

**PECO ENERGY COMPANY
STATEMENT NO. 3**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PETITION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS
DEFAULT SERVICE PROGRAM
FOR THE PERIOD FROM
JUNE 1, 2015 THROUGH MAY 31, 2017

DOCKET NO. P-2014-_____

DIRECT TESTIMONY

WITNESS: SCOTT G. FISHER

SUBJECT: DEFAULT SERVICE PROCUREMENT

DATED: MARCH 10, 2014

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1 College and a B.E. from the Thayer School of Engineering at Dartmouth College,
2 with high honors. In addition, I received an M.S. in Engineering-Economic Systems
3 from Stanford University and an M.B.A. from the Tuck School of Business at
4 Dartmouth College, with high honors, and I presently serve as a guest lecturer at the
5 Tuck School of Business on energy industry matters.

6 **5. Q. Have you testified previously before this Commission?**

7 A. Yes, I testified in Docket No. P-2008-2062739, Petition of PECO Energy Company
8 for Approval of its Default Service Program and Rate Mitigation Plan (“DSP I”),¹ and
9 in Docket No. P-2012-2283641, Petition of PECO Energy Company for Approval of
10 its Default Service Program (“DSP II”).² I also testified in Docket No. P-2012-
11 2301664, Petition of Duquesne Light Company for Approval of a Default Service
12 Program and Procurement Plan for the Period June 1, 2013 through May 31, 2015.³

13 **6. Q. What is the purpose of your testimony?**

14 A. The purpose of my testimony is to evaluate PECO’s proposed default service plan
15 (the “Default Service Plan” or “Plan” or “DSP III”) to procure supply for default
16 service customers for the period beginning June 1, 2015, and ending May 31, 2017.
17 My testimony is divided into two parts. First, I briefly review PECO’s first two

¹ See *Petition of PECO Energy Company for Approval of Its Default Service Program and Rate Mitigation Plan* Docket No. P-2008-2062739 (Order entered June 2, 2009) (“*DSP I Order*”).

² See *Petition of PECO Energy Company for Approval of Its Default Service Program*, Docket No. P-2012-2283641 (Order entered October 12, 2012) (“*DSP II Order*”).

³ See *Petition of Duquesne Light Company for Approval of Default Service Plan For the Period June 1, 2013 Through May 31, 2015*, Docket No. P-2012-2301664 (Order entered January 25, 2013).

1 default service plans, DSP I and DSP II, and identify several lessons learned. This
2 discussion includes an analysis of the “residual compensation” incorporated in the
3 prices of the residential full requirements contracts procured by PECO for both
4 periods. Second, I evaluate PECO’s DSP III with respect to Act 129’s requirement
5 that the plan include a “prudent mix” of contracts designed to ensure the least cost to
6 customers over time.⁴

7 **7. Q. Please summarize your conclusions.**

8 A. First, with regard to the lessons learned from PECO’s DSP I and DSP II plans, I
9 conclude the following:

- 10 • The basic default service model used by PECO in DSP I and DSP II has
11 facilitated and supported substantial growth in the competitive retail
12 market. In fact, 87 alternative electric generation suppliers (“EGS” or
13 “competitive retail supplier”) currently serve PECO customers, which is
14 over double the number since the DSP I period began,⁵ and the percent of
15 customer load that has elected service from an EGS has increased
16 significantly, from 1.7%⁶ to 62%.⁷
- 17 • PECO’s open solicitations for fixed-price full requirements (“FPFR”)

⁴ 66 Pa. C.S. § 2807(e)(3.4).

⁵ Source: PECO. Data is for the week ending February 18, 2014.

⁶ See Pennsylvania Office of Consumer Advocate, “Pennsylvania Electric Shopping Statistics – October 1, 2010”.

⁷ Source: PECO. Data is for the week ending February 18, 2014, and includes customers who will be switched to EGSs within 45 days. Percentage of load is based on peak load contribution (“PLC”) values.

1 default service supply products have generally attracted robust
2 participation, indicating that many suppliers understand the products being
3 solicited and are willing to compete to provide those products.

- 4 • The high levels of participation combined with my quantitative analysis of
5 the results of PECO's DSP I and DSP II solicitations for FPFR residential
6 default service supply products indicate that the resulting contract prices
7 obtained by PECO are reasonable, considering the costs and risks that the
8 suppliers under these contracts assume to the benefit of customers.

9 Second, with regard to PECO's proposed DSP III, I conclude the following:

- 10 • DSP III incorporates a prudent mix of contracts designed to ensure least
11 cost to customers over time, taking into account the benefits of price
12 stability, and includes prudent steps necessary to obtain least cost
13 generation supply contracts on a long-term, short-term and spot market
14 basis, as required by Section 2807(e)(3.4) and Section 2807(e)(3.7) of the
15 Act.
- 16 • DSP III is designed to support the competitive retail market in PECO's
17 service area.

18 Each of these findings is described further below.

19

1 9. Q. Please provide a brief overview of the mix of products procured under DSP II.

2 A. PECO's DSP II, the plan currently in effect, builds upon the successes of DSP I while
3 including important improvements that are based on the lessons learned during DSP I.
4 DSP II retains tailored and separate default service supply portfolios for each of the
5 various customer classes as well as procurement of supply products through regular
6 competitive solicitations. DSP II also continues the reliance on FPFR supply
7 products for smaller customers. At the same time, the Plan begins to phase out the
8 block-and-spot aspect of the supply portfolio for the Residential customer class, and
9 replaces these products with FPFR products. For smaller customers, the Plan also
10 includes more frequent replacements of the supply products. Finally, the Plan
11 involves generally shorter product delivery periods and shorter times between product
12 procurement and the start of delivery in order to provide shorter-term price signals to
13 customers (while still providing some rate stability) and to help ensure that default
14 service rates are more reflective of contemporaneous market prices.

15 The following chart provides a summary of the DSP II portfolio for each customer
16 class:¹²

¹¹ All spot-priced full requirements products for Small and Medium Commercial customers and Large Commercial and Industrial customers were indexed to the PJM day-ahead energy markets.

¹² Transitional supply products are procured to reach the procurement cycles described in the chart for the Residential class (40% 1-year FPFR products and 60% 2-year FPFR products with semi-annual overlapping) and for the Small Commercial class (100% 1-year FPFR products with semi-annual overlapping). For example, six-month FPFR products with a delivery period spanning June 1, 2013 through November 30, 2013, covering 50% of the Small Commercial class' default service load, were procured to allow for the procurement cycle for this class to be reached.

