchange for a MAC.

R.D. at 57-58. As the ALJ found, the Companies have the right to a reconciliation process and thereby have no need for and no legal basis for implementing a MAC. The OCA submits that the ALJ's conclusions on this issue are in accord with the law and should be upheld.

4. The ALJ Correctly Found That Spurring Retail Competition Is Not A Legally-Sustainable Justification For The MAC, Nor Is Such A Conclusion Supported By The Evidence.

As discussed above, there is no provision in Pennsylvania law to authorize a profit on the provision of reconcilable default service. In addition, even if a MAC were to be considered, the assumption that this mechanism would provide an appropriate stimulus to shopping is not supported by the evidence. As OCA witness Kahal testified:

> While residential shopping within the past year has increased significantly, 75 to 80 percent of the Companies' residential customers remain on default service. It is simply common sense that EGSs would try to expand their residential business mainly by targeting default service. Their focus would be on attracting residential customers away from default service and, of course, default pricing. In fact, in marketing their product to residential customers, EGSs often stress the savings that their product can provide (and/or its fixed price attribute) relative to default service – not relative to the products offered by other EGSs. This is the key evidence that Dr. Reitzes overlooks.
>
> What this illustrates is that the residential default PTC is an important benchmark for both consumers and EGSs. An abrupt increase in the PTC (unrelated to wholesale market conditions) provides additional headroom for EGSs to raise their price offers, and it will be profit maximizing for them to do so.
>
> Under conditions when competitive retail markets are developing, it is difficult to predict actual behavior by suppliers with certainty, and my testimony does not assert with certainty what must happen. Rather, my position is that under the MAC proposal, which raises the default service umbrella price, there is a significant *risk* of increasing EGS price offers, at least for a period of time, thereby harming customers that do shop. In addition, it clearly will harm customers that remain on default service.

OCA St. 1-SR at 15-16. As Mr. Kahal testified, it is clear that the MAC will harm default customers by effectuating an enormous transfer of wealth from ratepayers to FirstEnergy shareholders. As for-profit entities, it should be equally clear that EGSs will take this opportunity to maximize their profits, which will also represent a significant, and unwarranted transfer of wealth from shopping customers to EGSs. Not only would default service customers be directly affected by an artificial increase in the PTC as proposed by FirstEnergy, shopping customers who accept a percent-off-the-PTC product offer would pay more and it is likely that other shopping customers who switched to an EGS would also pay more, as Mr. Kahal described, due to the artificially higher PTC.

In addition to finding that the MAC is impermissible under Pennsylvania law, the ALJ also provided the following:

> Further, I find the MAC would probably result in increased EGS charges for consumers who accept a percent-off-the-default service price offering.

R.D. at 56. The OCA submits that the only reasonable conclusion to be drawn from the evidence is not that the MAC will spur retail competition, but rather that it will serve to substantially increase prices for all consumers. The Companies have failed to carry their evidentiary burden as to the MAC, as there are no unrecovered costs to which the MAC would apply. As a return component, the MAC must also be rejected as FirstEnergy's proposal finds no support in the Public Utility Code or the controlling case law in Pennsylvania. FirstEnergy's attempt to implement a MAC finds no support in the law or in the evidence adduced in this case. Accordingly, the ALJ's findings on this issue are in accord with the evidence and should be upheld.

OCA Reply to RESA Exception 3, Dominion Exception 4: <u>The ALJ Correctly Rejected The Creation Of A Market Adjustment Charge As Re-Purposed By RESA And Dominion</u>. (RESA Exc. at 18-22; Dominion Exc. at 6-7; R.D. at 54-58; OCA M.B. at 47-50; OCA R.B. at 30-32)

RESA and Dominion made similar proposals as to the MAC. RESA proposed that the MAC revenues be used to cover the EDCs' costs of implementing the retail market enhancements, to cover any risks that the EDCs incur in providing default service, and then any remaining revenues be credited to all ratepayers. <u>See</u>, OCA M.B. at 48. Dominion's proposal is that the MAC charge be increased from ½ cent to a full 1 cent per kWh and that the revenues be used mainly as a credit to offset Non-Market Based Transmission Costs (NMB) that FirstEnergy plans to collect through the Default Service Support Rider, with any remaining revenue to accrue to the benefit of FirstEnergy. See, OCA M.B. at 49; see also Dominion St. 1 at 9-10; FE St. 7-R at 12-13. The ALJ considered and rejected these proposals, as follows:

> I am further not persuaded by RESA to recommend a modified MAC be made part of the DSPs. RESA argues the MAC revenues be applied to cover the EDCs' costs of implementing the retail market enhancements, to cover any risks that the EDCs incur in providing default service, and the balance of revenues should then be returned to all ratepayers through a non-bypassable charge. RESA St. 2 at 30-31. *Only default service customers would be charged for the MAC, but all residential customers pay the Default Service Support Rider (DSSR) and thus would receive the credit from the leftover MAC revenues. This appears to be inequitable on the surface.* I am further not persuaded by Dominion's proposed modification to the MAC which is similar to RESA's proposal for the same reasons of inequity.

