

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PETITION OF PECO ENERGY COMPANY FOR  
FOR APPROVAL OF ITS DEFAULT  
SERVICE PROGRAM AND RATE MITIGATION PLAN

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DOCKET NO. P- \_\_\_\_\_

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DIRECT TESTIMONY

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WITNESS: WILLIAM J. PATERER

SUBJECTS: DEFAULT SERVICE PROCUREMENT,  
PROCUREMENT CONTINGENCY PLANS

DATED: SEPTEMBER 10, 2008

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1 and demand side initiatives. In 2004, I was promoted to Senior Rates Specialist in the  
2 same group with project management responsibility for major regulatory projects,  
3 including regulatory approval of Exelon's proposed merger with PSEG. In 2007, I  
4 was promoted to my current position.

5 **5. Q. What is your educational background?**

6 A. I hold a Bachelor of Science in Mechanical Engineering from Villanova University  
7 and Masters of Science in Engineering from Catholic University. In addition, I have  
8 a Masters of Business Administration in Finance from Villanova University. I have  
9 also completed the Basic Rate Design Course offered by New Mexico State  
10 University and the EEI Advanced Rate Course offered by Indiana University.

11 **6. Q. Have you previously provided testimony to the Commission?**

12 A. Yes. I testified on behalf of PECO in the Commission's en banc hearing on Demand  
13 Side Response on December 19, 2002. I also submitted testimony in PECO's Wind  
14 Tariff proceeding at Docket No. R-0001638C0001, as well as in the Exelon merger  
15 application proceeding at Docket No. A-110550F0160.

16 **7. Q. What is the purpose of your testimony?**

17 A. The purpose of my testimony is to describe PECO's proposed Default Service  
18 Procurement Plan (the "Plan"). In doing so, I will explain how the Plan addresses  
19 Commission default service requirements and guidance through the use of multiple  
20 procurements, laddered delivery periods, tailored procurement strategies for each

1 customer group, and the incorporation of spot market energy in PECO's default  
2 service portfolio.

3 **8. Q. How is your testimony organized?**

4 A. I will first provide an overview of PECO's procurement process for default service  
5 supply. I will then explain: (i) the procurement classes (or customer groupings) for  
6 which PECO will procure supply; (ii) the portfolio of products that PECO intends to  
7 procure for each class and the schedule of such procurements; and (iii) PECO's  
8 contingency plans in the event of insufficient bidder participation or supplier default  
9 before the end of the supply delivery period.

10 **9. Q. Have you prepared any exhibits to accompany your testimony?**

11 A. Yes. PECO Exhibits WJP-1 through WJP-3 were prepared at my direction and under  
12 my supervision and are described in detail in my testimony.

13 **II. OVERVIEW OF PROCUREMENT PROCESS**

14 **10. Q. Please provide an overview of PECO's proposed procurement process.**

15 A. PECO plans to conduct multiple competitive solicitations to acquire generation  
16 service to meet its default service obligations beginning January 1, 2011, when  
17 PECO's transition period under Pennsylvania's Electricity Generation Customer  
18 Choice and Competition Act, 66 Pa.C.S. § 2801 *et. seq.*, is complete. PECO's  
19 competitive solicitations will utilize a Request for Proposals ("RFP") process to  
20 solicit bids for a portfolio of full requirements supply products, including energy at  
21 prices set in the day-ahead "spot" wholesale energy market administered by PJM

1 Interconnection LLC (“PJM”). In accordance with the Commission’s regulations,  
2 PECO is also seeking approval for the RFPs to be managed and monitored by an  
3 independent evaluator, NERA Economic Consulting, Inc. (“NERA”), to assure that  
4 the bidding is conducted in a fair and efficient manner and to report to the  
5 Commission. As a result, we expect that the results will be consistent with prevailing  
6 market prices for wholesale energy.

7 **11. Q. What is the term of PECO’s default service plan for which PECO is procuring**  
8 **supply?**

9 A. PECO’s Plan encompasses default service procurement for the period beginning  
10 January 1, 2011 through May 31, 2014. This term is consistent with the  
11 Commission’s regulations, which provide that an entity’s first default service  
12 program shall be for a period of up to three years. The Plan includes an additional  
13 five-month period to enable PECO’s procurements to align with the PJM planning  
14 period, as required by the Commission. *See* 52 Pa. Code § 54.185. The contracts on  
15 which suppliers will bid will have different terms, ranging from 12 to 41 months, with  
16 the terms of some contracts extending beyond May 31, 2014 to facilitate laddering of  
17 contract delivery periods.

