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June 18, 2012

VIA EXPRESS MAIL

Rosemary Chiavetta, Secretary
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400 North Street
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RECEIVED
JUN 18 2012
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: Petition of PECO Energy Company for Approval of Its Default Service Program
Docket No. P-2012-2283641

Dear Secretary Chiavetta:

Enclosed for filing are an original and nine (9) copies of the **Initial Brief of PECO Energy Company ("Initial Brief")** in the above-referenced matter.

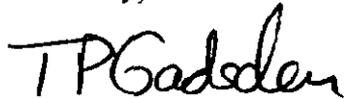
As evidenced by the attached Certificate of Service, a copy of the Initial Brief has been served upon Administrative Law Judge Dennis J. Buckley and all parties. Pursuant to 52 Pa. Code § 1.11(2), the enclosed Initial Brief shall be deemed filed on the date shown on the express delivery receipt attached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

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

Rosemary Chiavetta, Secretary
June 18, 2012
Page 2

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

Sincerely,



Thomas P. Gadsden

TPG/tp
Enclosures

c: Per Certificate of Service

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PETITION OF PECO ENERGY
COMPANY FOR APPROVAL OF ITS
DEFAULT SERVICE PROGRAM** :
: **DOCKET NO. P-2012-2283641**
:

**INITIAL BRIEF OF
PECO ENERGY COMPANY**

**Before Administrative Law Judge
Dennis J. Buckley**

RECEIVED

JUN 18 2012

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I. INTRODUCTION AND PROCEDURAL HISTORY

This proceeding was initiated on January 13, 2012, when PECO Energy Company (“PECO” or the “Company”) filed a Petition (“Petition”) pursuant to Section 2807(e) of the Pennsylvania Public Utility Code (the “Public Utility Code” or “Code”), 66 Pa.C.S. § 2807(e), requesting that the Pennsylvania Public Utility Commission (the “Commission”) approve PECO’s Default Service Program for the period from June 1, 2013 to May 31, 2015 (“DSP II”). DSP II is PECO’s second default service program and is designed to ensure that PECO’s default service customers continue to have access to adequate, reliable electric generation supply at the least cost over time and to enable PECO to recover its costs of furnishing that service. As described in the Petition, PECO’s DSP II contains all of the elements of a default service plan required by the Code, the Commission’s default service regulations (52 Pa. Code §§ 54.181 – 54.189), and the Commission’s Policy Statement on Default Service (52 Pa. Code §§ 69.1801-69.1817), including procurement, implementation, and contingency plans, a rate design plan, and copies of the agreements and forms to be used in procurement of default service supply.

PECO’s Petition also proposes a variety of retail market enhancements to be implemented as part of DSP II in accordance with the orders of the Commission in its Investigation of Pennsylvania’s Retail Electricity Market (the “Retail Markets Investigation”).¹ These programs include an Electric Generation Supplier (“EGS”) Opt-In Competitive Offer Program and a “Standard Offer” Customer Referral Program for existing default service

¹ These orders include *Investigation of Pennsylvania’s Retail Electricity Market: Recommendations Regarding Upcoming Default Service Plans*, Docket No. I-2011-2237952, 2011 WL 6740802 (Pa. P.U.C. Dec. 16, 2011) (“*Default Service Recommendations Order*”) and *Investigation of Pennsylvania’s Retail Electricity Market: Intermediate Work Plan*, Docket No. I-2011-2237952, 2012 WL 1066614 (Pa. P.U.C. Mar. 2, 2012) (“*Intermediate Work Plan Order*”).

customers, as well as other initiatives to encourage new and moving customers to select competitive electric supply from EGSs.

Copies of the Petition were served in accordance with 52 Pa. Code § 54.185(b).

Additionally, on January 28, 2012, the *Pennsylvania Bulletin* published the Commission’s notice setting a deadline for filing protests, complaints or petitions to intervene by February 13, 2012 and scheduling a Prehearing Conference for March 13, 2012 before Administrative Law Judge (“ALJ”) Dennis J. Buckley. Thereafter, the following entities were afforded active party status in this case:

Bureau of Investigation and Enforcement	(“I&E”)
Office of Consumer Advocate	(“OCA”)
Office of Small Business Advocate	(“OSBA”)
Coalition for Affordable Utility Service and Energy Efficiency in Pennsylvania	(“CAUSE-PA”)
ChoosePAWind.com	(“ChoosePAWind”)
Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc.	(“Constellation”)
Direct Energy Services, LLC	(“Direct Energy”)
Dominion Retail, Inc. and Interstate Gas Supply, Inc. d/b/a IGS Energy	(“Dominion”)
Exelon Generation Company and Exelon Energy Company	(“Exelon”)
FirstEnergy Solutions Corp.	(“FES”)
Green Mountain Energy Company	(“GMEC”)
Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company	(“FirstEnergy Utilities”)
NextEra Energy Services, Pennsylvania, LLC and NextEra Power Marketing, LLC	(“NextEra”)
Noble Americas Energy Solutions LLC	(“Noble”)
Philadelphia Area Industrial Energy Users Group	(“PAIEUG”)
PPL Energy Plus, LLC	(“PPL EnergyPlus”)
Retail Energy Supply Association	(“RESA”)
Tenant Union Representative Network & Action Alliance of Senior Citizens of Greater Philadelphia	(“TURN, et al.”)
UGI Energy Services, Inc. d/b/a UGI EnergyLink	(“UGIES”)
Washington Gas & Energy Services, Inc.	(“WGES”)

At the Prehearing Conference, a schedule was established for submitting written testimony, holding evidentiary hearings and filing briefs. See Second Prehearing Order (March 19, 2012). Written direct, rebuttal and surrebuttal testimony were submitted by various parties on the dates established for each submission. Attached hereto as Appendix A is a list of written

statements and accompanying exhibits (if any) submitted by witnesses appearing on behalf of PECO.

The parties to this case also engaged in extensive discovery. PECO responded to 117 interrogatories, and other parties collectively responded to 129 interrogatories, with many containing multiple subparts.

An evidentiary hearing was held at the Commonwealth Keystone Building in Harrisburg on May 22, 2012. At the hearing, various witnesses were cross-examined and the testimony and exhibits of all parties were admitted into evidence. The ALJ subsequently approved an outline for briefing of issues in this proceeding, and this Initial Brief will present DSP II and address the issues raised by other parties in accordance with the approved outline.

II. DEFAULT SERVICE PROCUREMENT AND IMPLEMENTATION PLANS

A. Summary Of PECO's Position

Since the commencement of PECO's current default service program ("DSP I") on January 1, 2011, customers comprising more than half of PECO's total customer load have elected to be served by EGSs, with the percentage of customers shopping ranging from approximately 25% of residential customers to 96% of large commercial and industrial customers. PECO St. No. 1, p. 5. PECO's DSP II is designed to further promote retail competition while continuing to provide customers with a competitively-procured, reliable default service product at least cost over time in accordance with the requirements of the Public Utility Code. DSP II seeks to build on the success of PECO's initial default service plan ("DSP I") using the same procurement class design and primary use of fixed-price full requirements

(“FPFR”) contracts² for default supply but proposes several enhancements, including shorter periods of time between default supply contract procurement and commencement of supply delivery. PECO St. No. 1, p. 9; PECO St. No. 3, p. 17. Significantly, in DSP I, there have been high levels of participation and competition in PECO’s solicitations for FPFR supply, and FPFR contracts – with their significant protection for default service customers against changing market conditions – have been obtained at reasonable prices. PECO St. No. 3, pp. 7-15.

In designing DSP II, PECO has closely followed the Commission’s recommendations in the *Default Service Recommendations Order*. DSP II has a proposed term of two years, beginning June 1, 2013 and ending May 31, 2015. PECO St. No. 2, pp. 4-5; *Default Service Recommendations Order*, p. 11. PECO’s procurement plan also limits the amount of supply extending past May 31, 2015 and defers the procurement of that supply until early 2014, leaving ample time to adjust (or eliminate) those solicitations to take into account any legal developments that result in PECO no longer serving as the default service provider after May 31, 2015. This approach does not presume any particular outcome of the Commission’s Retail Markets Investigation, but rather reflects a prudent balance between the benefits of achieving price stability and avoiding a “hard stop” on May 31, 2015 with the Commission’s

² An FPFR contract requires a supplier to satisfy a specified percentage (or “tranche”) of all of the default service customers’ supply requirements in every hour of the delivery period, regardless of the default service customers’ instantaneous changes in energy consumption, or how frequently customers migrate to or from default service, and regardless of how the supplier’s cost to satisfy its contractual supply obligations may change. FPFR products procured by PECO include energy, capacity, and ancillary services, as well as alternative energy credits (“AECs”) needed to satisfy the requirements of Pennsylvania’s Alternative Energy Portfolio Standards (“AEPS”) Act. PECO St. No. 3, pp. 6-7.

recommendation to limit extended contracts. *Default Service Recommendations Order*, pp. 20-21; PECO St. No. 1, p. 12.³

As in DSP I, PECO proposes to procure default service supply for four default service classes: the Residential Class, the Small Commercial Class, the Medium Commercial Class, and the Large Commercial and Industrial Class. Each DSP II class is comprised of established rate schedules under PECO's tariff, and reflects differences between the classes with respect to customer usage and shopping patterns. PECO's organization of customers into these four procurement classes reduces the potential that continued increases in shopping trends in one customer group will result in a higher default service price for another customer group. PECO St. No. 2, pp. 7-8.⁴

For the Residential Class, which is currently served by a 75% / 25% mix of FPFR contracts and block and spot supply, PECO is proposing to transition to a mix of one-year and two-year FPFR contracts. These supply contracts will be laddered, with six-month spacing between commencement of delivery periods. PECO will transition to this blend of contracts using products with term lengths that vary from six months to eighteen months. Block energy contracts procured during DSP I and extending into DSP II will be allowed to expire during DSP II, and PECO will not procure any new block energy products in DSP II. After the first FPFR

³ PECO's implementation of other recommendations of the Commission in the *Default Service Recommendations Order* are discussed *infra*. See Sections III.B (Reconciliation of Default Service Costs and Revenues); IV.B (Retail Opt-In Auction); IV.C (Referral Program); IV.E.1 (Time-of-Use Rates).

⁴ In DSP I, the Commission granted PECO a waiver from its regulations providing that default service providers should design procurement classes based upon peak loads of 0-25 kW, 25-500 kW, and 500 kW and greater in order for PECO to create the Small and Medium Commercial customer procurement groups. See Opinion and Order, *Petition of PECO Energy Co. for Approval of Its Default Service Plan and Rate Mitigation Plan*, Docket No. P-2008-2062739, 2009 WL 1644097 (Pa. P.U.C. June 2, 2009), pp. 6 & 9 (hereafter, "*PECO DSP I Order*"). For DSP II, PECO is again requesting a waiver to maintain its current procurement classes, which are also consistent with the Commission's recommendations in the *Default Service Recommendations Order*. See PECO St. No. 2, pp. 8-9 & n.2; *Default Service Recommendations Order*, p. 61 (recommending that EDCs create separate procurement groups for medium commercial customers).

supply procurement scheduled for Fall 2012, all FPFR products will be procured approximately two to four months prior to delivery (instead of five to nine months prior to delivery as under DSP I). PECO St. No. 2, pp. 10-13.

For the Small Commercial Class, PECO proposes to eliminate the DSP I two-year FPFR products and spot-priced full requirements products, and replace them with one-year FPFR products with semi-annual overlapping periods and an initial transitional procurement of six-month FPFR contracts to facilitate laddering. Like the Residential Class, all products will be procured approximately two to four months prior to delivery. *See id.*, pp. 12-14.

The proposed procurement design for the Medium Commercial Class eliminates the current one-year FPFR products and spot-priced full requirements products and instead relies upon six-month FPFR products, without overlap. Like the contracts for the Residential and Small Commercial Classes, all products will be procured approximately two to four months prior to delivery. For the Large Commercial and Industrial Class, which has been served using spot-priced full requirements contracts, PECO proposes to eliminate those contracts and obtain default service supply through direct procurements of energy and related services from the PJM energy markets. *See id.*

PECO's DSP II is thus designed to obtain a "prudent mix" of contracts to provide adequate and reliable default service supply, at least cost over time, for all default service customers, as required by the Public Utility Code. *See* 66 Pa.C.S. 2807(e)(3.7). The type of FPFR contracts that PECO seeks to procure have already been approved by the Commission for default service supply, are well-tested in the marketplace, and will provide Residential, Small and Medium Commercial Class customers in DSP II with the benefits of competition among generators in the underlying wholesale market and competition between default service suppliers

bidding to provide FPFR supply at the lowest price. PECO St. No. 3, pp. 21-22. PECO's proposed default service portfolios will continue to provide customers with significant protection against changing market conditions and an appropriate degree of rate stability consistent with the objectives of Act 129 of 2008 and the Public Utility Code, but will in no way limit customers from shopping for lower-priced generation or alternative products offered by EGSs during the term of DSP II. PECO St. No. 3, pp. 22-23.⁵ Furthermore, as explained in Section II.B.3 *infra*, PECO's proposal to eliminate procurement of future block energy contracts on behalf of residential customers will reduce price and volume-related risks that could be magnified as retail shopping increases in PECO's service territory. PECO St. No. 3, pp. 31-32.

The reduced periods between procurement and delivery that PECO has proposed for default service customers should also result in default service rates that are generally more reflective of contemporaneous market prices, and the shorter-term contracts for Small and Medium Commercial customers continue the benefits of FPFR products while also taking into account the different evolving competitive markets for these customers. PECO St. No. 3, pp. 25-28, 36-37. For Large Commercial and Industrial customers – the vast majority of which are already obtaining generation supply from EGSs – PECO's proposed procurement of default service supply directly from PJM eliminates the risks of higher costs that could arise from default service procurements that may be unsuccessful due to the small amount of remaining default service load for this class. PECO St. Nos. 2-R, pp. 9-10 & 3, p. 24.

⁵ See Preamble, Act 129 of 2008; *see also* Opinion and Order, *Petition of Pike County Light & Power Co. for Approval of Its Default Serv. Implementation Plan*, Docket No. P-2011-2252042, 2012 WL 1963545 (Pa. P.U.C. May 24, 2012), p. 29 (discussing Commission's final Act 129 default service regulations providing that a default service plan that meets the least cost over time standard "should not have, as its singular focus, the achievement of the absolute lowest cost over the default service plan time frame but rather a cost for power that is relatively stable and also economical relative to other options").

Many parties supported (or did not oppose) PECO's proposed procurement and implementation plans including the use of FPFR contracts, in testimony in this proceeding. In the following sections of this Initial Brief, PECO addresses the handful of issues that were raised and explains why the parties' proposed alternatives should be rejected.

B. Residential Class Procurement

1. Term Length of Supply Contracts

The only party to propose a change in the length of FPFR contracts for the Residential Class (other than RESA and its proposal to terminate all default supply contracts on May 31, 2015, which is discussed in Section II.B.2 *infra*) is FES, which asserts that PECO should replace the six-month contracts scheduled for procurement in November 2012 with twelve-month contracts. FES' proposal is based on its separate recommendation to change the term of PECO's proposed Opt-In EGS Offer Program (the "Opt-In Program") from six billing periods (as recommended by the Commission and proposed by PECO) to twelve months. If its recommended twelve-month term for the Opt-In Program is accepted, FES believes elimination of the six-month products will give residential customers a more stable Price-to-Compare ("PTC") for comparison with Opt-In Program prices. FES St. No. 1, p. 8.

As PECO witness McCawley explained in his testimony, the six-month default supply contracts to be procured are part of a carefully designed ladder supply portfolio that should not be undermined to accommodate the one-time Opt-In Program. PECO St. No. 2-R, p. 9. FES' proposal to increase the term of the Opt-In Program from six billing periods to twelve months should be rejected for reasons discussed in Section IV.C.2 *infra*, and its rationale for eliminating PECO's six-month contracts to facilitate comparison of a twelve-month Opt-In Program product with the PTC is therefore inapposite. *Cf.* FES St. No. 1-SR, p. 15 (explaining that FES sought to

eliminate six-month contracts to purportedly “maximize” the proposed Opt-In Program). The Commission should therefore reject FES’ proposal to change the term of PECO’s six-month contracts for the Residential Class.

2. RESA’s Proposal to Include 10% Spot Purchases for Residential Customers

RESA generally does not object to PECO’s use of one- and two-year FPFR contracts for the Residential Class, but proposes that PECO procure spot market power for 10% of its residential customer load. RESA St. No. 1, pp. 10-11. RESA does not provide any specific guidance as to how the spot power would be procured, but RESA contends that inclusion of spot-priced power is “an important element” to prevent default service prices from diverging from the underlying wholesale market. *Id.* at 11. Because inclusion of spot-priced power as proposed by RESA is likely to result in more volatile default service rates, and because it is very possible that these unnecessarily volatile rates would be **less** reflective of contemporaneous market prices, the Commission should reject RESA’s proposal.