R.D. at 57 (emphasis added). The ALJ correctly held that even if the creation of a MAC were legal, which it is not, the RESA and Dominion proposals would create impermissible subsidies between shopping and non-shopping customers.

In response to the RESA and Dominion proposals, OCA witness Kahal further testified:

> It must be made clear at the outset that 100 percent of MAC revenue is pure (pre-tax) profit for the EDCs. The testimony of Dr. Reitzes and Mr. Fullem on behalf of Joint Petitioners, along with responses to OCA data requests, have failed to document a single dollar of unrecovered cost, lost earnings or incremental EDC investment risk. Dr. Reitzes' testimony on the asserted risks is at best hypothetical with no empirical support whatsoever. Mr. Fullem even tries to justify the MAC based on costs *not* incurred, not costs that need recovery. I explain this in some detail in my Direct Testimony. Witnesses Kallaher and Butler make vague references to FE Companies' testimony, but they also provide no documented support for either the present or future existence of any unrecovered costs or uncompensated risks. ... As an administrative matter, witnesses Kallaher and Butler would create an enormous slush fund, obtained from default customers, for ill-defined and hypothetical costs and risks.

OCA St. 1-R at 8. The OCA submits that the core analysis of the MAC must start with whether or not there are additional *costs* to be recovered. The evidence in this matter shows that there are none. Moreover, the RESA proposal to impose additional costs on default service customers and then to refund a portion of that money to all customers is blatantly discriminatory. Accordingly, as with FirstEnergy's original proposal as to the MAC revenues, the RESA and Dominion proposals must also be rejected based on the overwhelming evidence adduced in this matter.

The RESA and Dominion proposals as to the disposition and treatment of MAC revenues are inherently discriminatory, represent poor public policy and could only be practically considered once the MAC was found to be in compliance with Pennsylvania law. Such is not the case. The OCA submits that the ALJ was correct in finding that the MAC should not be authorized and that the RESA and Dominion proposals must, accordingly, be rejected. The OCA respectfully requests the Commission to uphold the findings provided in the R.D. as to the MAC.

C. The OCA's Reply As To The Retail Market Enhancement Issues.

OCA Reply to FirstEnergy Exception 3, RESA Exception 4, Dominion Exception 1, and FES Exception 1 and 2: The ALJ Correctly Determined That The Costs Associated With The Creation And Implementation Of The Opt-In Auction Program And The Standard Offer Customer Referral Program Should Be Paid By The Participating EGSs. (FE Exc. at 23-26; RESA Exc. at 22-24; Dominion Exc. 1 at 3-4; FES Exc. at 1-9; R.D. at 116-117, 126-127; OCA M.B. at 82-84, 95-96; OCA R.B. at 48-49, 52)

1. Introduction.

FirstEnergy proposed to recover the costs of the Opt-In Auction Program and the Standard Offer Customer Referral Program from residential customers through the non-bypassable DSSR. See, OCA M.B. at 82-83, 86-87. The IWP Order provides the following as to the issue of costs for Opt-In Auction Programs:

> Concerning the OCA's and UGIES's request to have participating EGSs pay for the cost of implementing the Retail Opt-in Auctions, the Commission agrees. In the Commission's view, having 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.

IWP Order at 78. As to the costs of the Customer Referral Programs, the IWP Order provides the following:

> 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.

IWP Order at 32. In the R.D. the ALJ rejected the idea that the costs of the Opt-In Auction Program should be collected from customers. The R.D. provided that:

> The Companies have not presented substantial evidence demonstrating that there is good cause to justify deviating from the Commission's recommendation. I am not persuaded by the Companies' argument. The EGSs benefit from the auctions and they should bear the cost as opposed to the customers.

R.D. at 116. As to the disposition of costs for the Standard Offer Customer Referral Program, the ALJ held that:

> The Companies' plan deviates from the Commission's guidelines on this issue and I recommend denying this request and agreeing with OCA, OSBA and CAUSE-PA on this issue.

R.D. at 126. FirstEnergy, RESA, Dominion and FES filed Exceptions as to the cost recovery issue for the proposed retail market enhancements.[7] As discussed next, the OCA agrees with the Commission's IWP Order and the ALJ on this matter, as EGSs being the primary beneficiary of such programs should be responsible for the costs.

2. The Exceptions On This Issue Are Without Merit.

FirstEnergy's primary argument as to why all customers should pay the costs of the proposed retail market enhancements through the DSSR is a purported concern with being unable to recover these costs from the EGSs. FE Exc. at 23-24. The ALJ, however, adopted the Companies' alternative EGS cost recovery methodology for the Opt-In Auction Program, which specifically provides that:

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[7] The OCA notes that Dominion's Exception here does not include the Standard Offer Referral Program, as Dominion agrees that participating EGS should pay for the costs of the Referral Program, so long as such costs are reasonable. See OCA M.B. at 92. All of the parties filing Exceptions on this issue, however, agree with the FirstEnergy proposal to recover Opt-In Auction costs from customers.