DSP II

Residential	Small Commercial	Medium Commercial	Large Commercial and Industrial
<ul style="list-style-type: none"> • The roughly 25% portion of the portfolio that was block energy and spot market purchases in DSP I transitions to supply through FPFR products <ul style="list-style-type: none"> ◦ As the existing block products expire, they are replaced by FPFR products that terminate at the end of the DSP II period (May 31, 2015)¹³ ◦ The pre-existing five-year block energy product, and the associated spot purchases, remain throughout the DSP II period because this product does not expire until December 31, 2015, after the DSP II period has concluded • The roughly 75% remainder of the portfolio retains the same basic mix of products as in DSP I, but the procurement timing has changed: <ul style="list-style-type: none"> ◦ The mix of products consists of 40% 1-year FPFR products and 60% 2-year FPFR products^{14,15} ◦ The delivery periods of these products overlap on a semi-annual basis ◦ After the first procurement (Fall 2012), each product is procured 2-4 months before the start of delivery of that product 	<ul style="list-style-type: none"> • 100% 1-year FPFR products (following an initial transitional procurement of six-month FPFR contracts to facilitate laddering) • Delivery periods overlap on a semi-annual basis • All products (after the initial transitional procurement) are procured approximately 2-4 months prior to delivery 	<ul style="list-style-type: none"> • 100% 6-month FPFR products • No overlapping delivery periods • All products are procured approximately 2-4 months prior to delivery 	<ul style="list-style-type: none"> • 100% spot-priced FR products

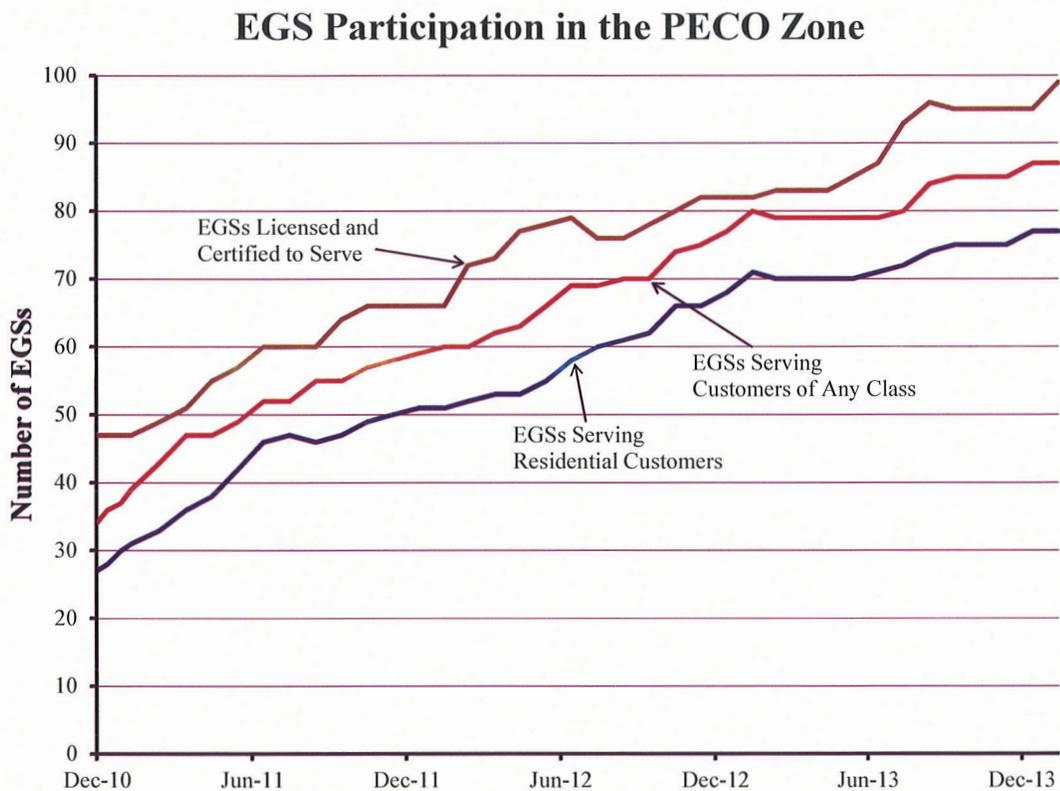
¹³ As the block energy products expire, the number of FPFR product tranches that replace the expiring block energy products is based on the volume of those block energy products and the volume of the targeted spot purchases that accompany the block energy products to serve the load.

¹⁴ In DSP I, 75% of the Residential supply was procured through FPFR products, with 30% of the Residential supply procured through one-year FPFR products and 45% of the Residential supply procured through two-year FPFR products. In other words, of the Residential supply that was procured through FPFR products, 40% was comprised of one-year products and 60% was comprised of two-year products.

¹⁵ One exception to this is that the two-year product that was procured in Fall 2013 was shortened to an 18-month product in order to reduce the amount of supply contract volume with deliveries extending beyond the DSP II period.

1 10. Q. Have the default service models used by PECO in DSP I and DSP II promoted
2 growth in the competitive retail market?

3 A. Yes. Since DSP I delivery began, the competitive retail market in PECO's service
4 area has grown considerably. As the following chart shows, there has been
5 substantial and continuous growth in the number of EGSs competing in PECO's
6 service area over the DSP I and DSP II periods:¹⁶



7
8 The number of EGSs licensed and certified to serve customers in PECO's service
9 area has more than doubled over the DSP I and DSP II periods, with 100 EGSs

¹⁶ Data provided by PECO.

1 currently licensed and certified to serve customers.¹⁷ Similarly, the number of EGSs
2 serving PECO customers has more than doubled since the DSP I period began, as has
3 the number of EGSs serving PECO residential customers. Currently, 87 EGSs serve
4 PECO customers, and 77 of these EGSs currently serve PECO residential
5 customers.¹⁸ Furthermore, 62% of PECO's total customer load is currently being
6 served by an EGS, with switching percentages equal to 36% for the Residential class,
7 60% for the Small Commercial class, 84% for the Medium Commercial class, and
8 96% for the Large Commercial and Industrial class.¹⁹ In contrast, as of October 1,
9 2010, only a few months before supply deliveries under DSP I began, only 1.7% of
10 PECO's total customer load was being served by an EGS.²⁰

11 Clearly, PECO's transition from long-term, capped default service rates to default
12 service rates based on competitive market pricing for PECO's prudent mix of default
13 service supply products has facilitated and supported the growth of the competitive
14 retail market. The successful phase-out of the block-and-spot aspect of the supply
15 portfolio and the greater reliance on FPFR products in DSP II also has supported
16 retail market development. Specifically, this has decreased the likelihood of material
17 reconciliations between supply costs and retail revenues that can distort default

¹⁷ Source: PECO. Data is for the week ending February 18, 2014.

¹⁸ Source: PECO. Data is for the week ending February 18, 2014.

¹⁹ Source: PECO. Data is for the week ending February 18, 2014, and includes customers who will be switched to EGSs within 45 days. Percentages of load are based on PLC values.

²⁰ Figure is "Percentage of Customers Load (MW) Served By An Alternative Supplier As Of 10/1/2010" as found in "Pennsylvania Electric Shopping Statistics – October 1, 2010" published by the PA Office of Consumer Advocate.

1 service rates and reduce the transparency of future default service rates, which is
2 important for customers to make informed supply decisions.

3 **11. Q. Mr. Fisher, you have testified that the majority of default service supply for the**
4 **Residential, Small Commercial, and Medium Commercial customer classes was**
5 **procured in the form of FPFR products in DSP I and DSP II. Please describe**
6 **the characteristics of a FPFR product.**

7 A. A FPFR default service supply product obligates the seller of the product to satisfy a
8 specified percentage of all of the default service customers' supply requirements in
9 every hour of the delivery period, regardless of the default service customers'
10 instantaneous changes in energy consumption, regardless of how frequently
11 customers switch to or from default service, and regardless of how the seller's cost to
12 satisfy its supply obligation may change. The seller is paid a predetermined price per
13 megawatt-hour for this service. The full requirements products that PECO has
14 procured under DSP I and DSP II include the generation components required to
15 supply PECO's default service customers, including energy, capacity, and ancillary
16 services, as well as alternative energy credits required for compliance with
17 Pennsylvania's Alternative Energy Portfolio Standards ("AEPS") Act. In PECO's
18 solicitations for FPFR products, qualified bidders compete with one another by
19 submitting the prices at which they are willing to provide the full requirements
20 default service supply, and the suppliers with the lowest prices are selected upon
21 approval of the procurement by the Commission.