As explained by PECO witness Fisher, residential customers cannot be billed on the basis of actual hourly spot market costs from month-to-month because they lack real-time meters, *see* PECO St. No. 3-R, p. 30, and because PECO is required to establish a default service rate that does not change more frequently than quarterly for these customers. 66 Pa.C.S. § 2807(e)(7). As a result, inclusion of spot market purchases in the Residential Class portfolio would require PECO to project spot market prices for an upcoming quarter for inclusion in the PTC, reconcile the actual costs incurred and billed revenue under the projected PTC, and then recover those costs from customers in subsequent periods. PECO St. No. 3-R, pp. 30-31. Because of the uncertainty about spot market prices, this deferred cost recovery can be significant and magnify the volatility already associated with spot market pricing. *See* PECO St. No. 3-R, p. 32 & PECO

Ex. SGF-2R (demonstrating that, due to the uncertainty regarding spot market prices and the associated need for deferred cost recoveries, spot-based default service rates could change by 20% if spot market prices deviate from projections by 10%).

Although RESA asserts that Mr. Fisher's example is "purposely mixing" the effect of spot market prices and reconciliation, RESA concedes that reconciliation is required and does not dispute Mr. Fisher's calculations regarding the potential effect on default service price volatility for residential customers associated with spot-based default service rates. RESA St. No. 1-SR, pp. 5-7. Indeed, RESA's proposal to incorporate 10% spot-priced power in PECO's proposed residential portfolio has significant drawbacks, and furthermore RESA offers no credible evidence for the Commission to conclude that adoption of the proposal would enhance retail competition, so the Commission should therefore reject its proposal.⁶

3. OCA's Proposal to Continue Block and Spot Supply Procurement for Residential Customers

In DSP I, twenty-five percent of the Residential Class portfolio (the "PECO Share") is served by PECO through a mix of forward purchases of energy blocks, and purchases (net of sales) of energy in the PJM-administered spot market. The forward block purchases are targeted to correspond to eighty percent of the PECO Share (i.e., twenty percent of the total Residential Class load), with the remainder of the PECO Share (i.e., a targeted five percent of the total

⁶ RESA's reliance on a chart showing historical switching of **non-residential customers** in Maryland does not support its inclusion of 10% spot market power for residential customers. Specifically, RESA witness Williams presented a chart of historical customer switching levels in Maryland and attributed a historical increase in the switching level to more market responsive default service rates. RESA St. No. 1, p. 9-10; RESA St. No. 1-SR, p. 5-6. However, Mr. Fisher explained that the increase in switching represented in Ms. Williams' chart occurred because market prices diverged from the default service rates that resulted from the supply solicitations. As Mr. Fisher noted, the president of RESA at that time attributed this increase to the fact that there was a drop in wholesale market energy prices after the locked-in default service rates were set, and not to the market reflectivity that RESA asserts would be achieved "in a small way" through its proposal. PECO St. No. 3-R, p. 33-34; RESA St. No. 1-SR, p. 5.

Residential Class load) served through spot market purchases (net of sales). PECO St. No. 2, p. 11. In DSP II, PECO proposes to phase out the PECO Share and the associated block and spot purchases to reduce price and volume risk to residential default service customers, especially in light of increasing customer migration to EGSs within PECO's service territory. PECO St. No. 3, p. 30.

The OCA opposes PECO's elimination of block and spot supply on the ground that the cost of supplying the PECO Share was purportedly 6% less expensive (approximately \$4.31 per megawatt-hour) than FPFR contracts during 2011. The OCA therefore asserts that removing block and spot supply may cause PECO's proposed portfolio for residential customers to no longer satisfy "least cost" requirements under the Public Utility Code. OCA St. No. 1, p. 7. The OCA's analysis is flawed in several respects and should be rejected.

The OCA Has Examined Only A Single Market Scenario. At any given time, a broad universe of potential energy market scenarios can occur, and the relative performance of different default service procurement approaches can be very different under different market conditions. PECO St. No. 3-R, p. 6. Indeed, OCA witness Hahn conceded that "under certain market conditions, the block and spot purchases might have cost more than the full requirements portion" of PECO's default supply. However, he does not consider those other possible market conditions and how the OCA's proposed approach may perform in the future. OCA St. 1, p. 8.

Under a block-and-spot procurement approach, there is no fixed-price guarantee for load-following service and deviations from forecasted quantities of load (due to changes in usage, weather, customer switching, economic growth, or other events) require a utility to take corrective action to rebalance its supply portfolio or rely on spot energy markets to either purchase supply when needed or sell excess supply when such supply is not needed. PECO St.

No. 3, p. 31. Since block products involve fixed-cost commitments that do not vary with the load obligation, in the event that customers were to exercise their option to switch to an EGS when wholesale market prices decline, PECO could be left with excess supply that it would be forced to sell at a loss to be recovered from increasingly fewer default service customers, or the default service customers would find that an unexpectedly high portion of their default service supply portfolio is composed of above-market contracts, resulting in higher default service rates. Similarly, if market prices were to increase and customers switched back to default service, PECO would need to make supply purchases in a now high-priced market in order to meet load requirements, and this would also increase default service rates. PECO St. No. 3, pp. 31-32.

Under the FPFRR-based procurement approach that PECO has proposed, the seller of an FPFRR product is responsible for assuming, managing, and covering the financial costs and risks associated with electricity supply, while customers receive price stability benefits that protect against adverse market and/or generation cost outcomes as well as customer switching, changes in law, and other supply risks. Sellers of FPFRR products must satisfy their default supply obligations regardless of how much market prices or generation costs may increase during the delivery period and regardless of the default service load level; customers, in turn, retain their right to switch to a lower-cost EGS at any time. PECO St. No. 3, pp. 22-23. In this way, FPFRR products function like insurance – simply because prices did not spike during a particular year does not mean that it was not valuable to have protection against such risks, and an “after-the-fact” cost comparison does not capture this value. PECO St. No. 3-R, p. 6. Because of these

benefits, the Commission has expressed a preference for FPFR procurement over “managed portfolios” of block and spot supply.⁷

In response to the OCA’s comparison of supply costs under a single market scenario, PECO witness Fisher conducted an analysis of more than 1,000 different but equally likely market scenarios to compare the potential consequences of an FPFR products approach for the Residential Class, as proposed by PECO, and a portfolio with a renewed block-and-spot component, as proposed by the OCA. Mr. Fisher’s analysis clearly demonstrates that the OCA’s preferred approach would expose customers to considerably more risk with regard to rate shock and supply cost uncertainty than PECO’s FPFR approach. PECO St. No. 3-R, pp. 16-25.

Notably, the continued use of block and spot procurement across the potential scenarios examined by Mr. Fisher also creates a risk of potentially large deferred cost recovery balances that could distort the default service rates against which EGSs will compete. These balances arise from the fact that under a block and spot approach, default service rates must be set based on the anticipated cost of default service supply, which inevitably will differ from the actual cost of supply. Because the actual costs must be recovered from customers in the future, the balances can cause default service rates to diverge from contemporaneous market prices and may also lead to overall higher costs of providing default service that must be passed on to customers. PECO St. No. 3-R, pp. 23-24; *see also* pp. 24-25 (discussing additional costs, risks, and uncertainty associated with continued block and spot procurement).⁸

⁷ See Final Rulemaking Order, *Implementation of Act 129 of 2008; Default Service and Retail Elec. Markets*, Docket No. L-2009-2095604, 2011 WL 4826268 (Pa. P.U.C. Oct. 4, 2011), pp. 54-56 (“*Default Service Regulations Order*”); *see also* PECO St. No. 3, pp. 22-23.

⁸ As an example of the potential effects of a block and spot procurement strategy on default service rates, Mr. Fisher noted that Wellsboro Electric Company’s default service supply costs under a block and spot procurement approach increased significantly due to market price changes in 2008, and that the Commission thereby approved recovery of

The OCA Ignores Market Timing Issues and Other Market Characteristics In Its

Single Market Scenario. While the OCA's study, which is based on a single market scenario, provides no basis for continuing block and spot procurement in DSP II in light of the risks and consequences associated with this procurement approach under the large range of potential future market scenarios, Mr. Hahn's comparison of the costs of block and spot procurement and FPFR contracts is also flawed because it does not address key factors that distort his results. For example, the FPFR contracts for the period that Mr. Hahn studied were generally procured much earlier than the times in which the block and spot purchases were made. In fact, almost 80% of the block and spot purchases were made after the underlying wholesale cost of energy dropped significantly (by up to 30%). As Mr. Fisher demonstrated, eliminating timing differences reduces the alleged cost disparity between procurement methodologies from 6% to approximately 1% over the time period studied. PECO St. No. 3-R, pp. 7-10. Furthermore, the OCA's calculation excludes a significant portion (over 40%) of the Residential Class DSP I FPFR supply tranches actually procured by PECO, and the residual compensation required by suppliers in their bid prices (to cover less easily quantifiable costs and risks) in these solicitations were the lowest of any of the Residential Class product solicitations held to date. PECO St. No. 3-R, pp. 11-12. The OCA also ignores the fact that the FPFR and block contracts have different delivery periods that extend beyond the time period studied by Mr. Hahn. In short, Mr. Hahn did not present an "apples-to-apples" comparison. *See id.*

the increased costs over a twelve-month period in order to avoid a 109% increase in rates. OCA witness Hahn suggested that this experience was irrelevant, in part because of the limited time period in which Wellsboro experienced the congestion that gave rise to the price increase. OCA St. 1-SR, pp. 5-6. However, Mr. Fisher's reference to Wellsboro was not intended to address Mr. Hahn's after-the-fact analysis; instead, its purpose was to underscore the on-going rate effects that can occur with block and spot supply procurement under adverse market conditions which are avoided through the use of FPFR products. PECO St. No. 3-R, p. 7.

In response to these criticisms, Mr. Hahn maintained that PECO and other parties supporting the elimination of block and spot supply procurement had failed to introduce any evidence that block and spot purchases cost more than full requirements contracts during DSP I. OCA St. No. 1-SR, p. 3. Despite Mr. Hahn's claim, PECO presented extensive analysis of DSP I solicitations that indicates that the pricing of FPFR products is reasonable, considering the costs and risks assumed by the winning bidders in these solicitations to the benefit of customers. PECO St. No. 3, pp. 7-15. Furthermore, PECO presented additional analysis, based on actual market data, that demonstrates that the OCA's recommendation to renew the block and spot procurement would expose customers to considerably more risk with regard to rate shock, supply cost uncertainty, and deferred cost recovery balances than PECO's FPFR approach. PECO St. No. 3-R, pp. 16-25. Finally, the OCA incorrectly interpreted the results of PECO witness Fisher's analysis when OCA witness Hahn claimed that Mr. Fisher's analysis "showed that full requirements contracts result in 6% higher prices than block and spot purchases." OCA St. No. 1, p. 7. Contrary to Mr. Hahn's interpretation, the 6% value in Mr. Fisher's testimony does not represent a price or rate difference between a FPFR product approach and a block and spot procurement approach -- instead, it refers to the "residual compensation" (the amount that the lowest-cost suppliers incorporate in their bid prices to cover certain identifiable costs and risks to the benefit of customers), and PECO has demonstrated that the amount of residual compensation charged by suppliers is reasonable. PECO St. No. 3, pp. 7-15. By incorrectly assuming that the difference in rates between a FPFR product approach and a block and spot procurement approach is the same as the residual compensation value, the OCA effectively counted the dollars saved by not paying a third party to assume certain costs and risks, without taking into account the

offsetting costs and risks directly borne by customers under the block and spot procurement approach. PECO St. No. 3-R, p. 14-15.⁹

Because the OCA's analysis does not address the real differences, benefits, and risks between FPFRR contracts and block and spot procurements, nor the particular circumstances of energy markets during the initial DSP I period for which Mr. Hahn endeavored to compare the cost of the different procurement approaches, the OCA has not demonstrated that elimination of block and spot procurement will in any way render PECO's portfolio not "least cost". To the contrary, phasing out block and spot supply will significantly reduce the risks to customers. The OCA's proposal to continue block and spot procurement should therefore be rejected.¹⁰

C. Small Commercial Class Procurement

The only party to object to PECO's proposed use of one-year, laddered FPFRR contracts for the Small Commercial Class is RESA, which asserts that a portion of the scheduled procurements – specifically, the one-year contracts to be procured in September 2014 – should be reduced to six-month contracts to avoid any "overhang" of supply contracts beyond May 31, 2015. RESA St. No. 1, p. 12. As explained in Section II.F *infra*, PECO has already limited the default service supply contracts that extend beyond May 31, 2015 consistent with the *Default*

⁹ Apparently in an effort to rebut PECO's arguments regarding customer migration risk, Mr. Hahn suggested that the block and spot procurement had performed well during a period of time when many residential customers were switching to EGSSs. OCA St. Nos. 1-R, pp. 4-5 & 1-SR, pp. 3-4. However, as Mr. Fisher explained, this customer migration took place during an uncharacteristically non-volatile period in the wholesale energy markets, which cannot be assumed in the future. PECO St. No. 3-SR, p. 6.

¹⁰ In the event the Commission rejects the OCA's block and spot proposal, the OCA offers an alternative proposal for procurement of additional seasonal on-peak block energy during the phase-out of existing block supply procured in DSP I. *See* OCA St. No. 1, p. 9. PECO considered this proposal in its design of DSP II, but concluded that it presented additional risks (e.g., low bidder participation and increased administrative costs) and therefore incorporated an additional tranche of FPFRR supply in the Residential Class portfolio in order to mitigate any incremental spot purchases that might otherwise be required (due to not procuring any additional seasonal on-peak energy blocks). PECO St. No. 2-R, p. 6. Therefore, the OCA's alternative block and spot proposal should be rejected.

Service Recommendations Order, and the Commission should therefore approve PECO's proposed procurement for the Small Commercial Class without RESA's proposed modification.

D. Medium Commercial Class Procurement

As described in Section II.A *supra*, PECO has proposed to replace the current mix of 85% one-year FPFR contracts and 15% spot-priced full requirements contracts procured under DSP I for the Medium Commercial Class with six-month FPFR contracts in light of the significant shopping by medium commercial customers. *See* PECO St. No. 2-R, p. 7 (noting that approximately 82% of customers that would be included in the Medium Commercial Class are shopping as of April 2012).

The OSBA is the only party to object to the proposed portfolio for the Medium Commercial Class, asserting that PECO is effectively pursuing a "current market price" standard instead of "least cost over time" and should instead maintain the same level of price stability provided to medium commercial customers in DSP I. OSBA St. Nos. 1, p. 6 & 1-R, pp. 1-2. The OSBA provides no further justification for its objection and entirely fails to address the fact that the vast majority of medium commercial customers are now shopping and appear to have a diminished need for the same level of price stability offered during the period immediately following the end of generation rate caps. PECO St. Nos. 2, pp. 5-6 & 2-R, p. 7; PECO St. No. 3, pp. 25-26. Furthermore, while six-month contracts could result in less price stability for these customers, the use of such contracts does not reflect a "current market price" standard but simply consideration of the appropriate level of price stability in light of the developing commercial opportunities for these customers. In fact, the OSBA concedes that this factor should be taken into account in the context of small commercial customers who are shopping at a lower level. *See id.* & OSBA St. No. 1, pp. 5-6 (agreeing with potentially reduced price stability for small

commercial customers given developing competitive market); PECO St. No. 3, p. 27 (noting that 52% of small commercial customers are shopping as of January 2012). The Commission should therefore approve PECO's proposed procurement for the Medium Commercial Class.

E. Large Commercial And Industrial Class Procurement

In DSP II, PECO has proposed to eliminate its current spot-priced full requirements contracts and procure all default service supply for the Large Commercial and Industrial Class directly from PJM. PECO St. Nos. 2, p. 13 & 3, p. 24. Through this procurement method, PECO will eliminate the risk of additional costs that could arise as a result of conducting an RFP that is not successful due to insufficient supplier participation. PECO St. No. 2-R, pp. 9-10.

Only RESA has objected to PECO's proposal, asserting that this procurement methodology creates the potential for PECO to "misallocate" administrative costs such that the default service price does not accurately reflect the costs of providing default service. RESA further contends that purchasing spot-priced supply from PJM is not a "competitive procurement process" or sufficiently transparent. RESA St. Nos. 1, p. 13 & 1-SR, p. 8. However, RESA concedes that it has no evidence that PECO has misallocated any such costs in the past (including during a period of contingency procurements of default service supply by PECO from PJM following an unsuccessful RFP), or that PECO will misallocate costs in the future. RESA St. No. 1-R, p. 8. Furthermore, PECO's tariff describes in detail the administrative costs that are to be recovered in default service supply charges and included in PECO's Generation Supply Adjustment ("GSA") filings, and the Commission retains full authority to review these costs. *See* PECO Ex. ABC-2 (Generation Supply Adjustment for Procurement Class 4 – Loads Greater than 500 kW); 66 Pa.C.S. § 506.