> I recommend the Commission direct EGSs pay for the program and adopt the Companies alternative suggestion regarding this issue. The cost of the auction itself would 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.*

R.D. at 117. The OCA submits that, under this cost recovery approach, it is reasonable to conclude that FirstEnergy bears no real risk of failure to collect its costs for the Auction Program. The OCA agrees with this method of cost recovery, and supports the ALJ's decision on this issue. See, OCA M.B. at 84.

As to costs for the Referral Program, the R.D. provides that:

> (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.

R.D. at 127. Here also, the ALJ accepted the Companies' preferred method of EGS cost recovery. As such, the OCA submits that there exists no substantial level of risk for FirstEnergy as to recovering its costs for the Referral Program, and its Exception on this issue should be denied.

FirstEnergy's additional arguments on the cost recovery issue center on potential decreased participation by EGSs (if they have to pay for the programs) and by customers as the offers produced by the auction process may not be as favorable to customers as they would have been had the customers paid for the program costs. FE Exc. at 24. The Exceptions of FES on this issue mirror those of FirstEnergy. FES Exc. at 2-9. RESA's Exceptions continue to focus heavily on the payment of these programs through the MAC. RESA Exc. at 22-24. As the MAC issue has already been discussed, the OCA will not revisit that matter here, other than to point out that since the MAC is collected only from default service customers, the proposal to collect all the costs of the Auction Program and Referral Program through the MAC is particularly perverse since these are the very customers who are not participating in or benefitting from these Programs. RESA's alternative proposal is in accord with FirstEnergy's preferred method, that being to recover the costs of the retail market enhancements from all distribution customers. RESA Exc. at 24. Dominion's main argument is that customers are the beneficiaries of the Opt-In Auction, very much in line with RESA's argument on this point, and thus should pay the costs. Dominion Exc. at 3-4.

OCA witness Kahal testified as to cost recovery for the Opt-In Auction Program, as follows:

> I also take issue with Joint Petitioners' proposal to assign all program implementation costs to all residential customers. If this program truly is cost effective and beneficial for the winning EGS, then that EGS should be assigned the program costs. Bidders should be notified of this requirement upfront (including EDC's estimate of expenses to be assigned), and EGSs are free to price this into their bids. If the winning EGS is incapable of incorporating these costs, then it may be that the program is simply not cost effective. There is no need for customers to provide subsidies to the winning EGS.

OCA St. 1 at 34 (footnote omitted). As Mr. Kahal testified, there is no valid reason for customers to pay the costs of these programs in order to create a larger profit margin for EGSs. The OCA submits that since the purpose of this program is to expose customers to the process and potential benefits of selecting an EGS, and will provide the opportunity for participating

EGSs to acquire large numbers of customers without incurring any of the typical marketing and acquisition costs, it is the EGSs that should pay for these costs.

Consistent with Mr. Kahal's testimony on the issue of cost recovery for the Auction Program, OCA witness Alexander testified as to cost recovery for the Referral Program, as follows:

> The EGSs that participate in the Customer Referral program and who obtain new customers through the EDC's marketing of this program should pay for incremental administrative costs. My recommendation is similar to that adopted by the New York Public Service Commission.

OCA St. 2 at 18-19.

The OCA submits that the Commission's IWP Order and the R.D. provide a more reasonable and logical approach to cost recovery for the Programs here. EGSs are being given an opportunity to significantly reduce their "one-off" acquisition costs, through the option of obtaining a large number of customers all at one time. Moreover, accepted cost-causation principles would dictate that those entities that caused the costs to be incurred should be the entities that are allocated those costs. It would be illogical indeed, to accept the premise that customers are causing the costs of these programs, which displace the EGS' acquisition costs. Accordingly, the OCA submits that the ALJ's decision on this issue is in accord with the evidence and should be upheld.

OCA Reply to RESA Exception 7: The ALJ Was Correct In Finding That Current Shopping Customers Should Not Be Excluded From Participating In The Auction Or Referral Programs. (RESA Exc. at 27-29; R.D. at 94-96, 123; OCA M.B. at 65; OCA R.B. at 39)

FirstEnergy proposed that customers who had already switched to EGS' service would not be targeted with advertising or solicited for participation in the Auction or Referral Programs, but those customers would not be barred from participation if they chose to do so. See, R.D. at 94-95, 118-120. As to participation in the Opt-In Auction Program, the

Commission's IWP Order provided that all residential customers should be eligible to participate, but the EDCs should target only default service customers for marketing of the programs. IWP Order at 42. The Commission also provided the following discussion of customer eligibility for the Referral Program, as follows:

> The standard offer will target/market residential default service customers; however, residential shopping customers will not be excluded if they specifically request to participate.