22

1 **12. Q. Have PECO's solicitations for FPFPR supply products generally attracted robust**
2 **participation?**

3 A. Yes. These open solicitations have generally attracted robust participation, indicating
4 that many suppliers understand the products being solicited and want to compete to
5 provide those products. Evidence of the high levels of participation includes the
6 following:

- 7 • Between 9 and 13 suppliers participated in each of the FPFPR product
8 solicitations in DSP I, and there were 11 different winning bidders.²¹
- 9 • The Commission has approved the bid results for approximately 98% of
10 the FPFPR default service supply product tranches that have been solicited
11 to date.²²

12 **13. Q. What does this indicate about the prices resulting from these solicitations?**

13 A. The high levels of participation in these open solicitations indicate that the resulting
14 prices have been competitive. Multiple bidders competed to sell the products solely

²¹ February 2, 2012 PECO Procurement: Winter 2012 Solicitation Results
(<http://www.pecoprocmement.com/assets/files/NERA%20PECO%20Winter%202012%20Exhibit%20G%20Release%20Final%202-2-2012.pdf>), p. 3. Participation in this context involves at least completing the steps required to be qualified to submit bids. Data about the number of qualified bidders, or the number of winning bidders, in the DSP II solicitations is not yet publicly available.

²² Source: <http://www.pecoprocmement.com/index.cfm?s=background&p=previousResults>. To date, 321 FPFPR default service supply product tranches have been solicited by PECO. (The number increases to 341 if the 12-month 2011 "opt-in" fixed-price products for the Large Commercial and Industrial class are included.) The Commission has approved the bid results for all but seven of these tranches. On a related note, insufficient bids have been received for some of the spot-priced full requirements products solicited in 2010 for the Large Commercial and Industrial class. (See *Fall 2010 Solicitation Approval Secretarial Letter (9/22/2010)*). Spot-priced full requirements products are quite different from FPFPR products, as spot-priced full requirements products do not offer the opportunity to potential suppliers to manage all of the costs and risks of full requirements supply at a fixed price on behalf of customers.

1 on the basis of price. In order to be selected, bidders needed to offer a price that did
2 not include unreasonable or excessive compensation for assuming and managing the
3 costs and risks associated with the products. Otherwise, the bidder would be
4 underpriced by another bidder. High levels of supplier participation are beneficial for
5 customers and are a sign that winning prices are the lowest possible for the product
6 being solicited.

7 **14. Q. Do the bidders in FPFR product solicitations require compensation in the prices**
8 **that they offer to help them cover the associated costs and risks of their**
9 **obligation, to the benefit of customers?**

10 A. Yes. As in any market, participants require compensation for the costs and risks
11 which they bear by providing a product.

12 **15. Q. Have you performed a quantitative analysis of the results of PECO's DSP I and**
13 **DSP II solicitations for FPFR default service supply products, in order to better**
14 **understand the compensation that is required by suppliers?**

15 A. Yes. I have performed an analysis of the residential supply product pricing.

16 **16. Q. What was the basic approach that you adopted in your analysis?**

17 A. For each of the FPFR product solicitations that PECO completed under DSP I and
18 DSP II, I calculated the values of the individual cost components that can be
19 quantified in a fairly simple way, and deducted them from the winning bid prices.
20 Then, by examining whether the difference (i.e., the "residual compensation" required
21 by suppliers to cover the other costs and risks that I did not individually quantify)

1 represents a relatively small or large portion of the winning bid prices, I determine
2 whether this “residual compensation” is reasonable, considering the costs and risks
3 assumed by FPR product suppliers to the benefit of customers.

4 **17. Q. Please identify the cost components of full requirements service that you**
5 **individually quantified.**

6 A. For each solicitation, I used market price information and load data available at the
7 time of the solicitation to quantify cost components related to energy (including the
8 effect of load shape), capacity, ancillary services, and various credits.

9 **18. Q. How did you quantify each of these cost components?**

10 A. For energy, I relied on forward block energy prices as reported by the New York
11 Mercantile Exchange (“NYMEX”).²³ I then added a load shaping adjustment to
12 account for the fact that market prices are generally higher during hours in which
13 customer loads are higher.²⁴ The load shaping was performed using actual PECO
14 hourly loads and prices.

15 For capacity, I applied PJM-published capacity prices to megawatt quantities of
16 required capacity, and divided the products by the commensurate megawatt-hour
17 loads in order to express capacity costs in terms of dollars per megawatt-hour. The

²³ For any solicitation in which sufficient PECO Zone forward prices were not available, NYMEX forward block energy prices for PJM Western Hub were used and a basis adjustment was applied. The basis adjustment was calculated based on historical market price data available as of the time of the respective solicitation. NYMEX prices were provided by Ventyx / Energy Velocity.

²⁴ The calculation of this load shaping adjustment involved applying actual historical percentage differences between load-weighted hourly energy prices and straight-average hourly energy prices.

1 capacity quantities were calculated based on the reported peak load contribution
2 (“PLC”) values for the appropriate classes of customers, and the corresponding
3 megawatt-hour load values were calculated from publicly available load values as of
4 the times of the solicitations.

5 The other cost components that I individually quantified include ancillary services
6 costs,²⁵ alternative energy credits (“AECs”),²⁶ Auction Revenue Rights (“ARR”)
7 credits,²⁷ and marginal loss credits.²⁸ These values tend to be much smaller than the
8 cost of energy and capacity and, therefore, they have a much smaller effect on the
9 results of my analysis.²⁹

10 For each solicitation, I quantified these cost components and then deducted the
11 resulting values from the winning bid price to determine how much was left over –
12 the “residual compensation” for all other cost and risk items that were not
13 individually quantified. The following illustrative chart graphically portrays this
14 approach:

²⁵ The ancillary services costs that I used were based on PECO’s historical ancillary services costs.

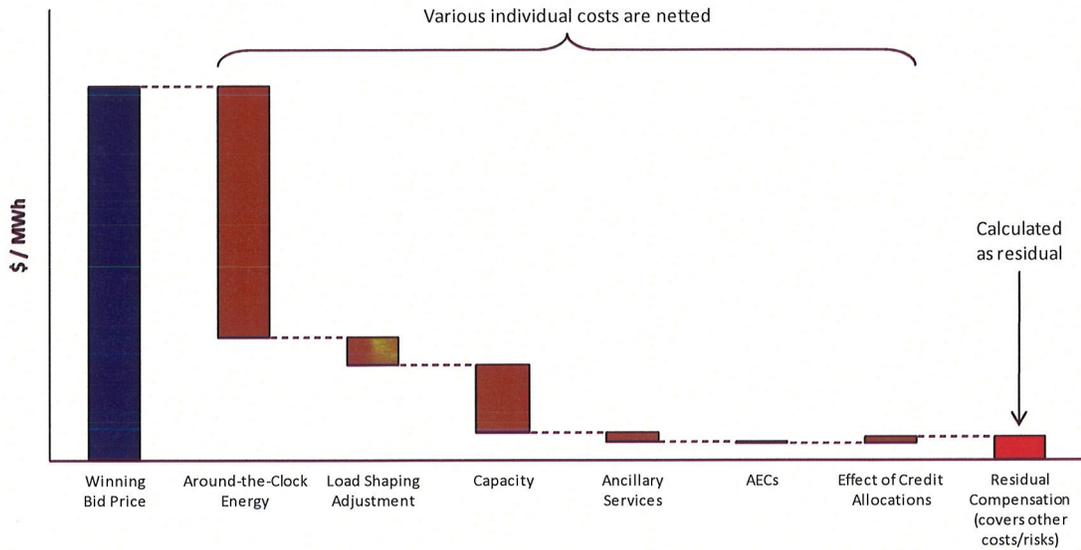
²⁶ The costs of AECs were calculated using AEC prices as of the time of the solicitation and the volume requirements of the winning suppliers.

