COMMONWEALTH OF PENNSYLVANIA
OFFICE OF SMALL BUSINESS ADVOCATE

July 9, 2012

E-Filed and Hand Delivery

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, and P-2011-2273670

Dear Secretary Chiavetta:

Enclosed for filing is the original of the Reply Exceptions, on behalf of the Office of Small Business Advocate, in the above-docketed proceedings. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

Daniel G. Asmus
Assistant Small Business Advocate
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Enclosures

cc: Parties of Record

Robert D. Knecht

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 certify that I am serving two copies of the Reply Exceptions, on behalf of the Office of Small Business Advocate, by e-filing, e-mail, and/or first-class mail (unless otherwise noted) upon the persons addressed below:

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Date: July 9, 2012

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
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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Dated: July 9, 2012

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On or about November 17, 2011, Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), Pennsylvania Power Company ("Penn Power") and West Penn Power Company ("West Penn") (collectively, "First Energy" or "the Companies") filed a Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company for Approval of Their Default Service Programs ("Petition") with the Pennsylvania Public Utility Commission ("Commission") pursuant to Section 2801 of the Public Utility Code, 66 Pa. C.S. §2801, as amended by Act 129 of 2008, ("Act 129") and 52 Pa. Code §§54.181 – 54.189 and 69.1801 – 1817. The Petition seeks approval of proposed programs to secure default service supply for the Companies' customers for the period June 1, 2013, through May 31, 2015.

The OSBA filed an Answer to the Petition as well as a Notice of Intervention and Public Statement on December 5, 2011.

An Answer and Notice of Intervention were also filed by the Office of Consumer Advocate ("OCA") on December 19, 2011. A Notice of Appearance was filed by the Commission's Bureau of Investigation and Enforcement ("I&E"). Interventions were also filed by ARIPPA, the York County Solid Waste and Refuse Authority ("YCSWRA"), Constellation NewEnergy, Inc. and Constellation Energy Commodities Group ("Constellation"), Exelon Generation Company, LLC. and Exelon Energy Company ("Exelon"), the Retail Energy Supply Association ("RESA"), Direct Energy Services, LLC ("Direct"), PECO Energy Company ("PECO"), CAUSE PA, First Energy Solutions Corp. ("FES"), Washington Gas Energy Company ("Washington Gas"), Dominion Retail, Inc. ("Dominion"), the Pennsylvania State University ("Penn State"), and the Met-Ed Industrial Users Group ("MEIUG"), the Penelec Industrial Customer Alliance ("PICA"), the Penn Power Users Group ("PPUG"), and the West Penn Power Industrial Intervenors ("WPPII") (collectively, the "Industrial Intervenors").

A Prehearing Conference took place on December 22, 2011, before Administrative Law Judge ("ALJ") Elizabeth H. Barnes, where the parties agreed to a procedural schedule and discovery modifications.

. The OSBA submitted the Direct Testimony, Rebuttal Testimony, and Surrebuttal Testimony of its witness, Robert D. Knecht.

Evidentiary hearings were held in Harrisburg on April 11-12, 2012. Witnesses for the parties, including Mr. Knecht, were cross-examined, and the testimony of the parties was entered into the record.

The parties filed Main Briefs and Reply Briefs. The Commission issued the ALJ's Recommended Decision ("RD") on June 15, 2012. Exceptions to the RD were filed on June 25, 2012, by the OSBA, OCA, Constellation, Penn State, Dominion, FES. RESA, and the Industrial Intervenors. Reply Exceptions are due July 9, 2012.

REPLY EXCEPTIONS

A. REPLY TO FIRST ENERGY EXCEPTION NO. 1 - The ALJ Correctly Rejected the Market Adjustment Charge ("MAC") Proposed by First Energy

The Companies proposed a market adjustment charge ("MAC") in their price-to-compare ("PTC") riders to compensate the Companies for "the risks they bear and the value they provide as default service providers . . . ."[1] The MAC was opposed by OSBA, OCA and I&E, while RESA and Dominion supported modified versions of the MAC.