IWP Order at 31. As to the Auction Program, the ALJ held that:

> I find the Companies' proposal to be in accordance with this *Intermediate Work Plan Final Order,* because the Companies have represented that their marketing, notifications and customer education efforts will only be targeted at non-shopping residential customers, even though all residential customers would be eligible to participate in the Retail Opt-In Aggregation Program. Shopping customers may participate in the Retail Opt-In Auctions; however, they may not be marketed to.

R.D. at 96. The R.D. also provided the same determination for the Referral Program, consistent with the IWP Order. R.D. at 123. RESA filed Exceptions on this issue, arguing that customers already being served by an EGS should be barred from participating in either the Auction or Referral Program. RESA Exc. at 27-29. RESA argues that the competitive market in the FirstEnergy service territories is too fragile and undeveloped to allow current EGS customers to participate. RESA Exc. at 28-29.

RESA has failed to provide substantial record evidence to show that the harms it alleges are realistic possibilities. The OCA submits that the ALJ's ruling on this issue is legally sound and should be upheld. The ALJ was correct in finding that:

> 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).

R.D. at 123. The record does not support the speculation that a significant number of current EGS customers will seek out the Auction or Referral Program, leave their existing EGS, pay early termination fees and participate. RESA has put on no evidence to show how many current EGS customers would likely pursue such a path, and even if they did, what material harm would come to the EGS community or the market in general from such activity.

Moreover, specifically barring customers from participating in a Commission-sponsored program raises the issue of legal, or at the very least, perceived discrimination. The OCA submits that such a situation could dampen, if not damage the public's perception of such programs. Accordingly, the OCA submits that the ALJ's ruling on this issue is in accord with the law and the evidence and should be upheld.

OCA Reply to RESA Exception 10, Dominion Exception 3: The ALJ Was Correct In Determining That No "Test" Should Be Performed Prior To The Opt-In Auction, And That Customers Should Be Given The Full Terms Prior To Participating In The Auction Program. (RESA Exc. at 32-34; Dominion Exc. at 6; R.D. at 97, 109-110; OCA M.B. at 77-78; OCA R.B. at 46)

1. Introduction.

RESA proposed a process whereby a test could be performed, before the Auction Program commenced, in order to ascertain optimal methods for customer enrollment and disclosure materials for the Opt-In Auction Program. RESA Exc. at 32-34. RESA and Dominion also argued that customers should enroll in the Opt-In Auction Program before the EGS Auction would be held, and then customers would be given an option to opt-out if they chose to do so after being supplied with the final price achieved through the EGS Auction. RESA Exc. at 32-34; Dominion Exc. at 6.

The ALJ rejected both of these proposals in the R.D.. R.D. at 97-98, 110-111. RESA and Dominion filed Exceptions on these issues. The OCA submits that the ALJ's ruling on these issues is consistent with the evidence in this proceeding and should be upheld.

2. <u>The ALJ Was Correct To Reject RESA's "Pilot Light" Proposal</u>.

RESA proposed a slightly scaled down version of a full pilot program that was considered during the RMI process. Specifically, the <u>IWP Order</u> provided:

> 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.

<u>IWP Order</u> at 47. The Companies opposed the RESA proposal to conduct a scaled down test pilot program. The Companies argued that: (1) there was insufficient time to perform the type of testing that RESA proposed; (2) the results of such testing would have questionable use; and (3) the proposal was nothing more than a pilot program, which the Commission had already rejected. R.D. at 109-111. OCA witness Alexander also testified on this issue, as follows:

> While the idea of a test such as recommended by Mr. Kallaher might be ideally useful, I do not see how such a program could be designed and implemented in time to implement a full scale program in June 2013. ... Mr. Kallaher does not offer EGS payment for this test and has not yet estimated its costs.

OCA St. 2-SR at 12 (footnote omitted). The ALJ held that "I concur with the Companies that the Commission has agreed 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." R.D. at 110. The OCA submits that RESA has failed to provide any substantial evidence as to why its current proposal should be adopted, especially considering the Companies' stated objections and operational constraints for implementing such a pilot. Accordingly, the ALJ's decision on this issue is consistent with the evidence produced in this proceeding and should be upheld.

3. The ALJ Was Correct In Finding That Customers Should Only Be Solicited For Participation In The Opt-In Auction After All Terms And Conditions Are Known.

The IWP Order provided that service under an opt-in auction program should begin on June 1, 2013 and also provided that EDCs should conduct the EGS Auction before customer enrollment occurs for the Opt-In Auction Program. IWP Order at 54-56. The ALJ adopted these procedures in the R.D. R.D. at 97-98. RESA and Dominion both filed Exceptions on this issue as these parties recommended that the EGS Auction be held after customer enrollment in the Auction Program so that the total number of participating customers will be known before EGSs bid in the auction. RESA Exc. at 32-34; Dominion Exc. at 6. The OCA submits that the ALJ's ruling on this issue is consistent with the evidence and should be upheld.