RESA's suggestion that the procurement of supply from wholesale energy markets is not sufficiently competitive for purposes of the Public Utility Code is also in error. RESA makes no claim that the underlying wholesale energy market operated by PJM is not competitive, and the Commission has previously concluded that procurement of spot-priced supply directly from wholesale energy markets is consistent with statutory requirements for default service supply.¹¹ The Commission should therefore approve PECO's proposed procurement of default service supply from PJM for its Large Commercial and Industrial Class.

F. Extension Of Supply Contracts Beyond May 31, 2015

In the *Default Service Recommendations Order*, the Commission provided two guidelines to EDCs regarding the duration of default service supply contracts in upcoming default service plans. First, the Commission recommended that EDCs file plans limiting or eliminating the existence of short-term energy contracts extending past the end date of the upcoming default service plan time period (May 31, 2015). Second, the Commission recommended that EDCs limit the proportion of long-term contracts that comprise their default service plan energy portfolios, and consider using already existing long-term contracts from previous or presently effective default service plans. *Default Service Recommendations Order*, p. 19. In making these recommendations, the Commission emphasized that it was not mandating a prescriptive portfolio of contract lengths, but rather was maintaining flexibility for EDCs to develop procurement portfolios that met the requirements of Act 129 and the "least cost over time." *Id.*, pp. 19-20.

¹¹ See *Pike County*, p. 30. While the Commission has repeatedly emphasized that Pike County is a unique case, its approval of Pike County's direct procurement of spot-priced supply from the New York Independent System Operator makes clear that such procurements can satisfy the Public Utility Code's statutory requirements for a competitive procurement process. See 66 Pa.C.S. § 2807(e)(3.1).

DSP II is consistent with the Commission's recommendations. PECO has limited the "overhang" of contracts in accordance with its laddering strategy to mitigate rate volatility associated with replacing a large portion of default service supply in a short period of time, and will not execute any contract that will extend beyond May 31, 2015 until early 2014. PECO St. No. 2-R, pp. 7-8. As noted in Section II.A. *supra*, in the event that legal developments result in PECO no longer serving as the default service provider for its service territory after May 31, 2015, there will be ample time to adjust (or eliminate) PECO's solicitations that extend beyond May 31, 2015. PECO St. No. 1, p. 12.

The only party to contest PECO's implementation of the Commission's recommendation is RESA, which generally opposes the laddering of contracts achieved through the later procurements in PECO's plan and asserts that it will be "easier" to add contracts extending past May 31, 2015 instead of removing scheduled procurements at a later date. RESA St. No. 1-SR, pp. 2-4. However, the Commission explicitly recognized that some EDCs may choose to include laddered contracts (consistent with the Commission's Default Service Policy Statement) in their portfolios to mitigate the risks of adverse impacts that could arise from a "hard stop" of default service supply contracts on May 31, 2015. *See Default Recommendations Order*, p. 20; 52 Pa. Code § 69.1805(1) (stating that default supply contracts "should be laddered to minimize risk" for residential and small commercial customers). RESA offers no explanation for why it believes that it will be easier to address these risks through a new procurement plan at some future date instead of removing a limited number of previously scheduled solicitations from PECO's plan if and when the need arises. Therefore, the Commission should reject RESA's proposal to eliminate PECO's scheduled 2014 procurements at this time.

G. Procurement Schedule

1. OCA's Proposal to Reallocate Tranches Between Solicitations

In its procurement plan, PECO has proposed to conduct a solicitation in November 2012 for 27 tranches of full requirements contracts with terms of six, twelve, and eighteen months with delivery of the associated default service supply to commence on June 1, 2013. *See* PECO St. No. 2, p. 5; PECO Ex. JJM-1.¹² A second solicitation for an additional seven tranches with a 24 month term will be conducted in January 2013. *See id.* The OCA has recommended that PECO revise these solicitations to divide the total tranches equally between each procurement (i.e., 17 tranches in November 2012 and 17 in January 2013) to increase layering and laddering of the resulting contracts. OCA St. No. 1, p. 8.

As the OCA acknowledges, the 34 tranches PECO is seeking to procure in November 2012 and January 2013 will complement 14 existing tranches (procured in Fall 2011 and November 2012) that commence delivery under DSP I and continue beyond May 31, 2013. OCA St. No. 1, pp. 8-9 & OCA Ex. RSH-3. Because the 14 tranches comprise relatively small volume (i.e., 14 tranches/48 tranches, or approximately 30%) of the fixed-priced supply for DSP II, residential customers are exposed to a large change in default service rates starting June 1, 2013. The longer that PECO waits to procure the bulk of its supply for June 1, 2013, the more residential customers will be exposed to market price uncertainty with regard to their default service rates. By procuring most of the currently unhedged supply earlier as proposed (i.e.,

¹² Under a full requirements contract, a "tranche" refers to a specified percentage of default service load for which a full requirements supplier is obligated to provide load-following service, including energy, capacity, ancillary services, and other services. *See* PECO St. No. 2, pp. 9-10 & PECO Ex. JJM-2, p. 12.

November 2012), PECO can reduce this rate uncertainty for residential customers. PECO St. No. 2-R, p. 8. The Commission should therefore approve PECO's proposed solicitation schedule and reject the OCA's recommendation to delay procurement of supply.

2. OCA's Proposed "Hold Back" for Opt-In Program

In response to PECO's proposed implementation of the Opt-In Program, the OCA has expressed concern that the possibility of substantial numbers of residential customers switching to EGSs through the Opt-In Program may lead wholesale default service suppliers to include higher premiums in their bids in default supply procurements scheduled before the Opt-In Program is completed (in November 2012 and January 2013). In order to address this perceived risk, the OCA proposes two alternative "scenarios" to PECO's proposal (referred to as Scenarios B and C) in which PECO would set aside or "hold back" some tranches of residential default service supply from the November 2012 and January 2013 procurements. OCA St. No. 1, pp. 10-13.¹³

Under the OCA's Scenario B, following the Opt-In Program, the percentage of load associated with each residential supply tranche would be adjusted to equal the anticipated megawatts expected to be supplied in the absence of the Opt-In Program, with any remaining supply tranches filled either through spot market purchases or additional solicitations. Under Scenario C, the tranche size would not be adjusted but a number of tranches corresponding to the OCA's revised customer participation cap of 20% of residential customer load would be held back, with unfilled supply tranches remaining after the Opt-In Program filled through block and

¹³ Scenario B and C each presume that the Opt-In Program participation load cap – i.e., the number of customers who can enroll with a participating Opt-In EGS – would be reduced from 50% of eligible default service customers (as recommended by the Commission and adopted by PECO) to 20%. OCA St. No. 1, p. 12. The OCA's proposal to reduce the participation load cap is addressed in Section IV.B.3 *infra*.

spot purchases. OCA St. No. 1, pp. 12-13 & OCA Ex. RSH-6 and RSH-7; PECO St. No. 3-R, pp. 36 & 38-39.

As a threshold matter, the OCA has failed to provide any credible evidence to support its theory that the Opt-In Program may have a significant effect on supply product bid prices. In fact, in January 2012 (i.e., after the Commission had already proposed the Opt-In Program), PECO conducted a procurement for default service supply that would extend into the DSP II period. Notably, the compensation that suppliers incorporated into their bid prices for customer migration and other risks was the lowest of any of the DSP I solicitations to date. PECO St. No. 3-R, p. 35. Moreover, even if such risk were to be assumed, there are numerous flaws and unresolved issues associated with the OCA's proposals that could seriously harm default service customers.

As explained by Mr. Fisher, in the event that the Opt-In Program does not result in substantial customer switching to EGSs, PECO under Scenario B, would be forced to immediately procure sufficient default service supply to meet all residential customer requirements as of June 1, 2013, at a time when market prices could be high. However, because the PTC for default service after June 1, 2013 will have been established through PECO's earlier procurements, PECO could face a substantial shortfall in revenues to pay for this additional supply. Any such shortfall could create the potential for an additional deferred cost recovery balance that would need to be recovered from customers, leading to both an unnecessary rate increase and greater divergence between default service rates and contemporaneous market prices. PECO St. No. 3-R, pp. 37-38. Furthermore, the OCA does not explain how the proposed adjustments to tranche size based on the Opt-In Program would interact with the tranche sizes of the supply contracts procured by PECO in DSP I that extend into DSP II. *See id.*, p. 38.

The OCA's Scenario C fares no better. Because the OCA does not propose to adjust the tranche size in this scenario, *see* OCA St. No. 1, p. 13, default service suppliers will continue to be required to supply a set percentage of default service load, just as under PECO's proposal, and face the same asserted volumetric risk the OCA seeks to address. What is different is that an increased portion of the residential supply portfolio – the amount of supply “held back” – would be served through block and spot purchases, with the same volumetric and price risk to default service customers that has led PECO to propose the elimination of block and spot procurement in DSP II. *See* PECO St. No. 3-R, pp. 39-40; Section II.B.3, *supra*.

In sum, the OCA has failed to provide any evidence that the Opt-In Program will cause wholesale suppliers to include excessive premiums in their bids to provide default service during DSP II, and the solutions offered by the OCA to address this asserted risk pose additional risks for residential default service customers. The Commission should therefore reject the OCA's “hold back” proposals.

H. Load Cap

In PECO's DSP I proceeding, the Commission approved a limit of 65% on the amount of default service supply that any single supplier could provide to a procurement class. *PECO DSP I Order*, p. 8. In 2010, the Commission authorized a temporary increase in this “load cap” from 65% to 67% for a procurement of default service supply for the Small Commercial Class where only three tranches were available, to encourage greater supplier participation (i.e., so for a

product of three tranches a supplier was not limited by the load cap to the possibility of winning only a single tranche since two tranches would exceed 65% of the supply being solicited).¹⁴

Consistent with the Commission's 2010 ruling, PECO is proposing a 67% load cap for all customer classes in DSP II. As explained by Dr. LaCasse of NERA Economic Consulting, Inc. ("NERA"), the Independent Evaluator of PECO's current procurements and proposed evaluator for DSP II procurements, the use of 67% instead of 65% will help participation when there is a small number of tranches for a class in a particular solicitation. PECO St. No. 4, p. 18. In addition, PECO is proposing to simplify administration of the load cap by applying the 67% limit to the total amount of supply won by a supplier instead of the amount of supply that can be won in each procurement. *See id.*

The OCA and RESA oppose PECO's proposed 67% load cap and instead argue for a 50% limit. The OCA alleges that a 67% load cap allows for a "highly concentrated" market with "too large" of a risk of a supplier bankruptcy. OCA St. Nos. 1, p. 19 & 1-SR, pp. 7-8. Similarly, RESA contends that a 67% load cap creates a "high replacement cost" if a supplier fails to meet its obligations, and notes that New Jersey has achieved competitive results in its default supply procurements with a load cap of approximately 33%. The Commission should reject the arguments of the OCA and RESA for several reasons.

First, the Commission has previously rejected a 50% load cap recommended by RESA for two other Pennsylvania EDCs and determined that a **higher** load cap than proposed by PECO – 75% – represents an appropriate balance between the goals of achieving supplier diversity and

¹⁴ See Order, *Petition of PECO Energy Co. for Expedited Approval to Increase the Load Cap for the Small Commercial Customer Class in its Spring 2010 Default Svs. Procurement*, Docket No. P-2008-2062739, 2010 WL 1975379 (Pa. P.U.C. May 11, 2010), p. 6 (approving 67% load cap).

obtaining lower prices from suppliers seeking economies associated with larger supply opportunities. As the Commission explained:

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

Joint Petition of Metropolitan Edison Co. and Pennsylvania Elec. Co. for Approval of Their Default Serv. Programs, Docket Nos. P-2009-2093053 and P-2009-2093054, 2009 WL 3778375 (Pa. P.U.C. Nov. 6, 2009), p. 16; *see also id.*, p. 18 (concluding that a 75% load cap appropriately balanced the interests of supplier diversity and obtaining the lowest cost bid for purposes of "least cost over time").

Second, the concerns of the OCA and RESA regarding supplier bankruptcy and "high replacement cost" are misplaced. As PECO witness McCawley explained, the credit mechanisms in Article 14 of the Supply Master Agreement ("SMA") approved by the Commission in DSP I and proposed for retention in DSP II provide adequate protections for default service customers from supplier default. In particular, the SMA grants unsecured credit to sellers for their aggregate transactions with PECO for all default supply across all procurement groups based on the credit rating of each seller or, where a guaranty is provided, its parent. No unsecured credit is granted to a seller whose credit rating is at, or falls below, investment grade. In addition, PECO performs a calculation of aggregate exposure under its SMAs every business day and requires the posting of collateral whenever a buyer's aggregate exposure exceeds the unsecured credit limit. PECO St. No. 2-R, pp. 10-11. Notably, the OCA concedes that the SMA requirements are "standard," and while it suggests that the provisions "do not guarantee that

collateral will be timely received” (OCA St. No. 1-SR, p. 8), neither the OCA nor RESA offered testimony in support of different security requirements in the event the Commission does not adopt a lower load cap.

Third, the OCA’s assertion that the load cap is consistent with a highly concentrated market is erroneous; market concentration is not measured by the amount of supply that each chosen supplier is allowed to provide, but instead is related to the universe of parties who are able to provide supply, and participation in PECO’s procurements to date has been substantial. PECO St. Nos. 3-R, p. 4 n. 3 & 4-R, p. 3.

Finally, RESA’s reference to the 33 1/3% load cap used in the New Jersey basic generation service (“BGS”) auctions does not support a lower load cap for PECO’s procurements. Dr. LaCasse, who also administers the New Jersey BGS auctions, detailed a number of differences between the BGS auctions and PECO’s procurements to explain that reducing the PECO load cap will not necessarily increase supplier participation. These differences include a much larger amount of supply available to bidders, with New Jersey offering approximately 5,400 MW of projected fixed-price supply to bidders in contrast to a maximum amount offered to date by PECO of 850 MW. PECO St. No. 4-R, pp. 4-5. A reduction in PECO’s load cap to 50% may, in fact, lead to less participation by suppliers and resulting higher prices for customers. Consistent with the Commission’s prior rulings, PECO’s proposed 67% load cap should be adopted.¹⁵

¹⁵ OCA’s additional suggestion that the load cap should be applied across all of PECO’s default supply portfolio (OCA St. 1-SR, p. 8) instead of on a customer class basis is also flawed. As Dr LaCasse explained, applying the load cap on a customer class basis avoids a situation where all of the residential class supply could be provided by a single supplier. Tr. 90-91.

I. Other Procurement And Implementation Plan Requirements

In accordance with the requirements of the Public Utility Code and the Commission's default service regulations, DSP II includes a number of other components, proposed factual findings, and requests for approval described in PECO's Petition and the testimony of Company witnesses to which no party has objected. These uncontested issues are briefly summarized below.

AEPS Compliance. The Alternative Energy Portfolio Standards ("AEPS") Act requires default service providers like PECO to obtain an increasing percentage of electricity sold to retail customers from alternative energy sources, as measured by AECs. *See* 73 Pa.C.S. § 1648.1 *et seq*; 66 Pa.C.S. § 2807(e)(3.6). As in DSP I, PECO will continue to require each full requirements default service supplier to transfer Tier I solar, Tier I non-solar, and Tier II AECs to PECO corresponding to PECO's AEPS obligations associated with the amount of default service load served by that supplier. PECO St. No. 2, p. 18.

In addition, PECO will continue to allocate AECs obtained through its prior Commission-approved Tier I solar, Tier I non-solar, and Tier II procurements towards suppliers' AEPS obligations under the SMA in accordance with the percentage of load served by each supplier.¹⁶ PECO will retain a percentage of its AECs to meet the AEPS requirements associated with any industrial default service customers and any load associated with the remaining portion of the PECO Share of residential customer load. PECO will also buy and sell AECs as required

¹⁶ *See* *Petition of PECO Energy Co. for Approval to Procure Tier II Alternative Energy Credits and Additional Tier I and Solar Alternative Energy Credits*, Docket No. P-2010-2210975, 2011 WL 1210938 (Pa. P.U.C. Feb. 14, 2011); *Petition of PECO Energy Co. for Approval to Procure Solar Alternative Energy Credits*, Docket No. P-2009-2094494, 104 Pa. P.U.C. 358, 2009 WL 2836781 (2009); *Petition of PECO Energy Co. for Approval of (1) A Process to Procure Alternative Energy Credits during the AEPS Banking Period and (2) A Section 1307 Surcharge and Tariff to Recover AEPS Costs*, Docket No. P-00072260, 2007 WL 7232899 (Pa. P.U.C. Dec. 26, 2007).

to meet AEPS requirements and manage its inventory of AECs obtained in prior procurements as previously authorized by the Commission. *See id.*

Contingency Plans. Under DSP I, in accordance with Section 54.185(d) of the Commission's default service regulations, 52 Pa. Code § 54.185(d), PECO employs a contingency plan in case it fails to obtain sufficient approved bids for all tranches of supply offered in a procurement or a supplier enters into a supply agreement and subsequently defaults on its obligations. In the event PECO fails to obtain sufficient approved bids for all offered tranches for a product in a solicitation, the tranches will be included in PECO's next default supply solicitation for that product. If necessary, PECO will supply any unserved portion of its default service load from the PJM-administered markets for energy, capacity and ancillary services and procure sufficient AECs at market prices to satisfy any near-term obligations under the AEPS Act. PECO St. No. 2, p. 15.