In her RD, ALJ Barnes found that "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."[2] The ALJ also found that the MAC conflicted with the Public Utility Code, would probably result in increased EGS charges, was not supported by substantial evidence as to the risk associated with default service, and contained, *inter alia,* an impermissible premium for "goodwill."[3] In sum, the ALJ rejected the Companies' proposal to implement the MAC.

First Energy excepted to the ALJ's recommendation to deny the MAC, devoting twelve pages of their Exceptions to this issue.[4] The Companies make the same arguments that were presented in their testimony. First, they argue that they provide value by using their credit capacity to purchase power without having to extend collateral.[5] The

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[1] First Energy Exceptions at 2.

[2] RD at 56.

[3] RD at 56-57.

[4] First Energy Exceptions at 6-18.

[5] First Energy Exceptions at 6-7.

Companies argue that they also provide value by serving as PJM-designated load serving entities, standing ready to serve load in the event of a supplier default.[6] The Companies go on to note several inchoate risks that the Companies supposedly bear, none of which has yet occurred, but for which the Companies argue they should nonetheless be compensated, because they purportedly are ready to bear these risks.[7]

The Companies then note that other jurisdictions have included charges like the MAC in default service rates.[8] They also make the argument, without offering any supporting evidence, that an entity other than an electric distribution company ("EDC") would not be willing to serve as a default service provider without being compensated for the above-mentioned risks.[9] Finally, the Companies posit that the MAC is an important competitive market enhancement, essentially arguing that the increase in the price to compare resulting from the imposition of the MAC upon consumers will make it easier for EGSs to compete on price.[10]

The OSBA's Main Brief cites the OSBA's witness, Robert D. Knecht, who responded to the Companies'arguments as follows:

> **Q. What arguments does Mr. Fullem advance in defense of the proposed MAC?**
>
> A. Mr. Fullem argues (a) the Companies are incurring risks associated with default supply for which they should be compensated through a return, (b) default service rates are not traditional regulation rates, and (c) the Companies have an unfair "brand equity" competitive advantage over EGSs as a result of "many years of providing reliable

[6] First Energy Exceptions at 7.

[7] First Energy Exceptions at 8-9.

[8] First Energy Exceptions at 9.

[9] First Energy Exceptions at 10.

[10] First Energy Exceptions at 11-12.

service," and default service customers should pay a higher price as a return on this "goodwill" asset.

Q. Has Mr. Fullem advanced any new arguments about the nature of the alleged risks faced by the Companies?

A. No, he has not. The only example of which I am aware in which an EDC serving as DSP is not able to fully recover its incurred costs involved net revenue reductions associated with load shifting from time-of-use ("TOU") rates, and most Pennsylvania EDCs (including all of the Companies) have implemented TOU programs that avoid this risk.

Q. Do you agree with Mr. Fullem that default service rates should not be subject to standard ratemaking principles?

A. No, I do not. Had the Pennsylvania General Assembly wanted to completely deregulate electric generation supply and allow incumbent EDCs to charge premium prices there would have been no reason for it to (a) require there be a DSP, (b) allow EDCs to serve as the initial DSP, (c) require the DSPs to develop default service plans, (d) explicitly allow DSPs to fully recover costs incurred in providing default service, and (e) give the Pennsylvania Public Utility Commission regulatory oversight over those default service plans.

I therefore conclude that default service rates are regulated rates provided under regulated default service plans.

Q. Do you agree with Mr. Fullem that default service customers should pay a premium in their default service rates for brand equity and goodwill?

A. No. First, as Mr. Fullem admits, normal regulatory ratemaking does not include a return on goodwill. Second, while I agree that the fact that customer shopping is lower than might otherwise be expected may be in some small part due to the historical high quality distribution service provided by the Companies, although Mr. Fullem provides no evidence relating to this factor. However, it is more likely that shopping levels are affected by (a) customer inertia, (b) a long-term business relationship between the Companies and customers that resulted from the Companies being granted a monopoly utility franchise, (c) trust that rates regulated by the Pennsylvania Public Utility Commission are reasonable, (d) for some customers, an inability to find an EGS willing to provide service, or whose EGS summarily returned them to default service, and (e) an unwillingness of some customers to continually shop for power to ensure that rates from EGSs are reasonable, which is a necessary part of being a shopping customer.[11] None of these factors would justify using a MAC to set default service rates above costs.