OCA witness Alexander testified as to the importance of asking customers to enroll only after the customer has been supplied with complete terms:

> [T]he suggestion that customers should be asked to enroll prior to receiving the price and full terms and conditions is unreasonable. This process would transform the opt-in auction into an opt-out auction by requiring customers to take affirmative action to de-enroll after receiving the actual price and terms. Nor is this proposal remotely similar to the retail competitive market in which customers agree to accept a specific EGS offer based on knowledge of the price and other terms of service.

OCA St. 2-R at 7. As OCA witness Alexander testified, it is critical for customers to receive the full terms and conditions of the Opt-In Auction, including the price, before being asked to participate. This is the procedure as set out by FirstEnergy, and consistent with the IWP Order. R.D. at 91. As the ALJ provided on this issue:

> 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). I agree with the Companies' position that customers cannot reasonably be expected to "shop" without knowing the price and terms of the product they hope to buy. *Id.*

R.D. at 97. The OCA submits that the ALJ's ruling on this issue is consistent with the evidence and should be upheld.

OCA Reply to FirstEnergy Exception 4, RESA Exception 9, FES Exception 4: The ALJ Was Correct In Finding That CAP Customers Should Not Be Authorized To Participate In The Auction Or Referral Programs. (FE Exc. at 26-30; RESA Exc. at 31-32; FES Exc. at 10-11; R.D. at 132-137; OCA M.B. at 97-98; OCA R.B. at 55-56)

1. Introduction.

FirstEnergy proposed that CAP customers be eligible to participate in both the Opt-In Auction Program and the Standard Offer Customer Referral Program. R.D. at 133. In the IWP Order, the Commission addressed the issue of CAP customers participating in the Auction Program, in relevant part as follows:

> 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.

IWP Order at 43. The IWP Order also addressed the issue of CAP customers participating in the Referral Program, and provided that at this time, CAP customers should not be authorized to participate. IWP Order at 31. On the issue of CAP customer participation in the Retail Market Enhancements, the ALJ held that:

> I am persuaded by the substantial evidence in the record which supports CAUSE-PA's and OCA's position regarding the preclusion of CAP customer participation in opt in auctions at this time primarily because of the Commission's directive

> that this issue be further discussed and investigated through a collaborative working group regarding Universal Service.

R.D. at 137. FirstEnergy, RESA and FES filed Exceptions as to this issue, arguing that CAP customers should be allowed to participate in the Programs. The OCA submits that the ALJ correctly decided this issue, consistent with the evidence, and the Commission should uphold that finding.

2. <u>The Parties' Exceptions On This Issue Lack Merit</u>.

FirstEnergy makes three arguments as to why CAP customers should be authorized to participate in the Auction and Referral Programs: (1) CAP customers are already able to shop in the FirstEnergy service territories; (2) CAP customers will not be subject to harm from participating; and (3) the Companies do not have the ability to screen out CAP customers during the enrollment phase. FE Exc. at 26-30.[8] As to the fact that CAP customers are currently shopping, the OCA submits that this is not a reasonable basis from which to infer that CAP customers should also be able to participate in the Auction and Referral Programs. In the R.D., the ALJ captured the critical points as to the potential harm created by authorizing CAP customers to participate in these Programs, as follows:

> The essential problem with CAP customer shopping as the CAP program is structured by Met-Ed/Penelec/Penn Power is that CAP customers bear the initial brunt of all cost increases if they were to choose a competitive product that has higher prices than what they could obtain on default service.

R.D. at 135. In the accompanying footnote to this discussion, the R.D. provided that:

> This is an essential distinction between Met-Ed/Penelec/Penn Power's programs and West Penn Power's program. Under West Penn Power's programs, CAP customers pay only a percentage of their income as their CAP payment each month. Thus, West Penn Power's customers pay a fixed amount each month regardless of their consumption bill. Under this program design, it is the other residential ratepayers who pay for the CAP program who would suffer harm if the

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[8] RESA's and FES' Exceptions on this issue are essentially identical to those of FirstEnergy. Accordingly, the OCA will not separately address the RESA and FES Exceptions.

> CAP customer were to participate in the competitive market and choose a rate that is higher than what he or she would pay on default service. This too is not a desirable outcome because it would needlessly increase the costs of the CAP program.