18 **12. Q. What is “laddering”?**

19 A. Laddering refers to a procurement methodology in which supply contracts do not all  
20 begin and end at the same time. In the interest of rate stability, the Commission has  
21 specifically encouraged PECO and other default service providers to use laddering to  
22 avoid switching to new contracts (with new prices) all at once and has permitted

1 contracts to extend beyond the term of a default service program for this purpose. *See*  
2 Policy Statement, at 5 and 52 PA. Code § 54.185(b)(3). In his testimony (PECO  
3 Statement No. 3), Mr. Scott Fisher also explains how laddering can “smooth” the  
4 effects of rate changes over time.

5 **13. Q. Is PECO seeking to begin procurement before the end of its transition period?**

6 A. Yes. PECO intends to solicit bids for default service supply before the end of its  
7 transition period so that PECO will not have to procure all of its default supply  
8 immediately before January 1, 2011. Assuming approval of its Plan, PECO would  
9 conduct three solicitations prior to January 1, 2011. Because the supply contracts  
10 PECO would enter into as a result of these solicitations vary in length and do not  
11 cover the entire term of PECO’s Plan (i.e., through May 31, 2014), PECO will also  
12 conduct four more solicitations after January 1, 2011 for additional default supply.  
13 The final solicitation is tentatively scheduled for April 18, 2013. A table showing the  
14 anticipated solicitations for each procurement class is included and described in the  
15 RFP rules attached to the testimony of Dr. LaCasse of NERA (PECO Statement No.  
16 4).

17 As noted above, the Commission has emphasized that there is significant risk in  
18 procuring all supply at a fixed rate for the entire duration of a default service  
19 program. *See* Final Rulemaking Order, at 33. PECO’s program of multiple  
20 solicitations over an extended time, including the time period prior to January 1,  
21 2011, is consistent with the Commission’s guidance and is intended to avoid

1 problems associated with procuring significant amounts of supply at the point in time  
2 when prices may be highest.

3 **14. Q. Will the competitive procurement solicitations be open to all wholesale suppliers,**  
4 **including affiliates of PECO Energy?**

5 A. Yes. All qualified suppliers who satisfy uniform bidder requirements will have an  
6 opportunity to participate in the Company's RFP. Details on supplier qualification  
7 requirements are included in PECO Statements No. 4 (Chantale LaCasse) and No. 5  
8 (John McCawley).

9 **15. Q. Does PECO propose any limits on the amount of supply that can be provided by**  
10 **a single supplier?**

11 A. PECO proposes to limit any successful bidder's supply to no more than eighty  
12 percent (80%) of each procurement class. As explained by Dr. LaCasse, there are  
13 two principal benefits to this type of limitation (known as a "load cap"). First, it will  
14 help ensure diversity in suppliers and limit PECO's exposure to any single supplier.  
15 Second, a load cap may increase bidder participation in the procurement process if  
16 smaller suppliers believe they have an increased chance of being successful bidders.

### 17 III. PROCUREMENT CLASSES

18 **16. Q. What are the procurement classes being proposed by PECO?**

19 A. PECO proposes to divide its default service customers into four classes for purposes  
20 of default service procurement: the Residential class, the Small Commercial class, the  
21 Medium Commercial class, and the Large Commercial and Industrial class. The

1 17. Q. Why is PECO proposing to divide its customers into four procurement classes?

2 A. There are several reasons. First, PECO is proposing to divide customers with lower  
3 peak demand – less than 100 kW – into a Residential class (for residential customers)  
4 and a Small Commercial class (for commercial customers) in order to enable each  
5 class to stand alone for procurement and retail rate pricing purposes. While these two  
6 classes are both likely to have a lower propensity for switching suppliers than  
7 customers with higher demand, their energy usage profiles and load factors can differ  
8 substantially and PECO anticipates their propensity to switch in the future may vary  
9 significantly. By creating these two procurement classes, PECO expects to obtain bid  
10 prices that better reflect the default service needs of these different kinds of  
11 customers. Furthermore, in the event that the Residential class and Small  
12 Commercial class develop different switching patterns over time, separate  
13 classification for procurement purposes will avoid concerns that the migration  
14 propensity of one customer group is resulting in a higher price for the other customer  
15 group. The Small Commercial class is also sufficiently large to support multiple  
16 solicitations for supply, as Dr. LaCasse of NERA explains in her testimony (PECO  
17 Statement No. 4).

18 Second, PECO is establishing the Medium Commercial class for commercial  
19 customers from 100 kW to 500 kW because we expect such customers to have a  
20 propensity to migrate that is substantially greater than customers with peak demand  
21 less than 100 kW. For these customers, we believe a different mix of supply  
22 contracts is more suitable, with no contracts longer than one year in length.