[11] See Exhibit IEc-S2 for a press report relating to an EGS returning shopping customers to default service in Pennsylvania.

> **Q. Did the Companies respond to your suggestion that, if the Companies feel that their compensation as default suppliers is inadequate and unquantifiable that they should initiate a proceeding to competitively retain a third-party DSP responsibility?**
>
> A. Not directly. Mr. Fullem opines that it is unlikely that the Commission would be able to turn DSP responsibility over to a third party without providing a return such as the MAC. This statement does not address my point. My conclusion was that if a third-party DSP is to be retained, it should be done so through a competitive procurement, and any return required by the new DSP would be determined through competitive forces. This approach would be far superior to setting an arbitrary and administratively determined $5 per MWh MAC charge in this proceeding.
>
> Moreover (and with the proviso that I am not an attorney), retaining a new DSP would presumably allow the Companies to establish and license unregulated subsidiary EGSs, who could then benefit from all the brand equity the Companies can command in the competitive marketplace.[12]

Mr. Knecht also addressed the Companies arguments that they should be able to recover these "costs" as part of the MAC.

> The OSBA opposes the MAC, because, among other flaws, it has no cost basis. For example, none of the four costs that are listed by the Companies' witness, Mr. Retizes, in his attempt to justify the MAC are credible. Mr. Knecht testified that, according to Mr. Reitzes, those costs include:
>
> - Personnel and "infrastructure" to ensure generation supply in the event of wholesale supplier default;
> - Unspecified potential cost increases associated with purchase of receivables ("PoR") program;
> - Increases in uncollectible expense associated with providing default service; and
> - Incremental working capital requirements in the event of wholesale supplier default.[13]

Mr. Knecht went on to demonstrate how these four purported "costs," and other costs put forth by the Companies to justify the MAC, are not credible.

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[12] OSBA Main Brief at 17-18; *citing* OSBA Statement No. 3, Surrebuttal Testimony of Robert D. Knecht at 6-8.

[13] OSBA Statement No. 1, Direct Testimony of Robert D. Knecht at 5-6.

Q. Let's take these one at a time. Is the MAC justified by costs associated with ensuring generation supply in the event of supplier default?

A. No. First, it is unclear to which costs Dr. Reitzes refers. Wholesale supplier default is not going to cause generating plants to disappear or to go offline, or require the Companies' to construct new generating capacity. As long as the generating capacity necessary to meet all customers' needs is physically in place and operational, the Companies will be able to contract for the needed supplies. At worst, the Companies can simply procure the necessary supplies on the PJM spot market (which is, in fact, the Companies' last backstop proposal in the event of supplier default).[14] The costs associated with such an effort are likely to be quite small relative to the overall size of default service revenues. Moreover, if the Companies incur these costs, they are fully recoverable as part of the default service charge.[15] There is no need for an additional charge to prospectively recover speculative costs that may never be incurred.

Q. Are the potential unspecified costs associated with the PoR program a legitimate basis for the MAC?

A. No. Costs associated with the PoR program are not default service costs; they are costs associated with providing a service to EGSs. To the extent that these costs can be identified, they should be charged to the EGSs for whom the service is provided. Common practice in Pennsylvania is to incorporate these costs into the PoR purchase price discount. There is no reason to charge default service customers for a service that is provided to EGSs.

Q. Are increases in uncollectibles expense a justification for the MAC?

A. No. The Companies are permitted to make a reasonable estimate of what their default service uncollectibles costs will be, and to include a provision for recovery of those costs in default service rates. The Companies have generally chosen to address this issue by incorporating the uncollectibles costs for all electric supply (shopping and non-shopping) in the non-bypassable default service support rider ("DSSR"). The Companies are at risk for supply-related uncollectibles costs from both default service customers and all shopping customers

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[14] In its DS Plan Final Order at page 71, the Commission indicates that ". . . adequate credit protection mechanisms should be a part of all supply contracts to protect customers in the event of a bankruptcy or other inability to perform." Note that unlike the Companies, the Commission correctly understands where the risk of supplier default lies – with the customers and not the DSP. Costs incurred by the DSP associated with replacing a failed wholesale supplier will be passed on to default service ratepayers. *See Investigation of Pennsylvania's Retail Electricity Market: Recommendations Regarding Upcoming Default Service Plans*, Docket No. I-2011-2237952, Order Entered December 16, 2011 ("DS Plan Final Order").