R.D. at 135-136, fn 48. As the ALJ correctly notes, West Penn CAP customers would be indifferent to participating in the Programs, for all practical purposes, because those customers are already paying a set amount per month. The costs of the West Penn CAP Program to other customers, however, could increase, if for instance, a CAP customer participated in the Auction or Referral Program and during the Program the contract price rose above the then-current PTC. The added costs would create a larger CAP shortfall, and increase the costs of the Program. As to the Met-Ed/Penelec/Penn Power CAP customers, the same scenario as just discussed, where Program prices increase above the then-current PTC will cause higher costs for these CAP customers than would have been the case had they remained on default service. The ALJ correctly recognized the harm that the Commission warned of in the IWP Order, and accordingly reached the right decision on this issue. See, IWP Order at 43.

In accord with the IWP Order, and the R.D., OCA witness Alexander testified that:

> It 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. While this concern is important for all potential enrollees in this program, it has obvious and vital importance for customers who, by definition, are unable to afford their bills for essential electricity service. Mr. Kallaher's suggestion that CAP customers will find value in participating in this program that go beyond the price for service is not realistic or appropriate.

OCA St. 2-SR at 12.

The evidence of record shows the potential harm to CAP customers and CAP programs from authorizing CAP customers to participate in these Programs. The OCA agrees with the ALJ that the issue of CAP customer participation should be resolved through the RMI Universal Service Working Group. R.D. at 137. The OCA submits, however, that for purposes of this proceeding, CAP customers should not be authorized to participate in these Programs and the Commission should order FirstEnergy to take all reasonable and necessary steps to ensure this outcome.

OCA Reply to RESA Exception 14, FES Exception 3: The ALJ Correctly Found That The Standard Offer Referral Program Should Be Deferred To A Later Date. (RESA Exc. at 39-40; FES Exc. at 9-10; R.D. at 128-131; OCA M.B. at 84-96; OCA R.B. at 53-54)

The OCA recommended that the Standard Offer Customer Referral Program should not be implemented directly on the heels of the Opt-In Auction Program, as unnecessary customer confusion and concern would likely result. OCA St. 2-SR at 12-13. The ALJ provided the following disposition on this issue, in relevant part:

> According to the Companies' proposals, non-shopping customers will have been solicited for the Opt-in Aggregation program before the Customer Referral Program begins. This solicitation will come through bill inserts and other direct marketing avenues sent to non-shopping customers with an explanation of the program design. After this solicitation occurs, the Customer Referral Program will roll out with different terms and I find the evidence supports a finding that the potential for customer confusion is likely given the perceived similarities of the programs which have very different outcomes. Therefore, I agree with OCA Witness Alexander's suggestion that the Companies be directed to delay offering a Customer Referral Program until after the one-time opt-in auction has concluded. OCA St. 2-SR at 13-14. This is in order to avoid unnecessary customer confusion.

R.D. at 130-131. RESA and FES filed Exceptions on this issue, arguing that the Referral program should go ahead on the present schedule as proposed by FirstEnergy. RESA Exc. at 39-40; FES Exc. at 9-10.[9] RESA and FES argue that there is insufficient evidence in this proceeding to establish that customers would be confused by the two Programs, and thus the Referral program should go ahead as originally proposed. Id.

The OCA submits that substantial record evidence exists to support the ALJ's finding on this issue. As OCA witness Alexander discussed in her Surrebuttal Testimony:

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9 The OCA notes that FirstEnergy filed no Exception on this issue.

> Both FirstEnergy and RESA oppose my recommendation to delay the standard Referral Program as described above until after the one-time opt-in auction has concluded. The implementation of both the opt-in auction and the referral programs during the same period of time (even if separated by 4-6 weeks) is likely to lead to customer confusion and the potential for customer dissatisfaction. This potential for confusion is exacerbated by the fact that the Opt-in Auction program will offer a 5% reduction off the PTC and the Referral Program will offer a 7% reduction from the then-current PTC, a distinction that does not appear to make sense in explaining the various programs to customers. Furthermore, the potential that customers who enroll in the Opt-In Auction may end up paying more than the PTC during the auction term whereas those who did not participate will be offered a 7% reduction in the then-current PTC will create the potential for customer dissatisfaction and complaints. In the meantime, a referral program "light" should be implemented by FirstEnergy which I described in my Direct Testimony.

OCA St. 2-SR at 13-14; see also OCA St. 2 at 13-18; OCA St. 2-R at 9-11. The OCA submits that it is reasonable, and consistent with the evidence, to modify when the Referral Program is implemented in order to provide the best chance for successful outcomes. The implementation of the Referral Program on the heels of the initial implementation of the Opt-In Auction Program will create unnecessary customer confusion. A reasonable period of time following the Opt-In Auction Program before the Referral Program is rolled out could make a substantial difference as to its ultimate success. Accordingly, the OCA requests that the Commission uphold the ALJ's decision on this issue.