²⁷ Auction Revenue Rights (“ARR”) credits were calculated by dividing zonal ARR credit allocations published by PJM by zonal loads calculated from PJM zonal load forecasts.

²⁸ Marginal loss credits were calculated using actual credit data provided by PJM.

²⁹ The values of both the ARR credits and the marginal loss credits were netted from the values of the other cost components that I calculated (i.e., these credit values effectively act as cost components with negative values), because a positive value for these credits equates to a positive dollar value allocated to the winning bidders in the solicitations.

Illustrative Full Requirements Product Price Analysis



1

2 19. Q. Do the residual compensation values that you calculated represent the expected
3 “profit margins” or “premiums” for the winning bidders?

4 A. No, these residual compensation values do not represent the expected profit margins
5 for winning bidders. While it is reasonable for winning bidders to expect some level
6 of profit in order to assume the full requirements obligations, there clearly are costs
7 and risks that were not quantified and deducted from the winning bid prices; suppliers
8 require the residual compensation to cover these costs and risks. Therefore, the
9 residual compensation that I calculated simply represents what is left over after
10 deducting the values of cost components that I individually quantified, and does not
11 represent the expected supplier profit or premium.

12

13

1 20. Q. What are some of the other costs and risks that this “residual compensation” is
2 intended to cover?

3 A. The residual compensation must cover a wide range of other costs and risks,
4 including:

- 5 • Customer migration – the financial costs and risks associated with the
6 uncertainty regarding customer switching and its effect on the default
7 service volumes to be supplied.
- 8 • Usage and price uncertainty – various costs and risks due to unexpected
9 events that affect usage and price levels.³⁰
- 10 • Unexpected congestion – various costs and risks associated with the
11 possibility that differences in prices between a given trading hub and the
12 delivery location will be higher than expected values.
- 13 • Adverse selection – the costs and risks associated with the likelihood that
14 high cost-to-serve customers (e.g., with less attractive load shapes) will
15 disproportionately remain on default service due to competitive retail
16 suppliers’ lack of interest in marketing to such customers.

17

³⁰ These include extreme weather patterns, changes in customer usage patterns, plant outages or transmission line outages (which also affect congestion costs), fuel price shocks, and unexpected economic growth levels. Furthermore, the general positive correlation between loads and prices (e.g., a heat wave drives up both prices and loads) compounds the potential costs associated with this uncertainty.

- 1 • Adverse developments in energy markets during the time a bid is held
2 open – even for a few days, while the bids are evaluated and considered
3 for approval by the applicable regulatory body.

- 4 • Potential changes in laws and regulations – such changes could impact
5 supplier costs during the contract period.

- 6 • Administrative and legal costs.

- 7 • Credit-related costs (e.g., costs associated with posting collateral).

8 Again, my analysis does not include a quantification and deduction of these costs and
9 risks from the winning bid prices. Therefore, winning bidders in the FPFR
10 solicitations would need to cover these costs and risks in the residual compensation
11 values that I calculated.

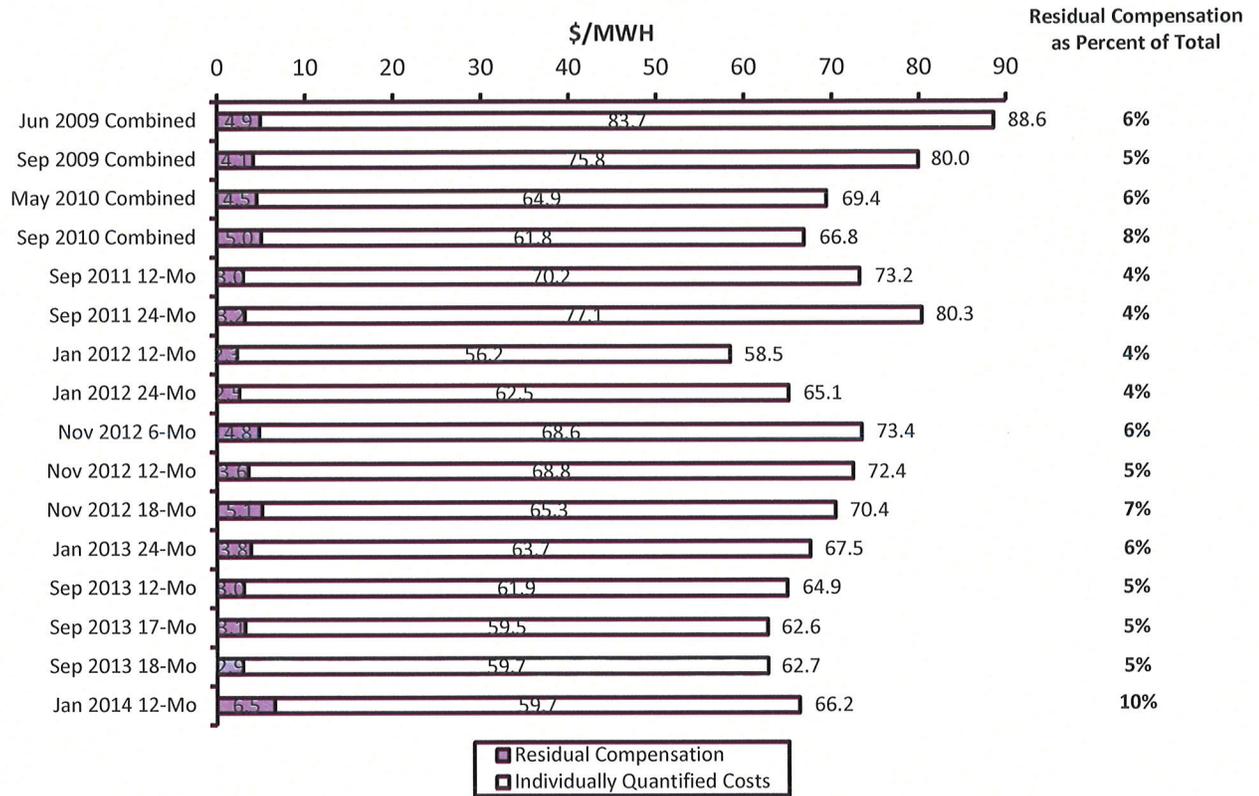
12 **21. Q. What residual compensation values did you calculate when you deducted the**
13 **values of the individually quantified cost components from the winning bid**
14 **prices?**

15 A. As the following exhibit shows, across all of the solicitations prior to the January
16 2014 solicitation, the residual compensation values range from about \$2 per
17 megawatt-hour to about \$5 per megawatt-hour (4% to 8% of the winning supply bid
18 price). The residual compensation value for the January 2014 solicitation was higher,
19 which likely is largely due to unprecedented short-term factors that I believe caused
20 potential default service bidders to divert their attention and resources to urgent

1

matters other than this solicitation.