[15] These type of costs fit within the administrative costs defined in the PTC at 52 Pa. Code § 69.1808(a)(4).

whose EGSs use the PoR program.[16] As shown in the response to OSBA-II-6, the Companies have been able to recoup a substantial percentage of their total uncollectibles costs (supply and distribution) from the charge on all customers. There is no reason to believe that the charge for uncollectibles does not provide the Companies with a reasonable opportunity to recover supply-related uncollectibles costs.

It is true, however, that the Companies necessarily absorb some risk associated with the recovery of default service uncollectibles costs. It is both unlawful (I am informed by OSBA counsel) and unreasonable to allow a utility to fully reconcile uncollectibles costs on a dollar for dollar basis, as it would discourage collections efforts. Therefore, the provision for uncollectibles costs in the default service rates may either understate actual uncollectibles costs, to the detriment of the Companies, or overstate actual uncollectibles costs, to the benefit of the Companies.

This risk could be substantially mitigated by establishing a charge for default service uncollectibles that is based on a pre-determined percentage of the default service rate. Other Pennsylvania utilities have adopted the approach of applying a percentage-based merchant function charge ("MFC") to default service customers for recovery of uncollectibles costs paired with a matching percentage discount for purchased receivables. If that pre-determined percentage is established based on historical averages, and if it is updated regularly, the Companies would face very little longer-term risk of under-recovering uncollectibles costs. In my view, this alternative approach is superior to the Companies' approach, in that it does not discriminate against EGSs who directly bill their customers, and it reduces risks faced by the DSP for both default service and shopping customer uncollectibles.

For reasons of their own, the Companies have chosen not to propose such a program.[17] As the existing method has been approved by the Commission, and since all EGSs service Small C&I customers may use the PoR program, I do not propose to modify the existing approach in this proceeding. While this approach is a little riskier than alternative approaches, there is no reason for the Companies to impose an arbitrary MAC tax associated with uncollectibles risk that they have voluntarily chosen to assume.

Q. The Companies propose that the MAC be set at the same per-kWh level for Residential and Small C&I default service

[16] Because the Companies purchase receivables with no rate discount, the cost of uncollectibles is not passed on to EGSs who use the PoR program.

[17] See OSBA II-6(d).

ratepayers, and at zero for Large C&I ratepayers. Is this consistent with uncollectibles cost patterns by rate class?

A. No, it is not. The rate of uncollectibles costs for Small C&I customers is far lower than that for Residential customers, as shown in OSBA-II-6. Moreover, the rate of uncollectibles for Large C&I customers is not zero. If the MAC were actually an effort to recoup uncollectibles costs, it would need to be differentiated by rate class, with substantially lower rates for Small C&I customers than for Residential customers.

Q. Are incremental working capital costs a credible justification for the MAC?

A. No. The Commission's regulations explicitly contemplate working capital costs as a recoverable cost of providing default service.[18] To the extent the Companies believe that they face the possibility of incurring additional working capital costs as a result of supplier default, they should propose a mechanism for recovering those specific costs if they should ever be incurred. There is no need for a large generic markup of default service rates to justify some costs that the Companies are unlikely ever to incur and which are fully recoverable under existing regulatory procedures. Moreover, to the extent working capital costs related to electric supply are shifted to the PTC, they should be backed out of distribution rates.[19]

Further, with the exception of West Penn, the Companies are already requiring default service ratepayers to contribute to working capital financing through the reconciliation charges. That is, the Companies are recording costs as incurred but revenues only as billed, leaving approximately one half-month of unbilled revenues in the reconciliation account, which is subsequently billed to default service ratepayers through the reconciliation charges. While the Companies have mitigated this impact by spreading it over a 12-month period, they are nevertheless implicitly requiring default ratepayers to provide working capital financing. To the extent that the Companies modify their default service plans to directly include working capital costs, and to the extent that the Commission allows the Companies to retain their existing accounting method, these costs should be offset by the working capital benefits that the Companies receive from the accounting mismatch.