D. The OCA's Reply As To The Time-Of-Use Proposals.

OCA Reply to FirstEnergy Exception 2, RESA Exception 6: The ALJ Was Correct To Reject The FirstEnergy And RESA Time-of Use Proposals For West Penn And Penn Power Customers. (FE Exc. at 18-22; RESA Exc. at 26-27; R.D. at 74-80; OCA M.B. at 51-58; OCA R.B. at 32-36)

1. Introduction.

The Commission has provided the following guidance as to the provision of TOU rates:

> After review of the comments, the Commission will maintain its recommendation that EDCs contemplate contracting with an EGS in order to satisfy their TOU requirement. The Commission does wish to clarify that this recommendation is not, in and of itself, a rejection of the other proposals raised, such as instituting

> peak time rebate offers or creating a separate wholesale auction for TOU rates. Such ideas may indeed have merit, and we will allow the EDCs to evaluate these proposals for possible inclusion in their next default service filings.

Investigation of Pennsylvania's Retail Electricity Market: Recommendations Regarding Upcoming Default Service Plans, Docket No. I-2011-2237952 (Order entered December 16, 2011) (December 16 Order) at 47.

The OCA provided substantial evidence in this proceeding as to the OCA's concerns with several elements of the FirstEnergy TOU proposal for Penn Power and West Penn Power customers. Specifically, the deployment of smart meters in Penn Power and WPP's service territories are hardly adequate at this time to support any reasonable level of enrollment by customers and the proposed "on-peak" time frames of 7:00 AM to 11:00 PM every weekday will likely fail to entice residential customers to sign up. See, e.g., OCA St. 2 at 19-24. Based on these and other concerns, especially the estimated TOU Program costs, the OCA recommended that the TOU Proposal for West Penn and Penn Power not be accepted. OCA St. 2-R at 11-12; OCA St. 2-SR at 15-16.

The ALJ provided the following disposition of this issue:

> I agree with Ms. Alexander that the expectation that customers will accommodate higher on-peak prices from 7 a.m. to 11 p.m. every weekday and shift enough usage to the middle of the night and on weekends in order to experience bill savings is unrealistic. I am concerned the proposed on-peak period is 16 hours long and encompasses most of the average person's waking hours. The proposed TOU rate auction proposal appears to be overly expensive and will likely provide little if any benefit to customers due to the limited availability of fully-operational smart meters in the service territories of West Penn and Penn Power, and for the reason the on-peak time period encompasses 16 hours of every weekday. The proposed TOU rate options should not be approved as they need reform to select a reasonable TOU rate option for residential customers. I recommend this proposal be deferred until there is a larger penetration of smart meters and a TOU rate option that is reasonable and typical of TOU rates in general. This finding is supported by the testimony of OCA witness Ms. Alexander, OCA St. 2 at 21-22. West Penn may seek continuance of its Critical Peak Rebate (CPR) program in the interim beyond its current approved term as part of West Penn's energy

> efficiency/demand response programs since it has also been approved to serve as a TOU rate option.

R.D. at 78-79 (citation omitted). FirstEnergy and RESA filed Exceptions as to this issue. FE Exc. at 18-22; RESA Exc. at 26-27. The OCA submits that the ALJ's ruling on this issue is consistent with the evidence, represents sound public policy and should be upheld.

2. The ALJ Was Correct To Reject FirstEnergy's Proposal.

The evidence provides that West Penn and Penn Power do not have sufficient smart meter penetration levels in those service territories to support a TOU program as proposed by FirstEnergy. As OCA witness Alexander testified:

> The Company has installed 370 residential smart meters for Met-Ed and 5,200 smart meters for West Penn, but there are no smart meters installed for Penelec and Penn Power customers. FirstEnergy currently offers an optional distribution-only TOU rate for Met-Ed or Penelec customers and has no plans to change that program at this time. Penn Power offers a TOU option that is available for up to 5,000 customers. This Penn Power option adjusts the price to compare rate by a fixed on-peak TOU factor and a fixed off-peak TOU factor. However, there are no customers taking service under this option. West Penn Power offers a Critical Peak Rebate program to shopping and non-shopping customers who have a smart meter installed. Participating customers receive 50 cents for each kWh of load reduced during summer peak load periods. This program is funded through West Penn's Act 129 Energy Efficiency and Conservation Surcharge. This is a very popular program with approximately 17,800 customers enrolled as of January 2012.

OCA St. 2 at 20-21 (footnotes omitted). In addition, as the ALJ noted, an on-peak rate from 7 am to 11 pm every weekday is simply an unrealistic option. R.D. at 78. As to this issue, OCA witness Alexander testified that:

> In addition, the rate structure being proposed for TOU in which the entire day from 7:00 AM to 11:00 PM at night is charged at an on-peak rate is excessive. I am not aware of any residential TOU rate that charges an on-peak price for 16 hours a day. Typically, TOU rates identify a portion of each day to send the price signal that reflects the highest demand or wholesale market price for electricity. To suggest that residential customers can accommodate higher on-peak prices from 7 AM to 11 PM every weekday and shift enough usage to the middle of the night and on weekends in order to experience bill savings is unrealistic.