1 Third, PECO is separating customers with demand over 500 kW for the same reasons  
2 PECO proposes to separate the first three classes: separation will help assure that this  
3 class and the other classes pay a price for default service supply that appropriately  
4 reflects load shape, enables PECO to implement a procurement term structure  
5 (including spot supply pricing) particularly suitable for this class, and creates a class  
6 that should be more homogeneous with respect to migration propensity.

7 **18. Q. Do the Commission's regulations and policy statement support PECO's**  
8 **proposed procurement classes?**

9 A. Generally, yes. The Commission's regulations (52 Pa. Code § 54.187) and Policy  
10 Statement (§ 69.1805) provide that default service providers should design  
11 procurement classes based upon peak loads of 0-25 kW, 25-500 kW, and 500 kW and  
12 greater, but the Commission does give default service providers some discretion.  
13 While separating customers into a Residential class, a Small Commercial class for  
14 customers with demands less than 100 kW, and a Medium Commercial class for  
15 customers with demands between 100 KW and 500 KW, and a Large Commercial  
16 and Industrial class for purposes of procurement creates four customer classes instead  
17 of three classes, PECO believes that this division is appropriate because it clearly  
18 separates residential and commercial costs. Further, this division clearly separates the  
19 smallest commercial customers who will have a lower propensity to migrate and  
20 medium-sized commercial customers who may have a greater propensity to migrate.  
21 PECO believes (and Dr. LaCasse concurs) that a 100 kW breakpoint is appropriate to  
22 separate small and medium commercial customers as it will alleviate concerns that  
23 bidders may be less interested in bidding to serve only small commercial customers

1 with demands less than 25 kW due to the small aggregate demand of that group  
2 procured over multiple solicitations. Because of the Commission's regulations,  
3 however, PECO is formally requesting a waiver of the provisions of 52 Pa. Code §  
4 54.187 to permit four procurement classes as I have described.

5 **19. Q. Are there any exceptions with respect to customer size and procurement class?**

6 A. Yes. For consistency of procurement and efficient administration, PECO has  
7 included all of its lighting class customers (AL, TL, POL, SLE, SLS, and SLP) in the  
8 Small Commercial class. There are a small number of lighting customers with peak  
9 demand equal to or exceeding 100 kW. The few customer accounts that exceed 100  
10 kW are customers with a large number of lighting fixtures, even though each  
11 individual fixture itself may use only a few kilowatts.

12 **IV. RFP PRODUCT DEFINITION AND SCHEDULE OF PROCUREMENT**

13 **20. Q. What are the products that PECO will solicit for each of its procurement**  
14 **classes?**

15 A. PECO is proposing to purchase a portfolio of products for each procurement class  
16 through a series of RFPs. Consistent with the Commission's default service  
17 regulations and Policy Statement, each procurement class will have its own unique  
18 procurement strategy that takes into account and balances customer sophistication  
19 regarding energy, rate stabilization, and opportunities to access competitive  
20 alternatives. Policy Statement, at 6. For instance, PECO is soliciting full  
21 requirements service products for its Residential, Small and Medium Commercial

1 classes, with a portion of the portfolio incorporating energy at the prices established  
2 by PJM's day-ahead spot market.

3 For Large Commercial and Industrial customers, PECO will offer default service  
4 based upon hourly PJM day-ahead market prices. In addition, consistent with Section  
5 69.1805 of the Policy Statement, PECO will conduct a solicitation for full  
6 requirements contracts to support a one-year fixed price optional service for Large  
7 Commercial and Industrial customers for the period January 1, 2011 – December 31,  
8 2011. This fixed price offering is a transition product that will only be offered at the  
9 beginning of the first year of the Plan, and any customer remaining on this product  
10 after the first year will be transferred to hourly priced default service. Customers who  
11 elect this option will not be able to switch to an EGS or hourly priced default service  
12 during the one-year term of the fixed price service.

13 **21. Q. What products will wholesale suppliers be responsible for should they be chosen**  
14 **to serve a percentage of PECO's load?**

15 A. Each winning wholesale supplier will be required to enter into a supply master  
16 agreement ("SMA") with PECO as part of the procurement process. Under the SMA,  
17 a supplier is obligated to supply "full requirements" load-following service, which  
18 includes energy, capacity, ancillary services, and any other services or products  
19 necessary to serve a specified percentage of PECO's default service load twenty-four  
20 hours a day, three hundred and sixty-five days a year. Because the contract is "load  
21 following," the amount of energy and other services and products a supplier must  
22 provide will vary depending upon PECO's actual default service load. PECO

1 remains responsible for all distribution services to its default service customers, as  
2 well as transmission costs for Network Integration Transmission Service (“NITS”)  
3 and related services that it will recover through its current unbundled retail  
4 transmission rate. Mr. McCawley explains the components of full requirements  
5 service in detail in his testimony.