Q. At pages 12 to 13 of his testimony, Mr. Fullem argues that the Companies provide value to default service customers in that they are creditworthy counterparties to supply agreements, and they are therefore not required to provide collateral under the default service supply contracts. Is this a reason to impose a MAC?

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[18] 52 Pa. Code § 69.1808(a)(5).

[19] See 52 Pa. Code § 69.1808(b) for the Commission's views on ensuring that gas supply costs are removed from distribution rates.

> A. No, it is not. First, avoided collateral costs are not a cost incurred by the Companies. There is no reason for default service customers to pay for value that costs the Companies nothing. Second, the creditworthiness of the Companies is substantially related to (a) the Companies' legislated monopoly franchises to provide distribution services at regulated rates, and (b) the Companies' legislated authority to recover all costs incurred in providing default service at virtually zero risk through the use of a reconciliation mechanism. In effect, the creditworthy nature of the Companies comes from the ratepayers and the government; it is not related to any costs incurred by shareholders. There is no reason to charge default service ratepayers for this service.
>
> **Q. At pages 14 to 15 of his testimony, Mr. Fullem argues that if any entity other than a utility were providing default service, it would require a return. Is this a credible reason to impose a MAC?**
> **A.** No, it is not. Any return that a non-utility might require to provide this service would need to be commensurate to the risk of the service, which is minimal.
>
> It is important to recognize that the MAC would result in a very large increase in the profitability of the Companies. In OCA-II-8, the Companies estimate the full-year value of MAC revenues at about $95 million, based on increased shopping levels over 2011. Adding this amount to the allowed return on equity for the Companies' distribution rate base would increase the Companies' implied return on equity by more than 6 percentage points (600 basis points), from the currently authorized level of 10 to 13 percent to 16 to 19 percent.[20]
>
> The Companies do not offer any credible evidence that the magnitude of the proposed MAC reflects this risk.[21]

For the reasons listed above, it is apparent that the ALJ was correct in her recommendation that the proposed MAC be rejected. The Commission should deny First Energy's Exception No. 1 and adopt the ALJ's recommendation.

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[20] These calculations are based on figures provided in OCA-II-17.

[21] OSBA Main Brief at 12-16, *citing* OSBA Statement No. 1, Direct Testimony of Robert D. Knecht at 6-11.

B. REPLY TO FIRST ENERGY EXCEPTION NO. 3: The ALJ Properly Assigned the Recovery of the Costs of the Proposed Market Enhancement Programs to the EGSs

The Companies proposed to recover the costs of their proposed market enhancement programs from residential customers as a nonbypassable component of the DSS Riders, or alternatively, to follow the Commission's *Intermediate Work Plan Final Order* and collect the costs from the EGSs participating in the program.[22] The ALJ recommended that the Companies follow the Commission's guidance, and have the EGSs bear the costs of the auctions rather than the customers.[23]

The Companies excepted to this disposition, arguing that assigning the costs of this market enhancement program to EGSs would present risks of which the Commission was unaware at the time it entered the *Intermediate Work Plan Final Order*.[24] Specifically, those risks are (1) that the costs would not be recovered at all, (2) that the costs would be a disincentive for EGSs to participate in the auction, and (3) that assigning costs to the EGSs will make the program less attractive to residential customers, because the resulting EGS prices would be above-market.[25]

First, it is difficult to believe, as the Companies would have us do, that the Commission was unaware of the risks and effect of cost recovery on EGS participation and pricing during the course of the Commission's retail market investigation. Cost recovery is, after all, a commonly found, if not *the* central component in most of the cases

[22] First Energy Exceptions at 23, *citing Investigation of Pennsylvania's Retail Electricity Market: Intermediate Work Plan*, Docket No. I-2011-2237952 (Order entered March 2, 2012) at 32, 78 ("*Intermediate Work Plan Final Order*").