OCA St. 2 at 21-22. The FirstEnergy Exceptions on these two critical issues raise no new arguments or facts that were not already carefully considered and rejected by the ALJ. As such, the ALJ's finding on this issue is consistent with the evidence and should be upheld.

3. The ALJ Correctly Determined Not To Adopt RESA's Alternative TOU Proposal At This Time.

RESA recommended an alternative approach 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, RESA suggested that the data should be compiled and analyzed either by the Commission's Bureau of Conservation, Economic and Energy Planning (CEEP) or a consultant hired by the EDCs. R.D. at 79.

Conceptually, the OCA has no opposition to consideration of the general framework offered by RESA in this regard, as Ms. Alexander provided in her Surrebuttal Testimony:

> The FirstEnergy proposal is overly expensive and fails to consider other potentially reasonable approaches, such as that recommended by Mr. Kallaher on behalf of RESA, Mr. Fein on behalf of Constellation Energy or a simpler RFP approach.

OCA St. 2-SR at 15; see also OCA M.B. at 58.

As Ms. Alexander testified, the approaches for a TOU program as discussed by RESA and Constellation are potentially workable solutions. The OCA submits, however, that neither the RESA or Constellation proposals are fully fleshed out in the record of this case. The ALJ provided determined that "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)." R.D. at 79. RESA's Exception on this issue centers around having the Commission order a collaborative process in order to create a TOU Program, consistent with RESA's recommendation. RESA Exc. at 26.

The OCA submits that the evidence of record in this proceeding supports the ALJ's decision. The RESA proposal should not be adopted at this time. The OCA is not opposed to a collaborative process as recommended by RESA, but submits that if the Commission decides to entertain this proposal then such a process should be open to considering a full spectrum of ideas.

OCA Reply to RESA Exception 16: RESA's Exception On The Referral Program Product Offering As Provided In The R.D. Is Misplaced. (RESA Exc. at 41-42; R.D. at 123-124; OCA Exc. at 32-34; OCA M.B. at 84-95; OCA R. B. at 51-52)

The OCA notes that there appears to be some confusion as to what the ALJ held in the R.D. regarding the Product offering for the Referral Program. RESA filed an Exception on this issue stating that the ALJ erred in requiring participating EGSs to offer a product that would always be 7% off the PTC for the entire 12-month contract term. Specifically, RESA argues that "the Commission did not establish that the 7% discount is required to change quarterly with the PTC." RESA Exc. at 42. RESA's description is consistent with the Referral Program that FirstEnergy originally proposed, but is inconsistent with the revised version presented by FirstEnergy in its Rebuttal Testimony. See, OCA M.B. at 84-94. The R.D. held that the revised Referral Program provides a 7% discount off the PTC at the time the offer is made, but there is no requirement that the discount track the PTC as it changes quarterly throughout the term of the contract. R.D. at 123-124.

The OCA's position is that the 7% discount should be maintained throughout the term of the contract, as measured against the then-current PTC. In addition, the OCA supports a contract term of four months, not 12 months as recommended by the ALJ. See, OCA Exc. at 32-34; OCA M.B. at 84-95. RESA's Exception on this issue is misplaced and should be dismissed. The OCA submits, however, that the OCA's Exception on this issue should be adopted. See, OCA Exc. at 32-34.

E. The OCA's Reply As To Operational Issues.

OCA Reply to RESA Exception 17: The ALJ Was Correct In Recommending That RESA's Proposed Operational Improvements Should Be Addressed Within The RMI Proceeding. (RESA Exc. at 43-44; R.D. at 139-140; OCA M.B. at 98; OCA R.B. at 57)

RESA recommended that the Companies investigate implementing a secure, web-based system to provide EGSs with electronic access to customer usage and account data, subject to appropriate customer authorization. R.D. at 137 (citations omitted). The ALJ provided the following discussion of this issue:

> 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.

R.D. at 139-140. As the ALJ explained, there is a working group already in place within the RMI process that could address this issue.

The OCA agrees with the ALJ on this issue. The OCA submits that this is an issue best left for a separate working group where the full details can be discussed. There is no evidence of record in this case to ascertain the costs of such a program, whether there are operational constraints that the Companies would need to address, such as customer privacy issues, nor are there any proposals from RESA as to how these costs, once known, should be allocated. This issue should not be finally decided here on such sparse facts. Accordingly, the OCA submits that the ALJ's ruling on this issue is consistent with the evidence adduced in this proceeding and should be upheld.

III. CONCLUSION

For the reasons detailed in these Reply Exceptions, and its Main and Reply Briefs, the OCA submits that the Exceptions of FirstEnergy, RESA, FES and Dominion on the issues discussed herein should be denied and the ALJ's recommendations adopted.

Respectfully Submitted,

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Dated: July 9, 2012

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CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, the Office of Consumer Advocate's Reply Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 9th day of July 2012.

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