Breakdowns of Winning Bid Prices



Note: For solicitations prior to the September 2011 solicitation, bid price results were released only on a combined product basis.

2

3 **22. Q. What were the unprecedented short-term factors that you believe caused**
 4 **potential default service bidders to divert their attention and resources to urgent**
 5 **matters other than PECO’s January 2014 solicitation?**

6 **A.** During the weeks leading up to PECO’s January 2014 solicitation, the regional
 7 energy market was in the throes of a prolonged cold spell that PJM characterized as
 8 “record-breaking . . . in its nearly 87-year history.”³¹ All conventional forms of

³¹ “PJM Grid Meets Month-Long Challenges of Cold January,” PJM News Release, January 31, 2014.

1 generation, including gas, coal, and nuclear, were challenged by the extreme
2 conditions, with unplanned generator shutdowns from the cold and the stress of
3 extended run times, natural gas curtailments, and fuel-oil delivery problems.³² As a
4 result, hourly wholesale energy market prices were very volatile during January 2014,
5 and on both a day-ahead and real-time basis, the average PECO Zone hourly energy
6 price for January 2014 was by far the highest of any month in the almost fifteen years
7 since PJM introduced full market-based energy pricing.³³ Consequently, it is quite
8 understandable that potential default service bidders may have needed to divert
9 additional resources to urgent portfolio management issues precipitated by the
10 extreme market conditions at the time of PECO's January 2014 default service supply
11 solicitation. In fact, relatively low bidder participation was observed in a solicitation
12 for Standard Offer Service³⁴ supply for the electric utilities in Maryland that was held
13 just one day before PECO's January 2014 solicitation, and the Bid Monitor for that
14 solicitation testified that bidders cited price volatility associated with the large run-
15 ups in the prices of natural gas and electricity caused by the cold spells as a reason for
16 not participating in the solicitation.³⁵

³² "PJM Grid Meets Month-Long Challenges of Cold January," PJM News Release, January 31, 2014.

³³ The January 2014 average PECO Zone day-ahead hourly energy price was \$168.45/MWH, which is over 50% higher than the next-highest monthly average day-ahead price since PJM introduced full market-based energy pricing. Similarly, the January 2014 average PECO Zone real-time hourly energy price was \$140.81/MWH, which is over 35% higher than the next-highest monthly average real-time price since PJM introduced full market-based energy pricing. Source: PJM price data, provided by PJM and by Ventyx / Energy Velocity.

³⁴ "Standard Offer Service" in Maryland is analogous to default service in Pennsylvania.

³⁵ *Direct Testimony of Frank Mossburg, Boston Pacific Company, Inc., on Behalf of the Staff of the Public Service Commission of Maryland*, Public Service Commission of Maryland Case Nos. 9056 & 9064, January 30, 2014, p. 6.

1 In addition, in light of the urgencies caused by the weather-related turbulence in the
2 markets, both PJM and the neighboring New York Independent System Operator,
3 Inc., (“NYISO”) submitted filings shortly before bids in PECO’s default service
4 supply solicitation were due, requesting expedited Federal Energy Regulatory
5 Commission (“FERC”) approval of changes in their wholesale energy market bidding
6 requirements and in their energy charges.³⁶ Intervenor were required to file their
7 comments on these filings within one week after the filings were made, with
8 comments in the NYISO proceeding due just one day after the PECO default service
9 supply bids were due and comments in the PJM proceeding due just two days after
10 the PECO default service supply bids were due. Due to the potentially significant
11 economic effects that the outcomes of these expedited proceedings could have on
12 market participants, numerous parties dedicated resources to developing and
13 submitting comments in these proceedings in the short periods of time allotted.

14 Potentially compounding these issues was the fact that bids were due in multiple
15 other default service supply solicitations on the same day or within one day of
16 January 28, which was PECO’s January 2014 solicitation’s bid due date.

17 Specifically, the four electric utilities in Maryland, FirstEnergy’s Ohio utilities, and
18 Duquesne Light Company all held default service supply solicitations with such bid

³⁶ See *Request of PJM Interconnection, L.L.C. for Waiver and for Commission Action by January 24, 2014*, FERC Docket No. ER14-1144, January 23, 2014; *Request of PJM Interconnection, L.L.C. for Waiver, Request for 7-Day Comment Period, and Request for Commission Action by February 10, 2014*, FERC Docket No. ER14-1145, January 23, 2014; *Petition for Temporary Tariff Waivers, Request for Shortened Comment Period, and Request for Expedited Commission Action by January 31, 2014*, FERC Docket No. ER14-1138, January 22, 2014.

1 due dates.³⁷ Given the issues related to the market-related events that I have
2 described, potential bidders may have had abnormally limited resources available to
3 fully compete in multiple default service supply solicitations at that time, and some
4 may have chosen to focus on solicitations other than PECO's.

5 **23. Q. Do you believe that the residual compensation values that you calculated are**
6 **reasonable, considering the costs and risks assumed by the winning bidders in**
7 **these solicitations to the benefit of customers?**

8 A. Yes. As I explained earlier, the high levels of participation in these open solicitations
9 indicate that the resulting prices were competitive. Furthermore, these residual
10 compensation values represent only a small portion of the winning bid prices,
11 especially considering the other costs and risks that I described above, which FPFR
12 suppliers intend to cover through the residual compensation to the benefit of
13 customers.

14 III. EVALUATION OF PECO'S PROPOSED DSP III

15 **24. Q. Please summarize PECO's proposed plan for DSP III.**

16 A. PECO's proposed DSP III will continue the basic procurement strategy that was
17 established in DSP II, which includes procurement of a prudent mix of products from
18 competitive wholesale suppliers and has supported retail market competition. For the

³⁷ As described in Public Service Commission of Maryland Case Nos. 9056 & 9064, Order No. 86158, January 31, 2014, the Maryland utilities' bid due date was January 27, 2014. As described at <http://www.firstenergycbp.com/News.aspx>, the FirstEnergy Ohio Utilities' bid due date was January 28, 2014. As described at <http://sourcingssystem.procurexinc.com/duquesnerfp/>, Duquesne Light's bid due date was January 28, 2014.

1 Large Commercial and Industrial customers (peak demands greater than 500 kW),
2 PECO will continue to obtain default service supply based on spot market prices.
3 The competitive retail market for Large Commercial and Industrial customers in
4 PECO's service area is well developed, as 96%³⁸ of the load has switched to service
5 from competitive retail suppliers. This customer class does not rely on price stability
6 in its default service rates, and the continuance of default service based on spot
7 market prices is reasonable.

8 For the Medium Commercial customer class, PECO will continue to maintain a
9 supply portfolio that is comprised entirely of six-month FPFR products, all of which
10 are replaced every six months. In addition, the solicitation for any given product will
11 be held approximately two-to-four months before delivery of the product begins.

12 For the Small Commercial customer class, PECO will continue the procurement
13 design established in DSP II. Specifically, the default service supply portfolio will
14 consist of one-year FPFR products in which half of the products are replaced every
15 six months. The solicitation for any given product will be held approximately two-to-
16 four months before delivery of the product begins.

17 The supply portfolio for the Residential customer class will continue the procurement
18 design established in DSP II consisting of 40% one-year FPFR products and 60%
19 two-year FPFR products, with delivery periods that overlap on a semi-annual basis.