[23] RD at 116-128

[24] First Energy Exceptions at 4, 23-24.

[25] First Energy Exceptions at 23-24.

that arise before the Commission. This is not a new idea to them.

Second, the Companies themselves have proposed an alternative cost recovery methodology which is aligned with the Commission's guidance in the *Intermediate Work Plan Final Order*. This alternative approach is what the ALJ recommended that the Commission adopt.

The OSBA addressed this issue in its Main Brief.

> [T]he OSBA's position is that if the opt-in auction is made applicable to Small C&I customers, the costs of the auction applicable to the Small C&I class should be recovered from the EGSs.[26] As already noted, this is consistent with Commission guidelines and Orders. Furthermore, the recovery of auction costs from EGSs is consistent with long-standing Commission policy regarding cost recovery related to supply, in which default service customers are responsible for all costs associated with providing default service, and therefore, shopping customers should be responsible for all costs associated with EGS ("shopping") supply, including auctions which benefit the EGSs.[27] Mr. Knecht discussed the two philosophies behind cost recovery.
>
>> There are two general philosophies regarding the recovery of supply-related costs, both of which are internally consistent.
>>
>> One philosophy is that all costs related to the administration of the electric supply function should be borne by all customers. Costs incurred to establish a default service program are shared among all customers, under the argument that all customers are eligible for default service and all customers benefit from its existence. Costs incurred to enable and promote competitive markets are also shared among all customers, under the argument that competitive markets benefit all customers, whether they choose to participate or not.
>>
>> The Commission, however, has consistently followed the other philosophy. In this alternative approach, default service customers pay for default service costs, and shopping customers pay for costs related to shopping. Under the Commission's philosophy, the administrative costs incurred for default service procurements are recovered only from default service customers. In this philosophy,

[26] OSBA Statement No. 3, Surrebuttal Testimony of Robert D. Knecht at 19-21.

[27] OSBA Statement No. 3, Surrebuttal Testimony of Robert D. Knecht at 19.

> costs incurred to conduct procurements for EGSs should be borne by the shopping customers who benefit from that program. As a practical matter, it is much easier to recover the costs from the EGSs who actually participate in the auction, rather than trying to establish a charge which applies only to customers who participate in the auction. The EGSs will presumably recover these costs in their own rates.[28]

For the reasons set forth above, the Commission should deny First Energy's Exception No. 3, and adopt the ALJ's recommendation.

C. REPLY TO DOMINION EXCEPTION NO. 4, RESA EXCEPTION NO. 3. The ALJ Correctly Rejected the Proposed MAC as a Mechanism to Recover Default Service Costs

As noted in OSBA's Reply to First Energy Exception No. 1, above, the ALJ recommended that the proposed MAC be rejected as a mechanism to recover the purported risks and unrecovered costs of providing default service.

Dominion excepted to the ALJ's recommendation primarily on the grounds that the MAC would increase shopping while allowing the Companies to recovery their default service costs. Dominion also argued in favor of its proposal to double the size of the MAC, and by implication, widen the gap between the PTC and the price the EGSs offer.[29]

RESA also excepted to the ALJ's recommendation, arguing that all customers, including shopping customers, pay for some part of unidentified "bundled costs of default service," and arguing that RESA's proposal to return extra costs collected from default service customers to all distribution customers was equitable, contrary to the ALJ's

[28] OSBA Main Brief at 28-29; OSBA Statement No. 3, Surrebuttal Testimony of Robert D. Knecht at 19-20.

[29] Dominion Exceptions at 6-7.

finding.[30] RESA also argued that the reconciliation method available to recover bundled costs is inappropriate and that there would not necessarily be an increase in EGS pricing as a result of the MAC.[31]

As noted in OSBA's Reply to First Energy Exception No. 1, above, one of the effects of the MAC would be to increase the PTC, purportedly to make it easier for the EGSs to compete on the price for generation service. What is left unsaid is that the EGSs are already successfully competing for customers, and that an increase in the PTC would also open up the opportunity for EGSs to simply raise their prices, and profits, while competing at the same level they currently enjoy.