6 **22. Q. Please explain how a portion of PECO’s default service load will be supplied by**  
7 **spot market purchases.**

8 A. For the Residential class, PECO will solicit bids for approximately 5% of the total  
9 energy needs for that class to be priced based upon the PJM day-ahead spot market.  
10 Suppliers will be required to provide energy at PJM’s day-ahead spot market prices  
11 and also supply the associated capacity, ancillary services, and AEPS credits  
12 associated with the load served. For the Small Commercial and Medium Commercial  
13 classes, PECO will obtain spot market-priced supply for 10% and 15% of the class  
14 needs respectively. PECO will also solicit bids and offer its Large Commercial and  
15 Industrial class an hourly pricing option based on day-ahead PJM spot market  
16 purchases.

17 For each procurement class, both the term of the contracts and the percentage of  
18 energy priced in accordance with PJM’s spot energy markets included in the supply  
19 portfolio reflect a balance of exposure to market prices, rate stability, the competitive  
20 opportunities available to different customer classes, and the ability of those classes  
21 to pursue such opportunities.

1 23. Q. Is PECO planning to offer its Large Commercial and Industrial class customers  
2 any other options?

3 A. PECO expects that most of its Large Commercial and Industrial class customers will  
4 take advantage of market opportunities and therefore hourly pricing will be the  
5 “default” option for these customers. However, PECO is also planning to offer its  
6 Large Commercial and Industrial class customers a one-year fixed price offering,  
7 beginning January 1, 2011. Customers who are interested in this option must express  
8 their interest in advance of the offering. PECO will then conduct a solicitation for a  
9 fixed-price product for those customers and, assuming that the solicitation is  
10 successful (i.e., that bidders offer to supply this product), customers who expressed  
11 interest will have a limited window of 30 calendar days after the bid prices are known  
12 to confirm their decision to receive default service at the fixed-price rate. The fixed  
13 price offering is a transition product that will only be offered for the first year of  
14 PECO’s post-rate cap default service (January 1, 2011 through December 31, 2011),  
15 and any customer remaining on this product after the first year will be transferred to  
16 the default hourly priced service.

17 24. Q. Why is PECO requiring Large Commercial and Industrial class customers who  
18 want to enroll for fixed price service to indicate their interest in advance of a  
19 solicitation, enroll within 30 calendar days after the solicitation when the price is  
20 known, and then remain on the service for a year after enrollment?

21 A. As discussed by Mr. Scott Fisher (PECO Statement No. 3), large customers have  
22 historically shown a propensity to take advantage of market opportunities when it is

1 in their interest. Wholesale suppliers offering a fixed price default service product to  
2 large customers are likely to include an additional amount in their bids to cover the  
3 resulting risks and costs associated with customer migration. Requiring interested  
4 customers to express their interest before the solicitation, limiting the enrollment  
5 window to 30 calendar days following release of the price, and restricting the  
6 customer from shopping during the one-year period after enrollment are reasonable  
7 steps to limit the risk of customers switching and should help to lower the cost of  
8 providing default service supply to these customers.

9 **25. Q. Except for the one-year limitation on Large Commercial and Industrial**  
10 **customers who select PECO's fixed-price option, does PECO restrict a**  
11 **customer's ability to switch to or from PECO's default service and service**  
12 **provided by electric generation suppliers ("EGSs")?**

13 A. No. Consistent with the Commission's regulations, all default service customers can  
14 switch to an EGS for generation service instead of receiving default service from  
15 PECO after providing notice as required under PECO's tariff. A customer may also  
16 return to PECO's default service upon notice to PECO.