In the event of a supplier default and the immediate need to obtain supply for default service, PECO will initially rely on filling that supplier's portion of PECO's default service load through the PJM-administered markets for energy, capacity, and ancillary services. If the default occurs within a reasonable time before a scheduled procurement, the load served by the defaulting supplier will be incorporated into that next procurement. Otherwise, PECO will file a plan with the Commission for an alternative procurement. *Id.*

In DSP II, PECO will continue to procure default service supply from PJM-administered markets for energy, capacity, and ancillary services and obtain sufficient AECs at market prices to satisfy any near-term obligations under the AEPS Act where necessary to supply unfilled tranches or after a supplier default. However, in light of PECO's schedule of procurements, the unfilled tranches for products with supply periods of six months or more will be included in

PECO's next scheduled procurement with a shortened supply period so that the product delivery will end on the same end date as in the original procurement. *Id.*, pp. 15-16.

Independent Evaluator. The Commission's regulations provide that a default service provider's procurements shall be subject to monitoring by an independent third party evaluator selected by the provider and subject to approval by the Commission. *See* 52 Pa. Code § 54.186(c)(3). NERA, which has significant experience in the administration of procurements of energy and related products, has served as the independent evaluator in DSP I and PECO has selected NERA to continue in this role for DSP II upon Commission approval. PECO St. Nos. 2, p. 4 & 4, pp. 2-4, 7.

Competitive Procurement Documents. The Commission's regulations also require that a default service plan include copies of agreements to be used in the procurement of electric generation supply for default service customers, including SMAs and RFPs. 52 Pa. Code § 54.185(d)(6). For DSP II, PECO has proposed to use the same form of SMA used in DSP I, with improvements for administration of the agreements, revisions to conform to new PJM requirements, and other changes described in the testimony of Mr. McCawley. *See* PECO St. No. 2, pp. 19-20 & 2-R, p. 26; PECO Exs. JJM-2 & JJM-1R. Similarly, the RFP documents to be used in default service supply solicitations and administered by the Independent Evaluator are based on DSP I RFP documents, with minor improvements to conduct solicitations more efficiently, reduce administrative costs, and further encourage supplier participation. *See* PECO St. No. 4, pp. 6-11 & PECO Exs. CL-2 & CL-3. In DSP II, a redacted copy of the Independent Evaluator's report to the Commission on each solicitation will be provided to PECO to assist in developing future improvements and implementing any contingency procurements, with an additional copy provided to the OCA. *See id.*, pp. 19-20; PECO St. No. 4-S, pp. 2-3.

PJM Requirements. In order to comply with the Commission’s requirement that a default service plan be consistent with legal and technical requirements of the regional transmission organization in which the default service provider is located, *see* 52 Pa. Code § 54.185(d)(4), PECO’s SMA requires a supplier to undertake all scheduling and other actions necessary to deliver full requirements service to PECO in accordance with both the terms of the SMA and PJM’s rules and agreements. Each supplier must be a member in good standing with PJM and maintain such status during the term of the SMA, as well as all other regulatory approvals, including approvals required by the Federal Energy Regulatory Commission (“FERC”) necessary to perform its obligations. PECO St. No. 2, p. 21.

Absence of Withholding of Generation. In considering the approval of a default service plan, the Public Utility Code requires the Commission to find that neither the default service provider nor any affiliated interest has withheld from the market any generation supply in a manner that violates federal law. *See* 66 Pa.C.S. § 2807(e)(3.7)(iii). PECO does not own and has not withheld any generation supply in violation of federal law. PECO St. No. 2, p. 31; Tr. 51. The PECO affiliates that own generation supply are Exelon Generation Company, LLC (“Exelon Generation”) and its subsidiaries, which now includes the Constellation Energy Group, Inc. (“Constellation”) subsidiary since the close of the merger of Exelon Corporation and Constellation on March 12, 2012. Tr. 51. Under the FERC’s applicable codes of conduct, PECO does not discuss generation market related issues with those affiliates but can state that there has been no determination by a court or regulatory agency of competent jurisdiction that Exelon Generation or its subsidiaries have withheld from the wholesale energy market any generation supply in any manner that violates federal law. *Id.*

III. RATE DESIGN AND COST RECOVERY

A. Summary Of PECO's Position

Under PECO's DSP I default service rate design, PECO recovers default service costs from default service customers through a GSA charge. For each customer class with peak loads up to 500 kW – i.e., the Residential, Small Commercial and Medium Commercial Classes – default service rates established pursuant to the GSA change quarterly. These rates currently recover: (1) generation costs, certain transmission costs and ancillary service costs; (2) supply management, administrative costs and working capital, as provided in 52 Pa. Code § 69.1808; and (3) applicable taxes. PECO St. No. 5, p. 6. The projected GSA for each quarter – filed by PECO 45 days before the start of each quarter – forms the basis of the PTC which customers can use to evaluate competitive generation service offerings by EGSs. *Id.*, pp. 4 & 6. The projected GSAs for Residential, Small Commercial and Medium Commercial Classes also include a quarterly reconciliation component, or “E factor,” to recoup or refund, as applicable, under or over-collections of actual costs in comparison to billed revenue from prior periods. PECO St. No. 5, pp. 4-5.

PECO's default service rates for the Large Commercial and Industrial Class are also charged through a GSA. For those customers, default service rates are based upon the PJM day-ahead hourly locational marginal price (“LMP”) for the PJM PECO Zone, plus associated costs, such as capacity, ancillary services, PJM administrative expenses and costs to comply with AEPS requirements that are incurred to provide hourly-priced service, as well as administrative costs and working capital. PECO St. No. 5, p. 5. PECO files a monthly projection of the AEPS and ancillary service costs at least 45 days prior to the start of each month for customers and suppliers to use. *Id.* The default service rates for the Large Commercial and Industrial Class

also include a monthly reconciliation component to refund or recoup over/under collections from prior periods. *Id.*

PECO is proposing to maintain this rate design generally in DSP II, with several adjustments to the GSA to simplify and improve recovery of default service costs. These adjustments, which are reflected in the proposed GSA and Reconciliation tariff pages set forth in PECO Exhibits ABC-2 and ABC-3, consist of the following:

1. In order to align PECO's default service rates with PJM's planning year (which begins on June 1 of each year), the three-month periods used as the basis for projecting and adjusting default service rates for the Residential, Small Commercial and Medium Commercial Classes are being shifted from the three months ending March 31, June 30, September 30 and December 31, to the three months ending August 31, November 30, February 28 (or February 29 during a leap year) and May 31. PECO will establish an interim projection period for the two-month period of April and May of 2012 that will include any over/under collections experienced during the months of October and November of 2012. PECO St. No. 5, pp. 6-7.
2. Any over/under collections of default service charges for the Residential, Small Commercial and Medium Commercial Classes will be reconciled on an annual basis instead of a quarterly basis, for reasons discussed in Section III.B, *infra*.
3. Any two months with large over/under collections for the Large Commercial and Industrial Class will be combined to mitigate wide swings in the PTC from month-to-month. PECO St. No. 5, pp. 11-12.
4. PECO's currently separate AEPS Surcharge will be incorporated into the GSA charge along with other default service charges, for reasons discussed in Section III.F, *infra*.
5. The following rate provisions will be eliminated from PECO's tariff: declining block prices for all tariff rates and the Wind Energy Service Rider in connection with the elimination of the PECO Wind program in favor of new customer referral programs. PECO St. No. 5, p. 14.
6. Half of any net cost or credit associated with PECO's exercise of Auction Revenue Rights ("ARRs") will be included in the GSA "C" factor¹⁷ for the

¹⁷ The "C-factor" is the sum of any costs paid to full requirements suppliers, costs of spot-market purchases and costs for any other energy acquired through short- or long-term contracts for the period the rate is in effect. *See*

Residential, Small Commercial and Medium Commercial Classes and the ancillary services factor for the Large Commercial and Industrial Class, for reasons discussed in Section III.E., *infra*.

7. The GSA's definition of administrative cost is being clarified to specifically reference two additional categories of costs. First, the cost of the pricing forecast necessary to project rates on a quarterly basis for the Residential, Small Commercial and Medium Commercial Classes will be included in the GSA as an administrative cost. PECO St. No. 5, p. 16. Second, the GSA will recover any costs incurred due to retail market enhancements to the extent the costs are not recovered directly from EGSs or in other surcharges approved by the Commission. *Id.*

The current design of the GSA rates for the Residential, Small Commercial and Medium Commercial Classes is consistent with the Commission's default service regulations and the Public Utility Code and will remain so with the above adjustments. *See* 66 Pa.C.S. § 2807(e)(7) (providing that default service rates for residential and small business customers may not change more frequently than on a quarterly basis).¹⁸ In addition, the Commission's regulations at 52 Pa. Code § 54.187(c) also state that default service rates may not use a declining block structure. PECO's proposed rate design complies with these requirements because rates will continue to change quarterly for the Residential, Small Commercial and Medium Commercial Classes and declining block prices will be eliminated. PECO St. No. 5, pp. 4 & 14.

With respect to the Large Commercial and Industrial Class, the Commission's regulations at 52 Pa. Code § 54.187(j) require that default service rates for those customers be adjusted on at least a monthly basis. PECO's proposed hourly-priced default service product for the Large

PECO Ex. ABC-2, pp. 7-8 (Generation Supply Adjustment for Procurement Classes 1, 2, 3 – Loads Up To 500 kW and Generation Supply Adjustment for Procurement Class 4 – Loads Greater Than 500 kW).

¹⁸ *See also Default Service Regulations Order*, p. 27 (amending the Commission's regulations at 52 Pa. Code § 54.187 consistent with 66 Pa.C.S. § 2807(e)(7) to provide that default service rates for customers with peak loads up to 500 kW should not be changed more frequently than on a quarterly basis).

Commercial and Industrial Class complies with this requirement because rates will continue to change monthly. PECO St. No. 5, p. 5.

B. Reconciliation Of Default Service Costs And Revenues

As described *supra*, for the Residential, Small and Medium Commercial Classes, billed revenues and actual costs are compared on a quarterly basis to calculate a reconciliation charge in the GSA for the subsequent quarter to refund or recover, as appropriate, the net over or under-collection per customer class on a per-kWh basis. PECO St. No. 5, pp. 5-6. The reconciliation charge includes carrying charges, which are calculated at the interest rates specified in the Commission's regulations at 52 Pa. Code § 54.187(f). *Id.*

In DSP II, PECO is proposing to continue to adjust default service rates on a quarterly basis for Residential, Small Commercial and Medium Commercial customers to reflect changes in supply costs. However, PECO has recommended that prior period over/under collections be reconciled for those customers on an annual basis rather than on a quarterly basis. PECO St. No. 5, p. 6. As PECO witness Cohn testified, because PECO bills customers at different times throughout a month, the revenue billed and received for a prior month may diverge significantly from the actual default service expenses incurred in the current month. PECO St. No. 5, pp. 8-9. This monthly "billing lag" can result in significant fluctuations in the quarterly PTC which are unrelated to the actual costs of default service supply. There is also a cyclical effect whereby the increase in one quarter's reconciliation component due to seasonal changes in energy prices is then offset in a subsequent quarter. *Id.*

The Commission's regulations do not prescribe a time period for reconciliation adjustments. The Commission has, however, recognized that more extended periods for over/under collection reconciliation may result in more market-reflective default service rates.

See Default Service Recommendations Order, pp. 54-55. To that end, the Commission has recommended that EDCs contemplate the incorporation of quarterly, semi-annual and/or annual over/under collection reconciliations in default service plans commencing June 1, 2013. *Id.* By using an annual rather than quarterly schedule for the reconciliation of over/under collections, fluctuations in default service prices will be smoothed out and result in clearer price signals for both customers and EGSs. PECO St. No. 5, p. 10.¹⁹

Both RESA and Dominion oppose PECO's annual reconciliation proposal on the ground that quarterly reconciliation would purportedly result in more market-reflective default service rates. *See* RESA St. No. 1, pp. 15-16; Dominion Retail/IGS St. No. 1, p. 6. RESA contends that annual reconciliation will be "further divorcing" default service rates from underlying wholesale costs and will create "intermittent" opportunities for EGSs. Dominion similarly asserts that annual reconciliation will create a "boom or bust" cycle where suppliers are able to compete (or not) for long periods of time. *See id.* The OCA agrees with a twelve-month reconciliation process, but recommends that over/under collections continue to be reconciled quarterly with reconciliation charges recovered or refunded using a twelve-month rolling average. OCA St. No. 1, p. 17. The Commission should reject each of these proposals and approve PECO's proposed annual reconciliation for several reasons.

First, RESA's assertion that annual reconciliation will be "further divorcing" default service rates from the underlying wholesale supply costs is not supported by any analysis or

¹⁹ To the extent necessary, PECO has requested a waiver of the Commission's regulations at 52 Pa. Code §§ 54.187(h) and (i) to implement this annual reconciliation of the over/under collection component of the GSA for Residential, Small Commercial and Medium Commercial customers. PECO St. No. 5, p. 11. Because default service costs for Large Commercial and Industrial customers are reconciled on a monthly basis and not on a quarterly basis and therefore do not experience the same type of billing lag, PECO is not proposing any change in reconciliation for the Large Commercial and Industrial class.

formal study. Despite RESA's contention to the contrary, annual reconciliation is likely to result in clearer price signals to customers and EGSs in DSP II in light of PECO's proposed increased use of full requirements contracts and elimination of block and spot supply. PECO St. No. 5-R, pp. 3-4. Indeed, as Mr. Cohn demonstrated, annual reconciliation will result in less volatile rates: the annual reconciliation of over/under collections for the twelve months ending March 31, 2012 resulted in a single reconciliation surcharge of only 0.43%. *See id.* & PECO Ex. ABC-1R. On the other hand, employing a quarterly reconciliation schedule for the same data produces quarterly fluctuations in the PTC ranging from a surcharge of 6.37% to a credit of 7.74%. *Id.*

Dominion also failed to demonstrate that annual reconciliation results in default service rates that diverge from underlying market prices. Mr. Barkas' purported illustration of such divergence is inapposite, as Dominion did not establish that a purchased gas procurement strategy relies upon the equivalent of FPFR contracts used by PECO (which avoid significant price fluctuations associated with weather and other changes in market conditions). *See* PECO St. No. 5-R, p. 5. Mr. Barkas' assertion regarding the potential for "boom or bust" cycles resulting from annual reconciliation is also unavailing; as demonstrated by Mr. Cohn's analysis, there is less likelihood of significant swings in default service pricing associated with annual reconciliation than with quarterly pricing, and the actual amount of annual reconciliation is likely to be relatively small. PECO St. No. 5-R, p. 6.²⁰

The OCA's proposal to continue to reconcile on a quarterly basis but collect or refund the

²⁰ Mr. Barkas' suggestion that billing lag is a result of PECO's lack of familiarity with the issue or an inability to match its revenues with expenses (Dominion St. Nos. 1, p. 5 & 1-SR, p. 7) is also misplaced, and Dominion offered no testimony regarding alternatives to reconciliation to address the billing lag issues identified by Mr. Cohn. Nor does Dominion explain why default service customers will believe PECO is offering a one-year, fixed-rate product when the PTC will continue to change quarterly, or are better off experiencing quarterly swings unrelated to default service costs instead of a much smaller annual adjustment.

net balance of each quarter's reconciliation using an average over a prospective twelve-month period does not adequately address PECO's concern due to two major flaws in the hypothetical example presented by OCA witness Hahn. First, Mr. Hahn compares estimated revenue to billed revenue to calculate the over/under collection balances in his hypothetical. As Mr. Cohn observed, however, the appropriate calculation is to compare billed revenue to actual costs. PECO St. No. 5-R, p. 6. As shown on PECO Ex. ABC-1R, correction of this error reduces the magnitude of the over/under collection balances calculated by Mr. Hahn. *Id.* Even without correction of this error, however, Mr. Hahn's hypothetical actually demonstrates the price volatility that can be experienced with quarterly reconciliation, producing a price variance in the amount of \$140.82 compared to \$16.11 with annual reconciliation. *See* PECO St. No. 5-R, p. 7 & OCA Ex. RSH-8. According to both Mr. Hahn's hypothetical example and PECO Ex. ABC-1R, an annual rolling average reconciliation results in more price fluctuation than PECO's proposed annual reconciliation. PECO St. No. 5-R, p. 7.

Second, Mr. Hahn's hypothetical does not provide an apples-to-apples comparison of the various reconciliation schedules because it assumes significant price variation from the underlying supply contracts. Under DSP II, however, PECO does not face substantial price and quantity risk because most of its default service supply will be procured through FPFR contracts. PECO St. No. 5-R, p. 7. Indeed, Mr. Hahn conceded that his hypothetical suggested a higher level of variability and reconciliation than that which customers will actually experience. OCA St. No. 1, p. 17.