³⁸ Source: PECO. Data is for the week ending February 18, 2014, and includes customers who will be switched to EGSs within 45 days. Percentage of load is based on PLC values.

1 During the DSP III period, approximately 96% of the supply portfolio will transition
2 to this product arrangement. The remaining 4% of the overall default service supply
3 portfolio for the Residential customer class will consist of a mix of “long-term”
4 products and spot purchases.³⁹ Specifically, through December 31, 2015, this portion
5 of the supply portfolio will be represented by the existing five-year block product
6 obtained in DSP I as well as the spot purchases associated with that block product
7 that are needed to satisfy the hourly load requirements. Starting January 1, 2016, this
8 will be replaced by two tranches of FPFR products that each will have a delivery
9 period spanning four years and five months,⁴⁰ and the remaining sliver of the supply
10 need will be satisfied through spot purchases. Each of the FPFR default service
11 products for the Residential customer class will be procured approximately two-to-
12 four months before the start of delivery of that product.

13 The following chart provides a summary of the DSP III portfolio for each customer
14 class:

³⁹ Section 2807(e)(3.1) of the Act characterizes “long-term” purchase contracts as those of more than four years.

⁴⁰ This will allow for future supply products serving this portion of the load requirement to have delivery periods that correspond to the PJM planning cycle.

Proposed DSP III

Residential	Small Commercial	Medium Commercial	Large Commercial and Industrial
<ul style="list-style-type: none"> • 96% of the load is supplied by a mix of products representing a transition to: <ul style="list-style-type: none"> ○ 40% 1-year FPFR products with delivery periods that overlap on a semi-annual basis ○ 60% 2-year FPFR products with delivery periods that overlap on a semi-annual basis • The other 4% of the load initially is supplied by the pre-existing five-year block energy product purchased in DSP I and associated spot purchases; this block product expires on December 31, 2015, at which time the supply for this portion of the load is replaced by FPFR products spanning four years and five months (approximately 3% of the supply) and spot purchases (approximately 1% of the supply) • All products are procured approximately 2-4 months before the start of delivery of that product 	<ul style="list-style-type: none"> • 100% 1-year FPFR products • Delivery periods overlap on a semi-annual basis • All products are procured approximately 2-4 months prior to delivery 	<ul style="list-style-type: none"> • 100% 6-month FPFR products • No overlapping delivery periods • All products are procured approximately 2-4 months prior to delivery 	<ul style="list-style-type: none"> • 100% spot-priced FR products

3
 4 **25. Q. Mr. Fisher, the Act requires a default service plan to produce a prudent mix of**
 5 **contracts, and include prudent steps necessary to obtain least cost generation**
 6 **supply contracts on a long-term, short-term and spot market basis.⁴¹ What**
 7 **guidance has the Commission provided in interpreting that standard?**

8 A. On October 4, 2011, the Commission entered its Second Default Service Rulemaking
 9 Order, and in this Order it provided guidance based on input received from
 10 stakeholders. Some of the Commission’s guidance regarding the interpretation of

⁴¹ 66 Pa. C.S. § 2807(e)(3.4), and 66 Pa. C.S. § 2807(e)(3.7).

1 “least cost” and “prudent mix” is as follows:

2 [T]he [“least cost”] standard must give the DSP sufficient latitude to select
3 contracts that constitute a “prudent mix” which includes a sufficient
4 variety of products that adequately take into consideration price volatility,
5 changes in generation supply, customer usage characteristics and the need
6 to assure safe and reliable service.⁴²

7 In implementing default service standards, the Commission must be
8 concerned about rate stability as well as other considerations such as
9 ensuring a “prudent mix” of supply and ensuring safe and reliable service.
10 In our view, a default service plan that meets the “least cost over time”
11 standard should not have, as its singular focus, the achievement of the
12 absolute lowest cost over the default service plan time frame but rather a
13 cost for power that is both relatively stable and also economical relative to
14 other options.⁴³

15 Price stability benefits are very important to some customer groups, so an
16 interpretation of “least cost” that mandates subjecting all default service
17 customers to significant price volatility through general reliance on short
18 term pricing is inconsistent with Act 129’s objectives.⁴⁴

19 We agree with the majority of parties that the “prudent mix” of contracts
20 be interpreted in a flexible fashion which allows the DSPs to design their
21 own combination of products that meets the various obligations to achieve
22 “least cost to customers over time,” ensure price stability, and maintain
23 adequate and reliable service.⁴⁵

24 We do reject the positions of those parties that “prudent mix” be defined
25 to always require a specific mix or percentage of types of contract
26 components in each default service plan or a minimum of two types of
27 products.⁴⁶

⁴² *Default Service and Retail Electric Markets*, Docket No. L-2009-2095604 (Order entered October 4, 2011) (“*Second Default Service Rulemaking Order*”), p. 38.

⁴³ *Second Default Service Rulemaking Order*, p. 40.

⁴⁴ *Second Default Service Rulemaking Order*, p. 41.

⁴⁵ *Second Default Service Rulemaking Order*, p. 60.

⁴⁶ *Second Default Service Rulemaking Order*, p. 60.

1 26. Q. Do you believe that PECO's proposed DSP III incorporates a prudent mix of
2 contracts, and includes prudent steps necessary to obtain least cost generation
3 supply contracts on a long-term, short-term and spot market basis, as required
4 by Section 2807(e)(3.4) and Section 2807(e)(3.7) of the Act?

5 A. Yes, I do. There are several reasons for this conclusion:

6 1. The procurement process is designed to ensure the least cost to customers by
7 requiring qualified bidders in the supply product solicitations to compete and
8 be selected based on the lowest price. Furthermore, when FPFR products are
9 solicited, default service customers are provided the benefits of competition
10 on all aspects of the full requirements supply obligation, including the
11 portfolio management function.⁴⁷ It is reasonable to assume that bidders in
12 the FPFR solicitations will consider the costs and risks associated with all
13 forms of supply available to them to satisfy their fixed-price full requirements
14 obligation, and will reflect in their bid prices the benefits of any opportunity
15 that they believe is the least cost supply opportunity.

16 2. PECO's Plan predominantly relies on FPFR default service supply products,
17 which are well-tested in the marketplace. These products have been
18 successfully procured by PECO in DSP I and DSP II, and are frequently
19 procured by utilities in Pennsylvania and in other jurisdictions. In fact, FPFR

⁴⁷ FPFR product suppliers have the responsibility for continuously satisfying the uncertain and constantly changing supply requirements at the agreed-upon price, and therefore must manage the associated costs and risks through their supply portfolio decisions.

1 product solicitations are the most prevalent form of default service
2 procurement for smaller customers in restructured jurisdictions.⁴⁸

3 3. The types of products relied upon under the Plan have been shown to be
4 reasonably priced. Specifically, the generally high levels of participation in
5 the open solicitations for FPFR products, combined with my quantitative
6 analysis of the prices from PECO's FPFR residential default service supply
7 solicitations under DSP I and DSP II, indicate that the prices of such products
8 are reasonable, considering the costs and risks assumed by the winning
9 bidders in these solicitations to the benefit of customers.