17 **26. Q. Please describe the portfolio of contracts PECO is proposing for each customer**  
18 **class.**

19 A. For the Residential class, which has a peak load contribution of 3163 MW, PECO  
20 will procure 63 tranches of approximately 50 MW per tranche consistent with the  
21 following portfolio design:

- 1                           • 5% spot – 1 year full requirements contract with energy priced at
- 2                                   PJM’s day-ahead market prices
- 3                           • 30% – 1 year full requirements contracts
- 4                           • 65% – 3 year laddered full requirements contracts
- 5

6                   The Small Commercial class, with a total peak load contribution of 1388 MW, will be  
7                   procured in 28 tranches of approximately 50 MW in size in accordance with the  
8                   following portfolio design:

- 9                           • 10% spot – 1 year full requirements contract with energy priced at
- 10                                   PJM’s day-ahead market prices
- 11                           • 50% - 1 year full requirements contracts
- 12                           • 40% - 2 year laddered full requirements contracts
- 13

14                   The Medium Commercial class, which has a total peak load contribution of 1100  
15                   MW, will be procured in 22 tranches of approximately 50 MW each based on the  
16                   following portfolio design:

- 17                           • 15% spot – 1 year full requirements contract with energy priced at
- 18                                   PJM’s day-ahead market prices
- 19                           • 85% - 1 year full requirements contracts
- 20

21                   The Large Commercial and Industrial class has a total peak load contribution of 2703  
22                   MW, and PECO will solicit one-year contracts for full service requirements with  
23                   energy priced by the PJM day-ahead market. In addition, as I described previously,  
24                   PECO will also be offering a one-year fixed price offering for these customers.

25                   Exhibits WJP-1 through WJP-3 summarize, in graphic form, the above contract mix  
26                   and laddering strategy for each customer class.

1 27. Q. Will some of the multi-year contracts PECO proposes to enter into continue past  
2 May 31, 2014?

3 A. Yes. For a portion of the load of PECO's Residential and Small Commercial classes,  
4 PECO will seek to enter into contracts during the period of the Plan that will extend  
5 past May 31, 2014 to enable laddering of contracts. Absent contract terms that extend  
6 past May 31, 2014, PECO PECO's customers would be more likely to face a sudden  
7 and significant change in rates when the program term ends. Furthermore, the  
8 Commission has recognized that "[f]or laddering to occur, it may be necessary for  
9 some portion of the supply acquisition to overlap the end of one program term, and  
10 the beginning of another." See *Final Rulemaking Order*, at 24.

11 The amount of load served by contracts which extend past May 31, 2014 will be  
12 limited. For the Residential class, PECO is proposing to enter into contracts through  
13 May 31, 2015 (approximately 22% of residential load) and May 31, 2016  
14 (approximately 22% residential load). For the Small Commercial class, PECO will  
15 seek to procure one two-year contract (approximately 20% of class load) that will  
16 cover the period of June 1, 2013 through May 31, 2015. Exhibits WJP-1 and WJP-2  
17 show the contract terms for the Residential and Small Commercial classes, including  
18 the contracts that will extend past May 31, 2014.

19 This laddering approach will provide valuable rate stability to Residential and Small  
20 Commercial classes but also allow flexibility in subsequent procurement plans  
21 beyond May 31, 2014, should market conditions dictate a different procurement  
22 strategy at that time.

1 28. Q. **How will PECO satisfy its AEPS obligations with respect to sales to default**  
2 **service customers?**

3 A. PECO will require each default service supplier to transfer Tier I and Tier II AECs to  
4 PECO corresponding to PECO's AEPS obligations associated with the amount of  
5 default service load served by that supplier. Mr. McCawley (PECO Statement No. 5)  
6 discusses the details of the AEPS obligations of suppliers.

7 **V. CONTINGENCY PLANS**

8 31. Q. **Does PECO have any contingency plans in the event it either does not obtain**  
9 **sufficient supply through its procurement process or experiences supplier**  
10 **default?**

11 A. Yes. While not every potential contingency can be anticipated, PECO has identified  
12 two potential situations where it may need to utilize a contingency plan: (i) where  
13 PECO fails to obtain sufficient approved bids for all tranches of supply offered in a  
14 procurement, and (ii) where a supplier enters into an supply agreement and  
15 subsequently defaults on its obligations.

16 In the event where PECO fails to obtain sufficient approved bids for all offered  
17 tranches for that product, the tranches will be included in PECO's next default supply  
18 procurement for that product. If necessary, PECO will supply any unserved portion  
19 of its default service load from the PJM-administered markets for energy, capacity  
20 and ancillary services and procure sufficient AECs to satisfy any near-term  
21 obligations under the AEPS Act.

1 In the event of a supplier default, PECO will also initially rely on filling that  
2 supplier's portion of PECO's default service load through the PJM-administered  
3 markets for energy, capacity, and ancillary services. If the default occurs within a  
4 reasonable time before a scheduled procurement, the load served by the defaulting  
5 supplier will be incorporated into that next procurement. Otherwise, PECO will file a  
6 plan with the Commission with alternative procurement options and a request for  
7 approval on an expedited basis.

## 8 VI. CONCLUSION

9 1. Q. Mr. Patterer, does this conclude your direct testimony?

10 A. Yes.