Accordingly, the Commission should approve PECO's proposed annual reconciliation for the Residential, Small and Medium Commercial Classes and reject the proposals of RESA, Dominion and the OCA to continue with quarterly reconciliation.

C. EDC Recovery Of Additional PJM Charges

PECO's shopping customers currently remit generation and transmission costs to their EGSs who are their load serving entities ("LSEs"), while non-shopping customers are charged both generation and transmission costs under PECO's default service rates. Such transmission costs include certain PJM charges known as "generation deactivation" charges that are paid by all LSEs in the PJM PECO Zone. Generation deactivation charges are established under PJM's Open Access Transmission Tariff for payments to an owner of a generating facility which PJM has determined must be maintained in operation for reliability reasons pending completion of necessary transmission upgrades, even though the owner has sought to deactivate the facility. *See* PECO St. No. 2-R, p. 24.

In this proceeding, PPL EnergyPlus witness Alessandrini has proposed to depart from the existing cost assignment and to transfer responsibility for generation deactivation charges from LSEs to PECO. PPL EnergyPlus St. No. 1, pp. 3-4. Under Mr. Alessandrini's recommendation, PECO would collect generation deactivation charges via a non-bypassable, non-market based rider ("NMB Rider") from both shopping and default service customers. *Id.* RESA also supports recovery of generation deactivation charges through a non-bypassable NMB Rider from all customers. RESA St. No. 1, pp. 17-18. In addition, RESA proposes that PECO recover other PJM transmission charges in the same manner, including Network Integration Transmission Service charges ("NITS"), costs associated with transmission upgrades, and new PJM charges for Economic Load Response ("ELR") program payments. *See id.*

Mr. Alessandrini asserts that because the future amount of PJM generation deactivation charges is unknown and suppliers cannot hedge the risk of potential significant costs, wholesale suppliers and EGSs may charge customers a premium that is much higher than the actual costs.

PPL EnergyPlus St. No. 1, pp. 5-6. Ms. Williams agrees, and extends this concern to other PJM charges RESA seeks to require PECO to recover from customers. She also asserts that it is inequitable for EGSs to have to pay these costs while PECO assumes these charges for wholesale suppliers providing default service and recovers the expense through the PTC. RESA St. No. 1, p. 20. Mr. Alessandrini and Ms. Williams submit that shifting these unknown costs from LSEs to PECO will reduce market prices and make generation deactivation charges more transparent to customers. *See id.*

PECO does not support these proposals. PPL EnergyPlus and RESA have not shown how changing the existing cost assignment of generation deactivation charges and other PJM charges will lead to actual reductions in market prices. *Cf.* PPL EnergyPlus St. No. 1, p. 5 (stating only that EGSs, “depending upon the terms of their contract offers,” **may** also need to include premiums in their competitive offers to retail customers) (emphasis added). Indeed, as both Mr. Alessandrini and Ms. Williams acknowledge, EGSs are able to pass through the actual costs associated with each of these PJM charges to their customers without any risk premium. PPL EnergyPlus St. No. 1-SR, p. 7; RESA St. No. 1-SR, p. 16 (minimizing any “double-counting” issue because “many commercial customers already have these charges passed through as part of their existing commercial contracts”). While Mr. Alessandrini suggests that such “pass-through” charges can cause customer confusion and frustration because they are not within the control of an EGS (PPL EnergyPlus St. No. 1-SR, p. 3), he fails to explain why the responsibility for addressing any such confusion and frustration should be shifted from EGSs to PECO.

Inclusion by EGSs of actual PJM charges in future EGS customer contracts on a pass-through basis would eliminate any risk premium issues and fully address any concerns regarding

transparency and equity, as well as avoid any transition issues that could arise from the imposition of a new non-bypassable charge for those EGSs and customers who already have contracts that extend into the DSP II period. The Commission should therefore reject the proposals of both PPL EnergyPlus and RESA to shift responsibility for the recovery of generation deactivation and other PJM charges from EGSs to PECO.

D. Costs Included In The Generation Supply Adjustment Charge

As described *supra*, PECO's proposed GSA tariff includes an administrative cost factor in addition to the "C factor" and "E factor". Administrative costs will be allocated to each customer class based on default service supply sales unless a direct assignment is required. PECO St. No. 5, p. 6. Consistent with the Commission's Policy Statement at 69 Pa. Code § 69.1808(a)(4), the costs incurred to implement DSP II will be recovered through the administrative cost factor in the GSA. Administrative costs also include those related to information technology (IT) changes which will be amortized over the two-year DSP II term if expensed for accounting purposes or a five-year life if booked as capital for accounting purposes. PECO St. No. 5, pp. 17-18. PECO currently recovers IT capital costs associated with the implementation of DSP I through the GSA. PECO St. No. 5-R, p. 8.

OCA witness Hahn is the only witness that opposed PECO's proposal to include capitalized IT costs in the GSA.²¹ Mr. Hahn asserts that inclusion of capital costs is not allowed in a surcharge. OCA St. No. 1, p. 18. In support of this contention, Mr. Hahn cites a Pennsylvania Commonwealth Court decision (*Popowsky v. Pa. P.U.C.*, 869 A.2d 1144, 1155-58 (Pa. Cmwlth. Ct. 2005)) holding that a water utility could not use a surcharge to fund

²¹ Notably, Mr. Hahn does not take issue with PECO's proposed capital structure or return on equity for the amortization of capitalized IT costs.

infrastructure improvements to wastewater treatment collection systems. In that decision, the Commonwealth Court determined that the use of a surcharge is limited to the recovery of non-capital costs unless specifically permitted by law. *Id.* at 1155-56.

While PECO does not agree with Mr. Hahn's position, the Commission does not need to examine the validity of his conclusion because the facts are different here. Unlike the water utility in *Popowsky*, PECO is not seeking to recover capital expenditures relating to improvements to physical distribution facilities under the GSA. Rather, PECO is seeking to include IT capital costs incurred in connection with its obligation as default service provider in its service territory for which cost recovery is explicitly allowed. Under the Public Utility Code, default service providers have the right to recover *all* reasonable costs incurred pursuant to a Commission-approved competitive procurement plan on a full and current basis, pursuant to a surcharge under Section 1307 of the Public Utility Code. 66 Pa.C.S. § 2807(e)(3.9) (emphasis added); *see also* 52 Pa. Code § 54.187(a) (providing that a default service rate schedule "shall be designed to recover fully all reasonable costs incurred by the [default service provider]..."). The plain language of Section 2807(e)(3.9) does not limit such costs to non-capital items. In addition, the Commission's Policy Statement specifically identifies IT as a default service cost element to be included in the PTC. 52 Pa. Code § 69.1808(d). Notably, the Commission has approved inclusion of capital costs in other PECO surcharges. *See Order, Petition of PECO Energy Co. for Approval of its Act 129 Energy Efficiency and Conservation Plan and Expedited Approval of its Compact Fluorescent Lamp Program*, Docket No. M-2009-2093215, 2009 WL 3637663 (Pa. P.U.C. Oct. 28, 2009), p. 90 (approving recovery of capital costs under Energy Efficiency and Conservation Program Costs surcharge).

For the reasons set forth above, PECO's proposal to include in its GSA capital costs incurred for IT upgrades required to implement DSP II is reasonable and should be adopted in this proceeding.

E. Ratemaking Treatment Of Auction Revenue Rights

Auction Revenue Rights, or ARRs, are financial products that are allocated annually by PJM to firm transmission service customers. In PJM's allocation system, PECO receives an allocation based on generation resources that historically served PECO's customer load. ARRs entitle the holder to receive an allocation of the revenues from financial hedges of congestion risk known as financial transmission rights ("FTRs"), which are auctioned by PJM each year. Firm transmission holders can use ARRs to select transmission paths in the FTR auction. The auction collects revenue from the sale of FTRs, and the revenue is distributed to the ARR holders based upon their selection of transmission paths. PECO St. No. 5, p. 39.

The GSA currently does not specifically address the costs or credits associated with PECO's exercise of ARRs. As Mr. Cohn explained, PECO can receive value when it selects a transmission path with congestion because, in such case, the holder of the FTR will avoid congestion charges. PECO St. No. 5, pp. 15-16. On the other hand, PECO runs the risk of choosing the wrong transmission path in exercising its ARR rights and therefore incurring a loss. *Id.* To minimize the risk of loss to customers and provide an incentive to PECO to select financially beneficial transmission paths, PECO is proposing to replace its practice of "passing through" all ARR costs and benefits to customers with an equal (50%) sharing of ARR costs and benefits between PECO and default service customers. *Id.* Under PECO's proposal, half of any net cost or benefit will flow through the GSA for the corresponding customer class to which the ARRs were allocated.

Both RESA and the OCA oppose ARR sharing and recommend that PECO continue its current practice. RESA witness Williams' general assertion that ARR sharing could "skew" default service prices and negatively impact the competitive retail market (RESA St. No. 1, p. 17) is without merit as the scope of load for which PECO could exercise ARRs is limited only to the portion of the residential customer load that will continue to be served by block-and-spot energy products (which PECO has proposed to eliminate in DSP II) and the load of the relatively few customers remaining in PECO's Large Commercial and Industrial Class. Accordingly, the impact, if any, on the PTC for both the Residential and Large Commercial and Industrial Classes from ARR sharing will be minimal. *Id.*

Mr. Hahn's rationales for continuing PECO's "pass-through" practice are also flawed. In concluding that PECO does not face a significant risk of loss in exercising ARRs (and will thereby always benefit from any sharing), Mr. Hahn assumes that congestion patterns of ARRs do not change absent major new transmission construction projects, which typically span longer than the one-year ARR nomination period. OCA St. No. 1, p. 15. However, a number of other factors such as generator or transmission line outages or generation retirements can cause congestion. PECO St. No. 5-R, p. 9. Thus, Mr. Hahn fails to recognize that the actual value of ARRs is determined based on the FTR auction results, which are based on the perceived value of the paths and cannot be known in advance. Because PECO's proposed sharing mechanism strikes the proper balance between mitigating loss exposure for customers and providing an incentive to PECO to select profitable ARRs, it should be adopted.

F. Elimination Of Alternative Energy Portfolio Standards Surcharge

As explained in Section II.I, *supra*, the AEPS Act requires PECO to obtain an increasing percentage of electricity sold to default service customers from certain alternative energy

sources, such as wind, solar energy and biomass. PECO currently recovers the costs of compliance with its AEPS obligations through two separate mechanisms. First, the cost of FPFR contracts, which includes the transfer of Tier I and Tier II AECs to PECO to satisfy the AEPS obligations associated with the amount of default service load served by the FPFR supplier, is recovered through the GSA. PECO St. No. 5, p. 12. Second, PECO recovers the costs incurred for AECs obtained through its separate AEPS procurements under the separate AEPS Surcharge Rider. *Id.* Those AECs are allocated, in part, to FPFR suppliers in accordance with the percentage of load served by each supplier and used to meet AEPS requirements associated with industrial load and the remaining block and spot portion of the residential load. PECO St. No. 2, p. 18.

In this proceeding, PECO is proposing to eliminate the AEPS Surcharge from its tariff and incorporate all of its AEPS compliance costs into a single cost recovery mechanism – the GSA. To that end, PECO has developed tariff provisions to transition from the usage of two separate cost recovery mechanisms to exclusive use of the GSA to recover AEPS compliance costs. PECO St. No. 5, p. 13. This modification will assure that all AEPS compliance costs which are directly related to default service supply are reflected in the GSA. *Id.* No party contested PECO’s proposed inclusion of the AEPS Surcharge costs in the GSA or its recommended transition plan.²²

²² The OCA agreed with PECO’s proposal but stated that PECO must provide sufficient detailed information to assess “individual costs of DSP and AEPS compliance.” OCA St. No. 1, p. 17. However, the OCA did not provide any testimony regarding what additional information it believes may be necessary to conduct this assessment beyond the information already provided by PECO under its tariff regarding DSP and AEPS costs. *See* PECO Ex. ABC-2, pp. 7-8 (Generation Supply Adjustment for Procurement Classes 1, 2, 3 Loads Up To 500 KW and Generation Supply Adjustment for Procurement Class 4 Loads Greater Than 500 KW).

G. RESA's Proposal For A \$0.005/kWh Adder To The Price-To-Compare

RESA proposes to add a \$0.005 per kWh charge (the "PTC Adder") to the cost of default service supply for PECO's default service customers to recover two categories of cost: (1) default service costs that are "inadequately reflected" in the GSA and (2) the cost of implementing PECO's proposed retail market enhancement ("RME") programs. RESA St. No. 2, pp. 33-34. Revenues collected under RESA's proposed PTC Adder would be applied first to pay any verifiable costs incurred to provide default service that have not otherwise been collected by PECO under the GSA and then to pay RME program costs, with any remaining balance refunded to all PECO distribution customers. *Id.* As an incentive to continue retail market development, RESA recommends allowing PECO to retain up to ten percent of this balance if it satisfies benchmarks for increased migration of default service customers to EGSs. RESA St. No. 2, pp. 34-35. RESA, however, does not quantify the level of migration required to trigger that sharing mechanism. The Commission should reject RESA's proposal for several reasons.

First, RESA witness Kallaher provided no support for his assertions that PECO is at risk of failing to recover all costs associated with providing default service or that such costs are not properly allocated to default service customers. The costs allegedly at risk of not being collected include unforeseen fluctuations in uncollectible costs for default service and costs arising from wholesale supplier default. RESA St. No. 2, p. 33. Mr. Kallaher identified these costs, but submitted no cost data and did not indicate whether such costs have ever been incurred by PECO or not recovered under the GSA. Rather, Mr. Kallaher simply listed certain hypothetical expenses that may not have been charged to default service customers to date. Such hypothetical expenses cannot form the basis for cost recovery. *See, e.g., Barasch v. Pa. P.U.C.*, 493 A.2d

653, 655 (Pa. 1985) (holding that the Commission may not include hypothetical expenses, not actually incurred, in rates). RESA's assertion that the PTC Adder is necessary to reallocate other costs paid by distribution customers to default service customers (e.g., the costs of PECO's call center, see RESA St. No. 2-SR, p. 24), is also unsupported, as Mr. Kallaher provides no basis to change the Commission's determination of distribution charges approved by the Commission in PECO's most recent base rate proceeding.²³

Second, the amount of the PTC Adder – \$0.005 per kWh – does not align in any way with the administrative costs of providing default service or PECO's proposed RME programs. Mr. Cohn testified that the PTC Adder would collect, on average, approximately \$50 million **per year** from residential default service customers. PECO St. No. 5-R, p. 12. As shown on PECO Ex. ABC-4R, the **total** estimated cost to implement DSP II and PECO's proposed RME programs is \$4.5 million and \$5.2 million, respectively, and PECO will be recovering the administrative costs to implement DSP II from default service customers through the GSA. Accordingly, the revenue generated from RESA's proposed PTC Adder would far exceed the costs it purported to recover. Such a large and artificial increase in the PTC would send inaccurate price signals to customers and could lead to an increase in prices that EGSs offer. PECO St. No. 5-R, p. 12.

Finally, Mr. Kallaher's recommended disbursement of any excess proceeds from the PTC Adder is inequitable and violates the Commission's policy against cross-subsidization. Although the PTC Adder will apply only to default service customers under RESA's proposal, any remaining balance after payment of RME program costs and "uncollected" default service costs

²³ See *Pa. Pub. Util. Comm'n v. PECO Energy Co. – Electric Division*, Docket No. R-2010-2161575, 2010 WL 5651175 (Pa. P.U.C. Dec. 21, 2010), pp. 30-31.

would be refunded to a much larger, different group of customers – distribution customers, including those shopping with an EGS. PECO St. No. 5-R, p. 12. Thus, the PTC Adder would result in cross-subsidization of PECO’s shopping customers by its default service customers contrary to the Commission’s policy. *See Pa. P.U.C. v. Total Envtl. Solutions, Inc.*, 103 Pa. P.U.C. 110, 159-160, 2008 WL 4145507, at **37-38 (Pa. P.U.C. Jul. 30, 2008) (adopting the ALJ’s recommendation to provide for an across-the-board rate increase to all three of a water/wastewater utility’s customer classes to avoid cross-subsidization of availability customers by consumption customers).

In his rebuttal testimony, Dominion witness Barkas suggests that RESA’s proposed PTC Adder is appropriate for PECO on the ground that it is necessary to overcome the “substantial and persistent” bias that results from all customers starting on default service. Dominion St. No. 1-R, p. 10. Mr. Barkas, however, has not provided any support for his belief that such bias, if any, is likely to be overcome as a result of imposition of the PTC Adder. To the contrary, PECO has experienced a significant level of shopping in each of its rate classes following the expiration of rate caps on January 1, 2011, without any artificial price increase. PECO St. No. 5-SR, p. 3.

In light of the foregoing, the end-result of the PTC Adder is artificial inflation of the PTC with corresponding inaccurate price signals and cross-subsidization of PECO’s shopping customers by default service customers. Accordingly, the PTC Adder proposed by RESA and supported by Dominion should be rejected.