However, on the more substantive legal points, both RESA and Dominion are simply incorrect, as the OSBA pointed out in its Reply Brief.

> Both RESA and Dominion argue that MAC funds could be used to offset any identifiable costs that the Companies' incur as default supplier.[32] OSBA observes that this defense of the MAC is pointless – the Companies are already entitled to recover costs that are reasonably incurred in providing default service without additional recovery through the MAC.
>
> RESA goes on to argue that the MAC revenues should then be used to (a) subsidize electric generation suppliers' ("EGSs") marketing efforts through the opt-in auction and referral programs, and then (b) offset DSSR [default service support rider] costs that apply to both shopping and non-shopping customers.[33] In contrast, Dominion proposes that MAC revenues be refunded back to the non-shopping customers who paid the MAC in the first place, albeit through a mechanism that is somehow outside the price to compare ("PTC").[34]

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[30] RESA Exceptions at 19-20.

[31] RESA Exceptions at 21-22.

[32] RESA Main Brief at 37-38; Dominion Main Brief at 9.

[33] RESA Main Brief at 40.

[34] Dominion Main Brief at 10.

The fundamental difference between RESA and Dominion in this proceeding boils down to the importance of cost causation in rate design. In RESA's view, cost causation is irrelevant, and the only important issue is to increase shopping. By way of contrast, Dominion recognizes that refunding the MAC to all ratepayers through the DSSR would result in an unfair cross subsidy, and therefore modified its proposal accordingly.[35]

The OSBA submits that settled case law mandates that cost of service should be the over-riding rate design principle – the "polestar" criterion. When PPL Electric endeavored to increase transmission and distribution rates to non-residential customers in a way that was not consistent with allocated costs, the Commission's approval of that proposal was overturned by the Commonwealth Court, which stated:

> Because the flat percentage increase in transmission charges increases any previous discrimination in rates, and the Commission offers no explanation how discrimination in distribution and transmission rate structures are eventually going to be gradually alleviated, in effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns-especially *the polestar-cost of providing service.*
>
> Not only did the Commission allow gradualism to trump all other factors without providing a sufficient explanation, the total bill method is not in accord with the Competition Act. *Section 2804(3) of the Competition Act mandates rates for services as unbundled charges for transmission, distribution and generation and requires that rates and rate structures be set for each service primarily on a cost-of-service study.*[36]

In this proceeding, rather than allowing gradualism to trump cost of service, RESA is proposing that the goal of encouraging competition should trump cost of service. The OSBA submits that RESA's position is contrary to the established case law cited above. For that reason, the Commission would be correct to conclude that the costs of the opt-in auction and referral programs should be paid by the EGSs, for whom those programs are developed, as argued above. It would be similarly correct for the Commission to conclude that it would be inappropriate to impose a MAC that is unrelated to the cost of default service on non-shopping customers, and then return those revenues to all customers. A clearer

[35] Dominion Main Brief at 10-11; Dominion Statement No SR1 at 7. Note that Dominion witness Mr. Butler originally proposed that the MAC revenues be refunded through the DSSR, but changed his position in surrebuttal in response to OSBA's rebuttal testimony.

[36] *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020 (Pa. Commw. 2006) (emphasis added).

example of an unfair and inappropriate cross-subsidy would be difficult to find.[37]

As shown above, the position taken by Dominion and RESA is simply wrong. The Commission should deny Dominion Exception No. 4 and RESA Exception No. 3 and adopt the ALJ's recommendation.

D. REPLY TO RESA EXCEPTION NO 8: The ALJ Correctly Recommended the Exclusion of Small Business Customers from the Retail Opt-In Auction and Customer Referral Programs

The Companies proposed, consistent with Commission guidelines, that small Commercial and industrial ("Small C&I") customers of the Companies be excluded from participating in the opt-in auction and the customer referral program.[38] The ALJ agreed with the Companies, unpersuaded by arguments from RESA that the Small C&I class should be included notwithstanding the Commission's guidance.[39]

RESA excepted to the ALJ's recommendations regarding the inclusion of Small C&I customers in these programs, arguing that the low levels of shopping among these First Energy customers and the value added to EGSs by the easy inclusion of these customers in the auctions is a rationale for deviating from the Commission guidelines to include these customers in the auction and referral program.[40]

What RESA has refused to acknowledge throughout this proceeding is the fact

[37] OSBA Reply Brief at 9-11.