10 4. The Commission has recognized the benefits of reliance on full requirements
11 products in a default service portfolio, as it stated in its Second Default
12 Service Rulemaking Order:

13 The [full requirements] process insulates default supply customers
14 from the volatility associated with wholesale market conditions
15 with the supplier bearing the risks of factors such as customer
16 migration, weather, load variation and economic activity.⁴⁹

17 We do express a preference for continued reliance by DSPs on the
18 [full requirements] approach to the extent this method best suits the
19 DSP's particular procurement needs.⁵⁰

⁴⁸ Examples of specific jurisdictions in which full requirements supply products are procured include Connecticut, Delaware, Maine, Maryland, Massachusetts, New Jersey, Ohio, Pennsylvania, Rhode Island, and Washington D.C.

⁴⁹ *Second Default Service Rulemaking Order*, p. 54.

⁵⁰ *Second Default Service Rulemaking Order*, p. 56.

1 The seller of a FPFRR product is responsible for assuming, managing, and
2 covering the financial costs and risks associated with electricity supply, while
3 customers receive benefits that protect against adverse market and/or
4 generation cost outcomes. Sellers of FPFRR products must satisfy their
5 obligation, regardless of how much market prices or generation costs may
6 increase during the delivery period and regardless of the default service load
7 level. Yet if market prices decrease after these types of supply contracts are
8 signed, customers may elect service from a lower cost competitive retail
9 supplier.

10 5. PECO's Plan continues the use of a standard supply contract, which lets
11 bidders know the terms and requirements of the default service supply
12 obligation well in advance of the bid due date, and therefore allows qualified
13 bidders to submit firm bid prices knowing that these contract terms and
14 conditions will not change. The use of a standard contract also assures
15 qualified bidders that the selection of the winning bidders will be an objective
16 process. Consequently, the use of a standard contract encourages participation
17 in the solicitations from a large number of potential suppliers.

18 6. PECO's Plan is also prudent because it includes tailored supply portfolios for
19 different customer classes that take into account any benefits of price stability,
20 the different shopping propensity of each customer class, and the desire to
21 further develop the competitive retail market in PECO's service area.

22

1 27. Q. **Has the Commission supported the use of tailored supply portfolios for each**
2 **customer class?**

3 A. Yes. Specifically, in its Second Default Service Rulemaking Order, in its discussion
4 of the “prudent mix” requirement under Act 129, the Commission stated:

5 The Commission notes there was substantial unanimity on this point and
6 agrees with the parties that the “prudent mix” standard should be
7 interpreted to allow for a class-specific product mix that best matches the
8 needs of each DSP customer class.⁵¹

9 28. Q. **Mr. Fisher, does PECO’s proposed DSP III include a reasonable degree of**
10 **flexibility to accommodate the possibility of future changes in the default service**
11 **supply approach and the possibility of new retail market initiatives?**

12 A. Yes. PECO’s proposed DSP III incorporates this flexibility in several ways. First,
13 the default service supply product portfolios for the Large Commercial and Industrial
14 and Medium Commercial classes do not include any supply products with delivery
15 periods that extend beyond May 31, 2017, the end of the DSP III period. As a result,
16 the Commission can easily adopt a similar plan or a very different plan for the period
17 starting June 1, 2017, without the need to face situations involving pre-existing
18 default service supply products for these customer classes with deliveries that extend
19 beyond the DSP III period.

20 Second, the solicitations for Residential and Small Commercial supply products with
21 delivery periods that extend beyond May 31, 2017 (the end of the DSP III period) are

⁵¹ *Second Default Service Rulemaking Order*, p. 69.

1 not until September 2015 and September 2016, respectively. As a result, there is a
2 significant amount of time before new supply commitments extending beyond the
3 DSP III period are made, should changes need to be made due to legislative or
4 regulatory developments. In the meantime, these solicitations remain scheduled
5 because they allow for the option for a fairly seamless continuation of the laddered
6 procurement cycle as PECO transitions from DSP III to DSP IV,⁵² and they avoid
7 subjecting Residential and Small Commercial customers to a “hard stop” with regard
8 to their supply products at the end of the DSP III period. This is consistent with the
9 approach approved by the Commission in DSP II, and it helps to avoid the need to
10 replace a large portion of default service supply in a short period of time at the end of
11 the DSP III period. Customers could be exposed to magnified risks and rate
12 instability if a default service plan were to require that a large portion of the
13 customers’ default service supply must be procured in a short period of time, as
14 evidenced by the possibility of adverse short-term market conditions like those which
15 existed during the January 2014 solicitation.

16 Finally, PECO’s proposed DSP III provides flexibility because it relies on full
17 requirements supply products and it does not involve the procurement of any new
18 fixed-cost supply commitments that do not vary with load, like block energy
19 products. This is especially valuable given the increased customer migration activity

⁵² In its Second Default Service Rulemaking Order, the Commission recognized the importance of “laddering” contracts in procuring default service supply. Specifically, the Commission stated, “We agree with those parties that utilizing such practices as laddering contracts, with varying procurement periods and contract durations over multiple procurements provide definite benefits in terms of minimizing the impacts of market volatility and decreasing customer risk.” (*Second Default Service Rulemaking Order*, pp. 62-63.)

1 that already has been observed in PECO's service area, and given any uncertainty
2 about future retail market initiatives which could further affect customer migration.

3 **29. Q. Mr. Fisher, please describe the end state model for default electric service that**
4 **the Commission proposed in its Default Service End State Order in the**
5 **Investigation of Pennsylvania's Retail Electricity Market, with respect to its**
6 **relationship to default service procurement.**⁵³

7 A. For Residential and Small Commercial and Industrial customers, the Commission
8 proposed a significant shortening of the term lengths of the default service supply
9 products starting on June 1, 2015.⁵⁴ Specifically, the Commission proposed that
10 customers with peak demands below 100 kW, including Residential customers, be
11 served entirely by FPCR products with 90-day delivery periods, procured each
12 quarter. This supply portfolio would consist of substantially shorter-term supply
13 products for small customers than the products currently included in the major
14 Pennsylvania Electric Distribution Companies' ("EDC") approved default service
15 plans for these customers, as the current supply portfolios contain many products with
16 one-year and two-year delivery periods.⁵⁵

⁵³ *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (Order entered February 15, 2013) ("Default Service End State Order").

⁵⁴ *Default Service End State Order*, pp. 41, 48.

⁵⁵ *See Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company For Approval of Their Default Service Programs*, Docket Nos. P-2011-2273650, P-2011-2273668, P-2011-2273669, P-2011-2273670 (Order entered August 16, 2012), pp. 17, 19, 25-27; *Petition of PECO Energy Company for Approval of its Default Service Program II*, Docket No. P-2012-2283641 (Order entered October 12, 2012), p. 20-21, 31; *Petition of PPL Electric Utilities Corporation For Approval of a Default Service Program and Procurement Plan*, Docket No. P-2012-2302074 (Order entered January 24, 2013), pp.

1 Other key features of the Commission’s Default Service End State Order include:

- 2 • Having EDCs conduct solicitations for supply delivered after May 31,
3 2015, to obtain and offer only hourly-priced service with an administrative
4 adder for Medium and Large Commercial and Industrial customers (100
5 kW of peak demand and above) who have interval meters.⁵⁶
- 6 • Having EDCs conduct solicitations far enough in advance to permit them
7 to establish a final Price-to-Compare (“PTC”) no less than 45 days prior to
8 the effective date of the PTC.⁵⁷
- 9 • Having EDCs collaborate on solicitations in order to realize efficiencies
10 and reduce expenses, and directing the Office of Competitive Markets
11 Oversight to form a Procurement Collaboration Working Group as part of
12 this effort.⁵⁸
- 13 • Directing EDCs to develop and submit plans to the Commission by the
14 end of 2013 to implement seamless moves and instant connects in their
15 service territories by June 1, 2015.⁵⁹

7-10, 18, 29, 34; *Petition of Duquesne Light Company for Approval of Default Service Plan For the Period June 1, 2013 Through May 31, 2015*, Docket No. P-2012-2301664 (Order entered January 25, 2013), pp. 12, 36-37, 46, 50-51, 58.