IV. RETAIL MARKET ENHANCEMENTS

A. Summary Of PECO’s Position

During DSP I, PECO undertook a variety of retail market enhancements to promote retail shopping, including implementation of a comprehensive EGS purchase of receivables program,

extensive information technology and internet-based upgrades for both EGSs and customers, and a variety of outreach programs to educate customers about shopping and increase the number of customers who release usage information and other data on PECO's eligible customer list for EGSs. PECO St. No. 1, pp. 6-7. PECO is also an active participant in the Commission's Retail Market Investigation, and anticipates undertaking additional initiatives to support and enhance retail competition as that investigation proceeds. PECO St. No. 2, p. 22.

Consistent with its commitment to retail competition and the Commission's initial guidance for upcoming default service plans, PECO's DSP II Petition included a number of additional retail market enhancements, including an Opt-In EGS Offer Program and a Standard Offer customer referral program. Following the Commission's issuance of the *Intermediate Work Plan Order* on March 2, 2012, PECO filed supplemental testimony in this proceeding to address the Commission's final recommendations for the Opt-In EGS Offer and Standard Offer programs. *See generally* PECO St. No. 1-S and 2-S. For the reasons set forth herein, the retail market enhancements proposed by PECO, as revised by its supplemental testimony, should be approved without modification.

B. EGS Opt-In Competitive Offer Program

Under PECO's proposed Opt-In Program, EGSs would bid in response to a one-time request for proposals ("RFP"), conducted during the first quarter of 2013, to provide competitive retail service to up to 50% of PECO's residential default service customers at a fixed-price that is at least 5% below the applicable PTC for the quarterly period beginning June 1, 2013. PECO St. Nos. 2, pp. 23-24 & 2-S, p. 3. The EGS offer to customers will include a \$50 bonus payment which shall be paid by the EGS after offer acceptance and the customer's completion of three complete billing cycles with the selected EGS. PECO St. No. 2-S, p. 3.

In its Retail Market Investigation, the Commission recommended that EDCs conduct the Opt-In auction prior to customer enrollment on the grounds that enrollment before the product price is known will create customer confusion and could lead to a “worst-case” scenario where customers have enrolled but an insufficient number of EGSs then subscribe to the auction. *See Intermediate Work Plan Order*, p. 55. In accordance with this recommendation, PECO’s Opt-In Program RFP will be conducted before customer enrollment to ensure that customers know the price of the product being offered. PECO St. No 2-R, p. 13.²⁴

The bidding process will be supervised by an independent monitor who will tabulate bids in ascending order, with the price associated with the bid that results in the cumulative number of customers equaling or exceeding 100% of PECO’s non-shopping customers (excluding Customer Assistance Program (“CAP”) customers) establishing a final clearing price. PECO St. No. 2, p. 23 & PECO Ex. JJM-4S, ¶¶ 1.4 & 5.1. Upon approval of the RFP results by the Commission, one or more tranches of eligible customers will be randomly allocated to winning bidders (each an “Opt-In Supplier”) in accordance with the number of customers contained in their respective winning bids, and customers will be notified of the winning offer. Opt-In Suppliers will provide service to those customers who accept the offer for a term of six monthly billing cycles beginning with the customer’s next meter read date on or after June 1, 2013. PECO Ex. JJM-4S, ¶ 4.3. In addition, Opt-In Suppliers will be required to accept shopping customers who contact PECO to request an opt-in offer. PECO St. No. 2-S, p. 3.

²⁴ RESA seeks to reverse the proposed sequence of the Opt-In Program’s auction process relative to the customer enrollment period so that EGSs will know the total number of participating customers when they submit bids. According to RESA, in light of what it characterizes as “relatively low” shopping levels for residential customers in PECO’s service territory, adopting the structure proposed by PECO and recommended by the Commission would tend to decrease EGS participation and make EGSs more conservative in a price-only bid, which could negatively influence the success of the Opt-In Program. RESA St. Nos. 2, pp. 14-16 & 2-SR, p. 4. In the *Intermediate Work Plan Order*, however, the Commission acknowledged RESA’s concern regarding EGS uncertainty that may arise from holding the auction first but nonetheless rejected RESA’s arguments. *See id.*, p. 55.

Opt-In Suppliers will provide offers to their allocated customers through an offer package mailed by PECO on behalf of the EGS, which includes an offer letter with the clearing price, a description of the Opt-In Program's standard terms and conditions and the procedure by which the customer can accept the offer during the thirty-day opt-in period. PECO St. 2, p. 23; PECO Ex. JJM-4S, ¶ 6.3; Tr. 62-64. Customers who accept the offer by response postcard, through the Opt-In Supplier's website or by telephone will be enrolled by the Opt-In Supplier via a switching request and Electronic Data Interchange transaction in accordance with PECO's current Electric Supplier Coordination Tariff ("Supplier Tariff") and Electric Data Exchange Working Group protocols. *Id.*

The Commission's guidelines recommend that customers be able to exit a retail opt-in program at any time without paying a termination or cancellation fee. *Intermediate Work Plan Order*, p. 50. PECO's Opt-In Program conforms to this guideline. At any time during the six-month term of retail opt-in service, a participating customer may leave the Opt-In Program either by converting to another product from the Opt-In Supplier without switching, contracting with a different EGS or electing to return to default service. PECO St. No. 2, p. 24. Under those circumstances, the Opt-In Supplier will not be permitted to charge the customer an early termination fee or other penalties. *Id.*

Prior to the end of the program term, the Opt-In Supplier must provide the notices required by the Commission's regulations, PECO's Supplier Tariff and the "options" notices required under the *Intermediate Work Plan Order*. After receiving the required notices, the customer may choose to continue with its Opt-In Supplier. If the customer takes no action, the customer will remain on a month-to-month contract with his or her then-current EGS. In either

case, the obligations of the Opt-In Supplier to offer the clearing price and comply with other terms of the program will no longer apply. *See* PECO St. Nos. 2, p. 24 & 2-R, p. 19.

PECO's Opt-In Program is consistent with the Commission's guidelines for opt-in auction programs as set forth in the *Intermediate Work Plan Order*. Nonetheless, the OCA, RESA and FES proposed revisions to PECO's proposed Opt-In Program. In the following subsections, PECO addresses the competing objectives raised by those parties, which were all previously considered by the Commission, regarding the design and implementation of the Opt-In Program and explains why the parties' proposed revisions should be rejected.

1. Customer Eligibility

The only party to object to PECO's proposed eligibility rules for the Opt-In Program was RESA, which asserted that small business customers (i.e., those with loads of up to 25 kW) should also be allowed to participate. RESA St. No. 2, pp. 19-20. RESA's recommendation should not be adopted for two reasons. First, the small commercial customers that RESA proposes to include is far less homogenous than PECO's residential customer base because they are served under different tariff rates, each with different line loss factors. PECO St. No. 2-R, pp. 15-16. Consequently, extending the Opt-In Program to these customers would add complexity because different offers with different prices would have to be designed, solicited and marketed to different subsets of customers. *Id.*

Second, RESA witness Kallaher's contention that extending eligibility to a discrete subset of the Small Commercial Class is a justified departure from the Commission's guidance because small business customer shopping levels are allegedly only "slightly higher" than the level of residential customer shopping (RESA St. No. 2-SR, p. 7) is simply wrong. Contrary to Mr. Kallaher's assertion, shopping among small business customers is significantly higher than

that of residential customers in PECO's service territory – 39% versus 25%. *See* PECO St. No. 2-R, p. 16; RESA Ex. CHK-2, pp. 1-2 (PECO Responses to RESA-I-4 and RESA-I-5). In addition, the Commission considered and rejected Mr. Kallaher's rationale relating to improving small business shopping levels in concluding that opt-in programs should not include small commercial customers at this time. *See Intermediate Work Plan Order*, p. 42.

RESA also proposes to preclude customers who are already shopping from participating in the Opt-In Program on the ground that EGSs should not face the risk of losing market share as a result of the Opt-In Program. RESA St. Nos. 2, pp. 18-19 & 2-SR, p. 13. Mr. McCawley explained that PECO's marketing and customer education efforts would be targeted at non-shopping, non-CAP residential customers, but all residential customers would be eligible to participate in the Opt-In Program in accordance with the Commission's guideline in the *Intermediate Work Plan Order* (p. 42). PECO St. No. 2-R, p. 15. Notably, the Commission specifically recognized that the intent of retail opt-in programs is to encourage shopping by default service customers instead of customers who are already shopping, as suggested by RESA, before issuing its guidance that opt-in programs should be open to all residential customers. *See Intermediate Work Plan Order*, p. 42.

2. Composition of Product Offer

PECO initially proposed a twelve-month contract term for service under the Opt-In Program. In the *Intermediate Work Plan Order* (p. 50), however, the Commission recommended a term of six billing cycles. In response, PECO revised its Opt-In Program term to conform to the Commission's guideline.

The OCA (OCA Sts. 1, p. 13 & 2, p. 11) and FES (FES St. No. 1, pp. 7-8) both recommend a term of twelve months for the Opt-In Program.²⁵ The Commission previously considered and rejected a twelve-month term requirement on the grounds that a shorter-term opt-in auction product would minimize the risk of market unpredictability, may reduce risk premiums that suppliers incorporate into their prices, and might entice more suppliers to participate. *Intermediate Work Plan Order*, p. 50. PECO's proposed contract length is consistent with that guidance. PECO St. No. 2-R, p. 13.

With respect to price, the Commission considered proposals for both a product with a fixed price over the term of the retail opt-program, like the one PECO proposed, and a "percentage off" product, and it recommended a fixed-price product. *Intermediate Work Plan Order*, p. 70. The OCA was the sole party to oppose PECO's proposed fixed-price product and instead advocated for a product with a guaranteed savings off the PTC. OCA St. No. 2, p. 11.

Although PECO believes a guaranteed savings approach offers advantages and disadvantages, the OCA's recommendation is inconsistent with the Commission's guidelines. PECO St. No. 2-R, p. 14. For its part, the Commission balanced the attractiveness of a guaranteed savings price for customers with the difficulty of predicting market prices for EGSs before concluding that the fixed-price product is the "most reasonable monthly pricing option." *Intermediate Work Plan Order*, p. 70. Accordingly, PECO incorporated a fixed-price product into its proposed Opt-In Program.

²⁵ In rebuttal testimony, RESA noted that it is open to a 12-month contract term for the Opt-In Program product. RESA St. No. 2-R, p. 6. In addition, Mr. Barkas testified that Dominion could accept a twelve-month product. Dominion St. No. 1-R, pp. 7-8.

Consistent with the Commission's guidance in the *Intermediate Work Plan Order* (p. 69), the Opt-In Program also requires each Opt-In Supplier to mail a \$50 bonus check to customers within five days after the customer completes three full billing cycles on the program. PECO St. No. 2-S, p. 3; PECO Ex. JJM-4S, ¶ 7.5. No party opposed the inclusion of a mandatory bonus payment in the opt-in offer.

3. Customer Participation Cap

The Commission has recommended limiting participation in opt-in programs to 50% of an EDC's residential default service customer base. *Intermediate Work Plan Order*, pp. 59-60. PECO has proposed limiting the number of customers each Opt-In Supplier can enroll to 50% of the customers allocated to that EGS during the RFP process consistent with the Commission's directive. PECO St. No. 2-R, pp. 16-17; Tr. 55-56. PECO's proposed 50% customer participation cap is affirmatively supported by RESA (RESA St. No. 2-SR, p. 5) and Dominion (Dominion St. No. 1-SR, p. 4). The OCA was the only party that opposed the 50% customer participation cap and, instead, favors a 20% cap. OCA St. No. 2, p. 10. PECO is amenable to either a 20% or 50% customer participation cap and therefore does not object to lowering the customer participation cap as proposed by the OCA. PECO St. No. 2-R, p. 17. However, PECO does not agree with Ms. Alexander's contentions that a 50% cap carries significant risks or could lead to the program being publicly viewed as a failure. *Id.*

In addition, the OCA's concern regarding the enforcement of the customer participation cap is misplaced. Although the OCA opposes PECO's proposal to have the Opt-In Suppliers implement the customer participation cap by limiting enrollments (OCA St. No. 2, p. 11), it does not offer an alternative implementation strategy. PECO St. No. 2-R, p. 17. EGS implementation

of the cap, with Commission oversight, is the most cost-effective mechanism for enforcing the customer participation cap for the Opt-In Program and should be approved without modification.

4. Supplier Participation Load Cap

The Commission also recommended that no EGS should be able to serve more than 50% of the participating customers in retail opt-in programs after balancing the need for supplier diversity with obtaining the lowest price possible to customers. *Intermediate Work Plan Final Order*, p. 63. Consistent with the Commission's guidelines, under PECO's proposed Opt-In Program, no EGS would be able to win more than 50% of the available tranches in the RFP process. PECO 2-R, p. 18; Tr. 57-58. In light of the competing factors balanced by the Commission, PECO submits that the supplier participation cap should be no lower than 50%, but could be conducted with a higher cap or no cap at all. *Id.* Therefore, PECO does not oppose FES' proposal (FES St. No. 1, pp. 11-13) to eliminate the supplier participation cap from the Opt-In Program.

RESA recommends that the Opt-In Program include a requirement of at least four winning bidders on the ground that this requirement would "help EGSs that otherwise might not be able to participate in the market to do so" and thereby provide winning bidders "a critical mass of customers in a service territory." RESA St. No. 2-SR, p. 14. RESA's recommendation should not be adopted for two reasons. First, RESA has not provided any evidence that a four-bidder minimum would increase supplier participation in the one-time Opt-In Program RFP. Second, a good outcome for customers can be obtained even if fewer than four bidders participate in the Opt-In RFP. As Mr. McCawley testified, the 50% supplier participation cap will require a minimum of two winning suppliers and the price will be at least 5% below the applicable PECO PTC. PECO St. No. 2-R, p. 18.

5. Customer Options on Product Expiration and Notice Requirements

The only party opposing PECO's proposed customer options upon expiration of their opt-in contract and the notices they will be provided was the OCA, which proposed an additional ninety-day notice from the EDC to customers. OCA St. No. 2, pp. 12-13. The OCA's proposal for another notice is unwarranted because PECO's Opt-In Program already contains sufficient customer protections. EGSs participating in PECO's program must comply with the Commission's renewal notice guidelines. PECO St. No. 2-R, p. 19. In accordance with these guidelines, each customer will receive an initial notice fifty-two to ninety days before the end of the program, followed by a more detailed "options notice" at least forty-five days before the program ends. *Intermediate Work Plan Order*, pp. 73-75. The options notice will provide any new terms and conditions, pricing, other options being offered to the customer by the EGS at the end of the opt-in contract and a date by which the customer must take action to accept the offer. PECO St. No. 2-R, p. 19. If the customer does not take action, the customer will remain on a month-to-month contract with his or her then-current EGS without any termination penalties or fees. *Id.*

In addition, the OCA's proposed modification should be rejected because of operational constraints. PECO will not know whether a participating customer subsequently enrolled with the EGS on terms that are different from the original Opt-In Offer; if the customer did so, OCA's proposed notice would be confusing. PECO St. No. 2-R, p. 19. Moreover, as the Commission discussed in its guidance on retail opt-in programs, a customer affirmatively selects its EGS in the opt-in process and there is no reason for treating such a customer differently from any other customer whose contract with an EGS is about to expire. *Intermediate Work Plan Order*, pp. 73-

75. This affirmative action by the customer renders an additional “options” notice unnecessary. PECO St. No. 2-R, p. 19.

Ms. Alexander also proposes that, at the end of the Opt-In service period, EGSs be required to serve customers on a fixed price month-to-month contract. OCA St. No. 2, p. 14. As previously explained, PECO’s Opt-In Program contains significant consumer protections and customer communications. Given these protections and communications, the OCA has failed to demonstrate that requiring EGSs to offer a fixed-price to all customers who do not make an affirmative election at the end of the opt-in service period is warranted. PECO St. No. 2-R, p. 20.

6. Structure of the Retail Opt-In Auction – Sealed Bid Format Versus Descending Price Clock Auction

PECO proposes to conduct the Retail Opt-In Auction using a sealed-bid RFP process similar to the one used to procure default service supply. The only party opposing this competitive bidding format was FES, which asserts that a descending price clock auction (“DCA”) will result in lower prices for participating customers, by allowing participating suppliers to see indicative price information and adjust their bids accordingly in real time. FES St. No. 1, pp. 4, 14. FES witness Banks also claimed, without justification, that the DCA promotes supplier diversity.²⁶ FES St. No. 1, p. 16. FES’ proposal to employ the DCA for PECO’s one-time Opt-In Program should not be adopted for several reasons.

²⁶ The example that Mr. Banks provides does not illustrate that a DCA promotes supplier diversity. This example simply illustrates that an EGS that was a losing bidder could have been a winning bidder by bidding lower. However, as Dr. LaCasse testified, the former losing bidder will simply replace another bidder’s bid in the winning stack rather than become an additional winning bidder. Tr. 89.