[38] RD at 93-96, 123.

[39] RD at 93, 96, 123.

[40] RESA Exceptions at 29-31.

that shopping among Small C&I customers in the First Energy service territories is already robust and is increasing. As the OSBA noted in its Main Brief, "[s]hopping for Small C&I ratepayers in the First Energy service territory is substantial, it is steadily increasing, and it is much higher than the shopping rate for residential ratepayers, even for the smallest under- 25kV customers.[41] Neither [RESA witness] Mr. Kallaher nor any other witness offers any credible shopping statistics that would support Mr. Kallaher's conclusion [that Small C&I customers should be included]."[42]

In contrast to RESA's complete failure to support its position, the OSBA, in its Reply Brief, supported its position with actual shopping statistics.

> The table below shows the shopping levels for commercial customers at each of the EDCs in August of 2011 (some 8 months into the current default service program) and six months later at February 2012, based on OSBA Cross Examination Exhibit 1. As shown, competition was reasonably healthy in the commercial sector only eight months after the expiration of the rate caps, and it has continued to grow. (Note that Penn Power's rate caps expired several years ago.)

[41] Hearing Transcript, pp 114-119 (OSBA cross-examination of First Energy witness Raymond E. Valdes, OSBA Cross-Examination Exhibit No. 1).

[42] OSBA Main Brief at 26-27.

Commercial Class Shopping Statistics						
	Met-Ed	**Penelec**	**Penn Power**	**West Penn ST20**	**West Penn ST30**	**Total**
August 2011						
Shopping Load (GWh)	145.6	156.8	77.4	91.5	114.1	585.3
Total Load (GWh)	289.6	299.6	121.9	254.2	162.1	1,127.5
Percent Shopping (%)	**50%**	**52%**	**63%**	**36%**	**70%**	**52%**
February 2012						
Shopping Load (GWh)	143.5	185.7	79.8	93.3	115.8	618.0
Total Load (GWh)	238.3	304.1	115.5	241.9	156.6	1,056.2
Percent Shopping (%)	**60%**	**61%**	**69%**	**39%**	**74%**	**59%**

In addition, the table below shows the magnitude of the non-shopping residential and commercial load in February 2012. As shown, including commercial with residential would have only a small effect on the overall load subject to the auction, while doing so would add customers with very wide range of load sizes and shapes. Even if the entire non-shopping commercial load were included in the auction, the total eligible load for participating would increase by only a little more than 20 percent. It is difficult to understand how adding all of the complexity inherent in the commercial loads would make the auction more attractive to EGSs.

Non-Shopping GWh Load: February 2012				
	Residential	**Commercial**	**Total**	**Commercial %**
Met-Ed	478.6	94.7	573.4	**17%**
Penelec	358.6	118.4	477.0	**25%**
Penn Power	136.4	35.7	172.0	**21%**
West Penn	542.3	189.4	731.7	**26%**
Total	**1,515.9**	**438.2**	**1,954.1**	**22%**

[43]

Since it is apparent that shopping among First Energy's Small C&I customers is robust and is on the rise, there is no compelling reason that the Commission should follow RESA's lead and ignore its own guidance. Therefore, the Commission should deny RESA's Exception No 8 and adopt the recommendation of the ALJ.

III. CONCLUSION

For the reasons set forth above, the OSBA respectfully requests that the Commission:

a. Grant the OSBA's Exception;

b. Deny First Energy Exception No. 1 and Exception No. 3;

c. Deny Dominion Exception No. 4; and

d. Deny RESA Exception No. 3 and Exception No. 8.

[43] OSBA Reply Brief at 13-15.

Respectfully submitted,

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