Mr. Banks' sweeping conclusion that the DCA will result in a lower price than a sealed-bid RFP is not supported. As PECO witness LaCasse testified, auction literature does not offer simple answers as to which auction format yields the best price, much less conclude that a DCA will always produce a lower price for opt-in auctions. PECO St. No. 4-R, p. 6; Tr. 86. In addition, Mr. Banks does not explain why an EGS participating in a sealed-bid process, knowing full well that it has a single opportunity to submit a bid, would not be inclined to submit its best offer initially. PECO St. No. 4-R, p. 6; Tr. 88.

More importantly, DCAs are best suited for situations that are not applicable to PECO's Opt-In Program. First, in cases with multiple products that are substitutes, the DCA's multiple round format allows bidders to adjust their offers across products in response to relative prices, helping to achieve an efficient allocation of supply responsibilities. PECO St. No. 4-R, p. 6. However, PECO will procure only one product for the Opt-In Program. Second, DCAs are well suited to situations where bidder valuations may be uncertain because a DCA would typically feature a high starting price to attract bidder interest and then would provide indicative price information from round-to-round. PECO St. No. 4-R, p. 7; Tr. 87. By contrast, the starting price for the Opt-In Program is certain and will not be high. *Id.* Thus, the DCA is unlikely to result in multiple rounds that would inform bidders' valuations. In fact, as Dr. LaCasse testified, if there is just enough supplier interest (or if interest is short of the tranches available), the DCA would close at 5% less than the prevailing PTC, while a sealed-bid process would be expected to yield a better result because bidders would not know the level of supplier interest at the time of bid submission. *Id.*

The Commission did not prescribe an auction structure for opt-in programs, but rather observed that either a sealed bid process or a DCA would work well to provide a single clearing

price. *See Intermediate Work Plan Order at 77.* PECO selected the sealed bid format because it will be less complex and less expensive to implement, and because PECO has existing procedures in place to enable it to conduct a sealed bid RFP process and has successfully used this process in a number of procurements. PECO St. Nos. 2-R, p. 14 & 4-R, p. 7; Tr. 90. Therefore, the Commission should approve PECO's use of a sealed-bid RFP for the Opt-In Program.

7. PECO's Proposed Application Process and EGS Terms and Conditions

Under PECO's proposed Opt-In Program, participating EGSs must first qualify to bid by submitting an application to PECO demonstrating that it has a current EGS license issued by the Commission, the ability to comply with PECO's Supplier Tariff, and the financial resources to make a \$50.00 bonus payment to all customers who enroll and remain with the program for three complete billing cycles. PECO Ex. JJM-4S, ¶¶ 1.3 & 3.2; Tr. 60-61. In addition, qualifying bidders would be required to execute an Opt-In Supplier Agreement in the form set forth in PECO Exhibit JJM-4S in which they would commit to offer standard terms and conditions and comply with the RFP provisions. Ex. JJM-4S, Art. 7; Tr. 64-66. No party has objected to the qualifications set forth in the form application or the standard terms and conditions provided in the form agreement submitted by PECO. Accordingly, the form of Bidder Application and Opt-In Supplier Agreement should be approved for use in the Opt-In Program.

C. EGS Standard Offer Program

Under its original proposed EGS Standard Offer Program, PECO would have conducted a monthly solicitation to select the lowest 12-month fixed-price offer from EGSs that agreed to participate in the program. PECO St. No. 2, pp. 26-27. PECO would then feature the winning

EGS as the “Supplier of the Month” on its website, which would be updated monthly. *Id.* Residential customers, excluding CAP customers, could enroll with the EGS through the PECO website or by telephone. *Id.*

In its *Intermediate Work Plan Order* issued after the filing of PECO’s Petition, the Commission set forth its recommendations for Standard Offer programs which are summarized below. The standard offer should be provided for a minimum of four months, but should not exceed one-year and must be comprised of a 7% reduction from the EDC’s effective PTC at the time of the offer. *Intermediate Work Plan Order*, p. 31. Although the standard offer will target and market residential default service customers, residential shopping customers will not be excluded if they specifically request to participate. *Id.* Customers may choose to be assigned to an EGS of their choice or may choose a random assignment. *Id.* The Standard Offer Customer Referral Program should be presented during customer contacts to the EDC call centers, other than calls for emergencies, terminations and the like. *See id.*, p. 32. At the time of the first contact between the EGS and the customer, the customer will be reminded of the terms and conditions of the standard offer, including the date by which the customer must take action to exercise his or her options at the end of the term. *Id.* At the conclusion of the standard offer period, absent affirmative customer action to enter into a new contract with the EGS, the customer’s enrollment with a different EGS or the customer’s return to default service, the customer will remain with the EGS on a month-to-month basis, and shall not be subject to any termination penalty or fee. *Id.*

In light of the Commission’s directives in the *Intermediate Work Plan Order*, PECO replaced the “Supplier of the Month” program with a program consistent with the Commission’s guidelines in which customers may select a participating EGS of their choice or be randomly

assigned to one. PECO St. No. 2-S, pp. 5-6. Several parties have recommended revisions to PECO's proposed Standard Offer Program, and these proposed revisions and other issues are discussed, in turn, below.

1. Customer Eligibility

As recommended by the Commission, PECO's Standard Offer Program will target residential default service customers, but will be open to shopping customers as well. CAP customers, however, will be excluded. The only party to propose a change in customer eligibility is RESA, whose proposal to permit CAP customers to participate is addressed in Section IV.D *infra*.

2. Composition of Product Offer

Consistent with the Commission's guidance, EGSs participating in the Standard Offer Program will be required to offer generation service on a month-by-month basis for twelve complete billing cycles at a fixed price of 7% below the PTC at the time of customer enrollment. *Id.* Like the Opt-In Program, at any time during the twelve-month term, a participating customer may select a different offer from the Standard Offer Supplier without switching, switch to a different EGS or elect to return to default service. PECO St. No. 2, p. 27. Under those circumstances, the Standard Offer Supplier would not be permitted to charge the customer an early termination fee or other penalties. *Id.*

Two parties – the OCA and RESA – seek changes in PECO's Standard Offer product. The OCA proposes that the product term be four months in order to avoid the risk that a twelve-month contract could end up costing participating customers more than if they had remained on default service. OCA St. No. 1, p. 16. Even assuming the pricing suggested by the OCA, its concern is unwarranted; under PECO's Standard Offer Program, a customer who concludes that

the default service rate will be less expensive than the rate obtained through the Standard Offer Program is free to return to default service. *See* PECO St. 2-S & Ex. JJM-5S, ¶ 5.3.

While RESA supports a twelve-month term as proposed by PECO, RESA contends that the Commission intended the Standard Offer Program discount to last for only four months. RESA St. No. 2, p. 25. However, the Commission's guidance plainly provides that the discount is not limited to a four month period. *See Intermediate Work Plan Order*, p. 31 (explaining that the "standard offer" is a 7% reduction from the PTC, and "[t]he standard offer should be provided for a minimum of four months, but should not exceed 1 year.").

3. Customer Options Upon Product Expiration

At the time of first contact between a Standard Offer Supplier and a customer, the customer will be reminded of the terms and conditions of the Standard Offer, including the date by which the customer must take action to exercise his or her options at the end of the term. PECO St. No. 2-S, p. 6. At the end of the program term, the Standard Offer Supplier must provide the notices required by the Commission's regulations at 52 Pa. Code § 54.5(g)(1) and PECO's Supplier Tariff. PECO St. No. 2, p. 28. Similar to the Opt-In Program, and consistent with the Commission's guidance, if a customer does not affirmatively choose to receive service from a different EGS or elect default service after receiving the required notices, the customer will remain with the Standard Offer Supplier on a month-to-month contract. PECO St. No. 2-R, p. 21; *Intermediate Work Plan Order*, p. 21.

The OCA has proposed that customers should not be retained absent an affirmative agreement to be served by the EGS at the end of the Standard Offer Program term. OCA St. 1, p. 17. Under PECO's Standard Offer program, however, a customer will have chosen to enroll in the program and have been served for nearly a year, during which time the customer remained

free to return to default service or select another EGS. In these circumstances, there is no reason to treat these customers differently than other shopping customers. Accordingly, consistent with the Commission's determination in the *Intermediate Work Plan Order*, the OCA's proposal should be rejected.

4. Types of Customer Calls Eligible for Presentation of Referral Program

Under the Commission's guidance, the Standard Offer should be presented during customer contacts to the EDC call centers, "other than calls for emergencies, terminations and the like," including high bill calls after customer concerns are satisfied. *Intermediate Work Plan Order*, p. 31. The OCA, however, has proposed that calls eligible for referral be limited only to those from new and moving customers, or in which a customer specifically requests an explanation of the Standard Offer Program. OCA St. No. 1, p. 16. PECO does not agree with the limitation proposed by the OCA, but acknowledges that the Commission's list of calls in which the Standard Offer Program should not be presented is not exhaustive. For example, , calls related to outages are not an appropriate forum for presentation of the Standard Offer Program. PECO St. No. 2-R, p. 22.

5. Commencement Date of the EGS Standard Offer Program

Under PECO's proposal, the Standard Offer Program would not commence until the Opt-In Program is completed. PECO believes that a month between completion of Opt-In enrollment and the beginning of the Standard Offer Program is sufficient. PECO St. No. 2-R, p. 21 (noting that further delay could frustrate planning and synergies associated with implementation of retail market enhancements). While the OCA recommends that the Standard Offer Program generally be delayed until after an unspecified additional evaluation of the Opt-In Program and other retail marketing activities and a showing of a "documented need" for the program, the OCA failed to

present any specific evidence to support such a delay, which is plainly inconsistent with the Commission's directives in the *Intermediate Work Plan Order* to offer such a program. Moreover, PECO must have a date certain on which a new program is to start in order to plan, design and implement the necessary changes to its systems and business practices.

6. PECO's Proposed Application Process and EGS Terms and Conditions

Under PECO's Standard Offer program, an EGS seeking to be a Standard Offer Supplier must first submit a Standard Offer Supplier Application which sets forth minimum qualifications, including a current EGS license issued by the Commission and the ability to comply with PECO's Supplier Tariff. *See* PECO Ex. JJM-5S, Exhibit 1. As part of the qualifying process, an EGS will be required to enter into a Standard Offer Supplier Agreement (Attachment A to Exhibit 1). No party has objected to the terms and conditions set forth in the Standard Offer Supplier Application and Standard Offer Supplier Agreement. Accordingly, those documents should be approved for use in the Standard Offer Program.

D. Participation By Low Income Customers In Proposed Retail Market Enhancements

In its *Intermediate Work Plan Order*, the Commission concluded that the eligibility of CAP customers to participate in retail opt-in programs should be determined in each EDC's default service proceeding, and permitted only if those customers "should not be subject to harm, i.e., loss of benefits." *Intermediate Work Plan Order*, p. 43. At the same time, the Commission determined that CAP customers should **not** be allowed to participate in customer referral programs until further review of the issue could be conducted and referred the issue to the Universal Service subgroup of the Office of Competitive Market Oversight ("OCMO") to examine "the needs and interests of low-income customers as we move to a more robust

competitive market.” *Intermediate Work Plan Order*, pp. 17 & 31. Consistent with these guidelines, PECO proposes, at this time, to exclude CAP customers from participating in both the Opt-In Program and Standard Offer Program.

Both RESA and Dominion object to PECO’s proposed CAP exclusion. RESA asserts that CAP customers should be included in the Opt-In Program and the Standard Offer Program because, in its view, those customers could be adequately protected by making their CAP benefits “portable”. RESA St. Nos. 2, p. 21 & 2-R, p. 15. Dominion, in turn, contends that it is “incongruent” from a policy perspective to move toward full competition while excluding some customers from participation. Dominion St. 1-R, p. 5.

As PECO witness Feldhake explained in her testimony, complex unresolved issues remain with respect to CAP portability. These issues include (1) how to protect CAP customers from commodity volatility; (2) how to seamlessly integrate the Low Income Home Energy Assistance Program and CAP portability; (3) the need to allow PECO’s recent CAP tier changes and in-program arrearage forgiveness programs time to mature before making other major changes to its CAP program; (4) integration with PECO’s Rate RH phase-out; and (5) how to implement a discount on the customer’s bill, especially given that the discount would, in many cases, be larger than the customer’s distribution charges. In addition, the risk of higher costs for all customers associated with greater uncollectible expense needs to be considered and addressed. PECO St. 6-R, pp. 5-6. In light of these unresolved issues, the Commission, PECO, and other parties will be able to make a better determination of whether CAP customer participation in the Opt-In Program can be accomplished without subjecting those customers to harm after the completion of the OCMO Universal Service subgroup’s analysis. PECO Sts. 2-R, p. 16 & 6-R, p. 7. Dominion’s concern regarding CAP customers’ role in a robust competitive

market will also be addressed more effectively after the OCMO review of the provision of universal service within default service. PECO St. 6-SR, p. 5.

RESA asserts that CAP customers would not be harmed by participating in the Opt-In Program or Referral Program because they will continue to receive their “subsidy from the programs administered by PECO.” That contention, however, was based in part on Mr. Kallaher’s erroneous assumption that PECO uses a “percentage of income” methodology for determining CAP discounts.²⁷ As Ms. Feldhake testified, PECO, unlike many other Pennsylvania EDCs that use a “percentage of income” approach, employs seven income-defined tiers to determine CAP discounts. And, notably, RESA fails to explain how a portable subsidy would be implemented to mitigate the risks of harm to CAP customers arising from the potential for increases in commodity charges and increased uncollectible expense. PECO Sts. 6-R, p. 7-8 & 6-SR, p. 4. Accordingly, the Commission should adopt PECO’s proposal to await the work of the Universal Services subgroup before including CAP customers in the Opt-In Program and other referral programs.

CAUSE-PA agrees with PECO’s proposal to exclude CAP customers from the Opt-In and Standard Offer Programs. However, CAUSE-PA would expand this exclusion to certain non-CAP, confirmed low-income customers. CAUSE-PA St. 1, pp. 20-22. Specifically, Mr. Bertocci recommended that PECO screen low-income customers for CAP eligibility and inform them of the program prior to enrollment in the Opt-In Program. Mr. Bertocci also proposed that

²⁷ On May 21, 2012, RESA filed an errata sheet to correct this error in Mr. Kallaher’s rebuttal testimony and deleted statements that PECO’s CAP customers will continue to pay a percentage of their income under RESA’s proposal for CAP portability. *See* RESA Errata Sheet, ¶¶ 1 & 4. PECO appreciates that Mr. Kallaher now correctly understands that PECO uses a tiered CAP program, not a percentage of income program. But altering his testimony to reflect his awareness of PECO’s actual program structure does not resolve the complex issues associated with CAP customers that should be addressed in detail in the Universal Service subgroup review, consistent with the Commission’s guidance.

confirmed low-income customers who call PECO with “high bill” complaints be informed of CAP and enrolled, if eligible, prior to their inclusion in the Standard Offer Program. CAUSE-PA Sts. 1, p. 20 & 1-SR, p. 2.

Mr. Bertocci’s proposal for additional screening of non-CAP, verified low-income households is unwarranted. As Ms. Feldhake explained, PECO’s non-CAP, verified low income customer population is limited (only approximately 4,700 customers) and PECO already has performed regular outreach to those customers, which has resulted in actual contact with approximately 25% of those customers. In PECO’s experience, an even smaller subset of the customers contacted through targeted outreach are likely to elect the CAP Rate. As such, Mr. Bertocci’s proposed screening process would not materially increase the number of customers on CAP, but would create additional costs for PECO and the potential for customer confusion. PECO St. 6-R, pp. 10-11.²⁸ Mr. Bertocci’s screening proposal is also unnecessary because PECO already seeks to address high bill complaints through the avenues proposed by Mr. Bertocci, including enrollment in CAP and referral to other available low-income programs. *See id.*, pp. 12-13. Accordingly, CAUSE-PA’s proposal should not be adopted.

E. Additional Proposed Retail Market Enhancements

1. Time-Of-Use Offering

Consistent with the *Default Service Recommendations Order* (pp. 47-48), PECO supports EGS participation in its TOU program.²⁹ PECO St. No. 1, p. 18. In fact, PECO has already conducted an auction and selected vendors to provide TOU commodity service and to implement

²⁸ Mr. Bertocci conceded that the logistics for screening low-income customers prior to eligibility for the Opt-In Program may be difficult. CAUSE-PA St. No. 1-SR, p. 3.

²⁹ *See Petition of PECO Energy Co. for Approval of its Initial Dynamic Pricing and Customer Acceptance Plan*, 2011 WL 2113416, 289 P.U.R. 4th 193 (2011) (“*Dynamic Pricing Order*”).

and administer PECO's TOU pilot.³⁰ PECO St. No. 5-R, p. 10. On April 2, 2012, PECO filed a petition seeking expedited approval of, *inter alia*, the selected vendors as part of its smart meter program.³¹ *Id.*

RESA witness Kallaher agrees that soliciting EGS participation to provide the commodity service associated with PECO's TOU pilot is reasonable. RESA St. No. 2, p. 30. Nevertheless, Mr. Kallaher proposes that PECO satisfy its TOU obligation by certifying that one or more EGSs have agreed to offer a TOU rate and submit an annual report to the Commission on the number of EGSs actually providing TOU service rather than conducting an auction. RESA St. No. 2, pp. 31-32. Mr. Kallaher's proposal should not be adopted because PECO has already conducted the auction and the results are under Commission review and rulings in two separate proceedings could cause confusion or inconsistent recommendations regarding the same program. PECO St. No. 5-R, p. 10.

Mr. Kallaher's contention that the design of PECO's TOU pilot should be addressed in this proceeding also should be rejected. As noted previously, the Commission is already reviewing PECO's proposed Dynamic Pricing Plan Supplement which includes modifications to enable an EGS to provide TOU supply, at a separate docket. PECO St. No. 5-SR, p. 3. Adopting RESA's approach will simply undermine the Commission's pending review and potentially delay the launch of PECO's TOU pilot beyond the first quarter of 2013. PECO St. No. 5-SR, p. 4.

³⁰ If the service is not provided by an EGS, PECO will provide the commodity service in accordance with the tariff approved by the Commission in the *Dynamic Pricing Order*, effective on June 1, 2012. (PECO St. No. 5, p. 20).

³¹ See *Petition of PECO Energy Co. for Expedited Approval of its Initial Dynamic Pricing Plan Vendor Selection & Dynamic Pricing Plan Supplement*, Docket No. P-2012-2297304 (filed April 2, 2012).

2. New/Moving Customer Referral Program

PECO originally proposed a New/Moving Customer Referral Program for residential customers, with revised and enhanced call center scripts promoting shopping and PAPowerSwitch.com and an updated “New/Mover” kit with expanded information on shopping, included a list of current supplier offers and contact information. PECO St. No. 2, p. 28. In the *Intermediate Work Plan Order*, the Commission directed the OCMO to establish a working group comprised of EDCs and other interested parties to develop appropriate call center scripts for residential and small business customers by the second quarter of 2012, with implementation targeted for no later than the fourth quarter of 2012. *Intermediate Work Plan Order*, pp. 18-20. PECO intends to participate in the new working group. PECO St. No. 2-S, p. 7.

RESA contends that PECO, EGSs, and other parties should “concentrate” on implementing the Opt-In Program and Standard Offer Program in lieu of the New/Moving Customer Referral program. RESA St. No. 2, pp. 26-27. In addition, Mr. Kallaher proposes that PECO build functionality now for all customers who already know the EGS they would like to take service from to enroll with that EGS through PECO without any need to transfer the customer to the EGS first. *Id.*

Implementation of Mr. Kallaher’s “switch on connect” proposal is not possible due to current operational constraints. The proposal would likely require the full deployment of advanced metering infrastructure to enable establishment of the customer’s service and simultaneously process an EGS enrollment. PECO St. No. 2-R, pp. 22-23. Mr. Kallaher has not proposed an alternative method of offering immediate EGS service, without transfer to the EGS. *Id.* Accordingly, Mr. Kallaher’s proposal should be rejected.

3. Referral of PECO Wind Customers

As the PECO Wind program is eliminated, PECO will refer current PECO Wind customers to interested EGSs that can offer these customers a “green energy” product. PECO St. Nos. 1, p. 19 & 2, p. 30. Prior to the cessation of service under the PECO Wind program, PECO will make a one-time referral mailing to PECO’s Wind Program customers. PECO St. 2-R, p. 23. This mailing, *inter alia*, would describe the customer’s option to continue to purchase green energy by shopping with a renewable EGS and list all interested EGSs along with their contact information. GMEC St. No. 1, pp. 4-5. In addition, the mailing would direct customers to visit the PA Power Switch website. *Id.*

No party provided testimony objecting to the elimination of the PECO Wind program and a number of parties support it. However, several witnesses proposed modifications to the PECO Wind referral mailing. Mr. Kallaher proposes requiring PECO to share drafts of the referral mailing with EGSs prior to distribution to PECO Wind customers. RESA St. No. 2, p. 30. On behalf of GMEC, Mr. Holtz proposes: (1) that an additional mailing made just a few weeks prior to termination of the PECO Wind Program in December 2012; (2) that PECO allow GMEC and other eligible EGSs to insert marketing materials in the mailing; and (3) that PECO identify GMEC and other eligible EGSs in the referral mailing. GMEC St. No. 1, p. 6. Mr. Spencer requests inclusion of the ChoosePAWind website as well as “any other website that offers similar renewable products” in the referral mailing. ChoosePAWind St. No. 1, p. 6.

The foregoing proposals are unnecessary because registered EGSs will have the opportunity to respond to PECO’s request for information and be identified in the referral mailing. And, while ChoosePAWind.com is not a registered supplier, any members of ChoosePAWind.com who are eligible may respond to PECO’s request. PECO St. No. 2-R, p.

23. Accepting GMEC's recommendation to allow eligible EGSs to insert materials in the mailing would be unwieldy and would increase administrative and mailing costs. *Id.* For the foregoing reasons, PECO's proposal for a one-time referral mailing to PECO Wind customers should be adopted without modification.

4. Seamless Moves

PECO proposes to initiate a collaborative with interested EGSs to develop technical requirements and cost estimates for system changes required to permit residential and commercial customers to change their address of service and maintain EGS service. PECO St. Nos. 1, p. 19 & 2, p. 30. If more than 50% of participating EGSs express sufficient interest in the program, PECO will implement the appropriate changes. *Id.* No party opposed PECO's proposed seamless moves collaborative.

F. Recovery Of Program Costs For Proposed Retail Market Enhancements

PECO proposes to recover the costs of its RME programs from the EGSs that benefit from those programs, primarily through a 0.3% discount on purchased EGS accounts receivable ("POR"). PECO Ex. ABC-4R. Several parties – the OCA, I&E and CAUSE-PA – support PECO's recommendation. OCA St. No. 2-R, pp. 12-13; I&E St. No. 1-R, pp. 5-6; CAUSE-PA St. No. 1, pp. 22-23. Certain other parties have proposed modifications or raised concerns with respect to the specific cost recovery mechanisms recommended by PECO. Such modifications and other issues are discussed, in turn, below.

1. EGS Opt-In Competitive Offer Program

PECO proposes that the cost of the Opt-In Program be recovered directly from the winning EGSs, in proportion to the number of customers allocated to each EGS. PECO St. Nos. 2, p. 25 & 5, p. 19. In the event that the RFP process does not produce any winning EGSs, the

costs of the program would be recovered by PECO through a 0.3% POR discount until such costs are fully recovered. *Id.* PECO's proposed cost recovery mechanism for the Opt-In Program is consistent with the following Commission guidance: "[H]aving the participating EGSs pay for the auction implementation is a prudent way to recover the auction costs, given that the participating EGSs are the entities reaping the possible customer acquisition benefits resulting from the auction." *Intermediate Work Plan Order*, p. 78. Notwithstanding the foregoing, PECO's proposal was opposed by witnesses on behalf of RESA, FES and Dominion.

As previously explained, RESA witness Kallaher recommends that the cost of PECO's proposed retail market enhancements, including the Opt-In Program, be recovered through the PTC Adder. Mr. Kallaher's PTC Adder recommendation should be rejected for all of the reasons previously discussed in Section III.G, *supra*.

Mr. Kallaher (RESA St. No. 2-R, p. 16), joined by Mr. Banks (FES St. No. 1, p. 9), alternatively contends that the costs of the Opt-In Program should be recovered through a non-bypassable charge assessed on all customers who will purportedly benefit from a robust competitive market with a larger group of EGSs.³² Messrs. Kallaher and Banks further assert that recovery of the Opt-In Program costs from winning EGSs could diminish the appeal of the program and discourage EGS participation. FES St. No. 1, pp. 11-12; RESA St. No. 2-R, p. 17.

RESA and FES have not demonstrated that there is good cause to deviate from the Commission's recommendation to recover the costs of the Opt-In Program from participating EGSs. Like marketing and customer education efforts, the goal of PECO's proposed RME

³² Although he notes that Dominion prefers a non-bypassable surcharge, Mr. Barkas agrees that if Opt-In Program costs are recovered from EGSs, participating EGSs should pay on a proportional basis according to the number of customers acquired through the program. Dominion St. Nos. 1-R, p. 4 & 1-SR, p. 6; *see also* Tr. 108.

programs is to encourage increased customer shopping. PECO St. No. 5-R, p. 13. While Mr. Kallaher (RESA St. Nos. 2, p. 17 & 2-SR, p. 26) and Mr. Banks (FES St. Nos. 1, p. 9 & 1-SR, p. 7) assert that all customers will generally benefit from the Opt-In Program, neither witness has demonstrated that the alleged benefit justifies charging customers for what amounts to an EGS marketing expense. *Id.* Notably, Mr. Banks admitted that his opinion regarding PECO's proposed cost recovery mechanism was not based on any cost-benefit analyses and that FES had not determined whether PECO's proposal would affect FES' participation in the Opt-in Program. PECO Cross (Banks) Ex. 3 (FES Response to PECO Set II, No. I).

Messrs. Banks (FES St. Nos. 1 (p. 10) and 1-R (p. 15)), Barkas (Dominion Retail/IGS St. No. 1-R, p. 4) and Kallaher (RESA St. No. 2-R, p. 17) contend that the POR discount, which would be triggered in the event that the Opt-In Program did not yield any winning suppliers, is inappropriate because it would require EGSs with a greater market share earned outside of RME programs to pay more. However, PECO's proposed POR discount is consistent with the Commission's directive that EGSs be responsible for these program costs; notably, the Commission specifically found that PECO's proposal to recover RME costs through the POR discount "appears to be acceptable". *Intermediate Work Plan Order*, p. 32. In addition, all EGSs have the opportunity to participate in the Opt-In Program. PECO St. No. 5-R, p. 13. No witness has presented evidence that EGSs with larger market shares have decided not participate in the Opt-In Program if costs are recovered through the POR program in the event that there are no participating suppliers. Indeed, as previously explained, FES – despite its objection – may still participate in the Opt-In Program.

Mr. Banks also asserts that use of a POR discount to recover costs unrelated to the POR program does not follow cost causation and therefore will encourage EGSs to discontinue

participation in that voluntary program. FES St. No. 1, pp. 9-10. However, FES has not presented any evidence that use of a POR discount would actually deter EGSs from competing in PECO's service territory.

2. EGS Standard Offer Program

PECO proposes to recover the costs of the Standard Offer Program through the 0.3% POR discount. PECO St. No. 5, p. 19 & PECO Ex. ABC-4R. Notably, the Commission recommended that the costs of the Standard Offer Program, like the costs of the Opt-In Program, "should be the responsibility of the participating EGSs". *Intermediate Work Plan Order*, p. 32. And, as previously explained, the Commission also made clear in its *Intermediate Work Plan Order* that PECO's recommended use of a POR discount to recover the costs of the Standard Offer Program was acceptable. The parties opposing the POR discount and recommending a non-bypassable charge – FES and RESA – have not presented evidence to justify departure from the Commission's guidelines on this issue for the reasons discussed in Section IV.F.1, *supra*. Likewise, RESA's proposal with regard to recovery of Standard Offer Program costs through the PTC Adder is identical to its proposal to recover other RME program costs through the PTC Adder, and it should be rejected for the reasons discussed in Section III.G, *supra*.

Dominion agrees with PECO's proposal that EGSs should pay the costs of the Standard Offer Program. However, Dominion opposes the use of a POR discount to do so. Mr. Barkas contends that requiring non-participating EGSs to pay the costs of the Standard Offer Program "seems unfair". Dominion St. No. 1, p. 4. As an alternative to the POR discount, Mr. Barkas proposes that the costs of the Standard Offer Program be recovered through a predetermined fee that each EGS would pay for each customer acquired through the program. Dominion St. No. 1, pp. 4-5. While PECO does not object to Mr. Barkas' recommendation in principle, its adoption

would add complexity to administration of the Standard Offer Program. PECO St. No. 5-R, p. 14. For instance, a customer acquisition fee would require the tracking of referrals. *Id.* In addition, the Standard Offer Program would have to spell out when the fee is charged (i.e., upon referral or switching) and whether the customer must remain with the EGS for a minimum period to be deemed a referral. *Id.* Given these complexities, PECO's proposal to recover the Standard Offer Program costs through a POR discount should be adopted.

3. Other Enhancements

PECO is proposing to use the POR discount to recover the costs of the remaining retail market enhancements, including: (1) costs associated with referral of PECO Wind customers to EGSs who can offer customers a "green energy" product; (2) additional customer call center requirements for new/moving calls; and (3) costs associated with the analysis, design, testing and implementation of seamless moves. PECO St. No. 5, pp. 18-19; GMEC Ex. JH-1, p. 10.

On behalf of RESA, Mr. Kallaher generally contends that recovery of RME program costs through a POR discount is inappropriate because such costs are unrelated to the uncollectible accounts and administrative costs of PECO's POR program and instead advocates for a non-bypassable charge or PTC Adder. RESA St. No. 2, p. 28. Neither of Mr. Kallaher's contentions should be adopted for the reasons set forth in Sections III.G and IV.F.1, supra. With respect to seamless moves, Mr. Kallaher contends that it is inappropriate for EGSs to pay any costs associated with "switch on connect" because PECO should have built this functionality into its system thirteen years ago, at the beginning of retail choice in Pennsylvania. RESA St. No. 2, p. 29. Mr. Kallaher's unsubstantiated assertion should be rejected. He does not provide any evidence that PECO was obligated to construct such functionality, nor does he explain why all customers should have paid for such a feature earlier. PECO St. No. 2-R, p. 23.

V. OTHER ISSUES

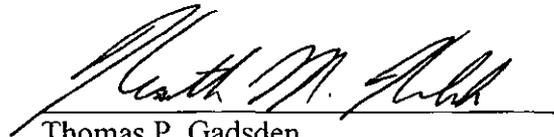
Under the Commission's Default Service Regulations, affiliates of default service providers are permitted to participate in competitive procurement for default service supply, *see* 52 Pa. Code § 54.186(5), provided that appropriate protocols are in place to ensure that such affiliates do not receive an advantage in the competitive procurement and the competitive process complies with the Commission's codes of conduct. The Commission has previously approved PECO's SMA as an affiliated interest agreement so that PECO's affiliates may participate in default service supply procurements, and PECO is maintaining the same protocols and other protections in DSP II to be administered by the Independent Evaluator. *See* PECO St. No. 4, p. 7 & PECO Ex. CL-3. In the event that an affiliate of PECO is a winning bidder in a default supply procurement, it will need to execute the SMA in the same manner and time period as other bidders. PECO therefore requests advance approval of the form SMA (PECO Ex. JJM-2) by the Commission as an affiliated interest agreement.

In addition, PECO requests that the Commission also provide advance approval under 66 Pa.C.S. § 2102 for the form agreements proposed by PECO for use in the Opt-In Program (Exhibit 1 to PECO Ex. JJM-4S) and in the Standard Offer Program (Exhibit 1 to PECO Ex. JJM-5S). Affiliates of PECO may also seek to participate in these retail market programs, and advance approval is appropriate since these affiliates will again be subject to the same timelines and program requirements as other bidders. Both PECO and its affiliates will remain subject to the Commission's codes of conduct in all aspects of these programs, and the Opt-In Program includes an independent monitor to manage the competitive bidding process.

VI. CONCLUSION

For the reasons set forth above, the Commission should approve PECO's Default Service Program for the period June 1, 2013 to May 31, 2015. In addition, the Commission should: (1) make the findings required by 66 Pa.C.S § 2807(e)(3.7); (2) grant the waivers and affiliated interest approvals requested in the Petition; and (3) grant such other approvals as may be needed to fully implement PECO's proposed Default Service Program.

Respectfully submitted,



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June 18, 2012

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PETITION OF PECO ENERGY COMPANY :
FOR APPROVAL OF ITS DEFAULT : **DOCKET NO. P-2012-2283641**
SERVICE PROGRAM :

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Initial Brief of PECO Energy Company** on the following persons in the matter specified in accordance with the requirements of 52 Pa. Code § 1.54.

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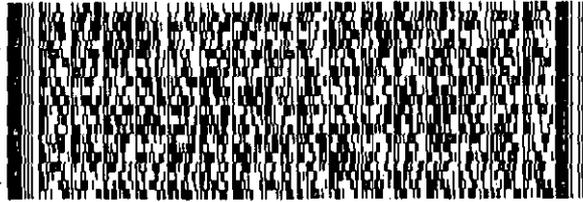
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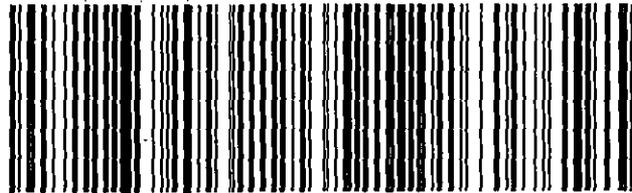
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