⁵⁶ *Default Service End State Order*, p. 29.

⁵⁷ *Default Service End State Order*, p. 41.

⁵⁸ *Default Service End State Order*, p. 42.

⁵⁹ *Default Service End State Order*, pp. 74-75.

1 **30. Q. In the Default Service End State Order, did the Commission recognize that some**
2 **of its proposed changes may require amendments to existing legislation?**

3 A. Yes, the Commission acknowledged that procuring only a 90-day default service
4 product for Residential and Small Commercial and Industrial customers may require
5 a change to the existing statutory procurement standard, and in any event a legislative
6 change was desirable for a variety of reasons. The Commission also stated that any
7 necessary legislative changes would need to be made in 2013 to establish June 1,
8 2015, as the implementation date for its proposed end state default service model.⁶⁰
9 To date, such changes have not been adopted by the General Assembly.

10 **31. Q. Why did the Commission propose to significantly shorten the term lengths of the**
11 **default service supply products for small customers in Pennsylvania?**

12 A. In the Default Service End State Order, the Commission stated that its proposed
13 default service supply portfolio was developed to establish a better platform for the
14 sustainability of the competitive retail electricity market.⁶¹ The Commission stated
15 that without the proposed changes, it would have substantial concerns that the current
16 retail electricity market construct would not be viewed as sustainable by EGSs.⁶² The
17 Commission stated:

18 Under the current construct, the EDC purchases large portions of load
19 months, and even years, in advance of delivery. This, in turn, creates the

⁶⁰ *Default Service End State Order*, pp. 16, 41, 43, 45-46, 48.

⁶¹ *Default Service End State Order*, pp. 10, 13, 15, 23-24, 41, 48.

⁶² *Default Service End State Order*, pp. 14-15.

1 potential for a situation in which the PTC is based more on historical
2 market conditions than that at the time of delivery. Further exacerbating
3 this issue are the instances when the EDC’s PTC fails to reflect the actual
4 cost of service due to inaccurate customer migration projections, certain
5 accounting practices or inaccurate spot market price projections. These
6 inaccuracies can lead to the inclusion of significant reconciliation costs
7 within the PTC that have little or no relationship to the present market for
8 energy and, therefore, can potentially further move the PTC away from
9 market conditions at the time of delivery.⁶³

10 Therefore, the Commission explained that its “main goal in developing a revised
11 default service product is to create a more market-based PTC. This type of product
12 will mitigate the potential for ‘boom/bust’ scenarios to occur.”⁶⁴ When describing a
13 “more market-based PTC,” the Commission emphasized the importance of
14 structuring the default service model (and PTC) to more closely track current market
15 conditions, thereby better ensuring that EGSs are not subject to “boom/bust” cycles.⁶⁵
16 The Commission explained that “bust” situations are those in which the EDC’s PTC
17 is substantially lower than contemporaneous market price levels, causing customers
18 to elect the lower-priced default service.⁶⁶ The Commission expressed its concern
19 that, in the long term, such a scenario may drive EGSs out of the market and result in
20 a lack of EGS options for customers in the future when the default service price
21 rises.⁶⁷ The Commission also concluded that the 90-day FPFR “product, as proposed,

⁶³ *Default Service End State Order*, pp. 23-24.

⁶⁴ *Default Service End State Order*, p. 24.

⁶⁵ *Default Service End State Order*, pp. 10, 13-14, 23-24, 41, 45.

⁶⁶ *Default Service End State Order*, pp. 23-24.

⁶⁷ *Default Service End State Order*, pp. 23-24.

1 will reduce the likelihood of over- and under-collections...”⁶⁸

2 **32. Q. Do you believe that the products in PECO’s DSP III supply portfolio for**
3 **residential customers should have significantly shorter term lengths?**

4 A. No. I do not believe that any significant shortening of the product term lengths in
5 PECO’s residential default service supply portfolio is appropriate at this time.

6 The Commission has explicitly acknowledged that price stability is an important
7 consideration in developing a default service plan:

8 In implementing default service standards, the Commission must be
9 concerned about rate stability as well as other considerations such as
10 ensuring a “prudent mix” of supply and ensuring safe and reliable service.
11 In our view, a default service plan that meets the “least cost over time”
12 standard should not have, as its singular focus, the achievement of the
13 absolute lowest cost over the default service plan time frame but rather a
14 cost for power that is both relatively stable and also economical relative to
15 other options.⁶⁹

16 Price stability benefits are very important to some customer groups, so an
17 interpretation of “least cost” that mandates subjecting all default service
18 customers to significant price volatility through general reliance on short
19 term pricing is inconsistent with Act 129’s objectives.⁷⁰

20 Accordingly, in assessing the relative merits and drawbacks of a portfolio consisting
21 of generally shorter-term products, it must be recognized that such a portfolio would
22 erode the price stability provided to default service customers. This is an important
23 consideration because small customers generally realize the greatest benefits from

⁶⁸ *Default Service End State Order*, p. 41.

⁶⁹ *Second Default Service Rulemaking Order*, p. 40.

⁷⁰ *Second Default Service Rulemaking Order*, p. 41.

1 default service price stability. Some small customers who need price stability may
2 not have the time, incentive, knowledge, sophistication, or resources to elect an EGS
3 offering that provides the price stability that they seek with competitive pricing. The
4 mix of one-year and two-year FPCR products in PECO's residential default service
5 supply portfolio, and the semi-annual overlapping of their delivery periods, are
6 important to insulate customers from sudden and large price fluctuations. In contrast,
7 supply portfolios with generally shorter-term products would unnecessarily increase
8 residential customers' exposure to substantial price fluctuations. Act 129 appears to
9 be consistent with this position, as it requires that a default service plan include a
10 "prudent mix" of contracts that takes into account any benefits of price stability.⁷¹

11 Moreover, there is no convincing evidence that further shortening the term lengths of
12 the default service products would better facilitate the development of the competitive
13 retail market for residential customers in Pennsylvania. In fact, the greater price
14 stability provided by PECO's proposed residential supply product portfolio will
15 facilitate retail competition by providing a more predictable and stable default service
16 rate, making it easier for EGSs to market savings off of the default service rate, and
17 making it easier for customers to compare EGS offers with default service rates and
18 more confidently make retail supply decisions.

19

⁷¹ 66 Pa. C.S. § 2807(e)(3.4), and Act 129 of 2008 (Preamble).

1 **33. Q. Do market data indicate that PECO’s proposed default service supply portfolio**
2 **will reduce EGS participation in the market due to concerns about the**
3 **possibility of future “bust” periods?**

4 A. No. Based on market data from PECO’s service area, as well as from other large
5 EDC service areas in Pennsylvania, there is no reason to believe that default service
6 supply portfolios with product term lengths similar to (or even somewhat longer than)
7 those proposed by PECO will reduce EGS participation in the market due to any
8 concerns about the possibility of future “bust” periods. In fact, market data indicate
9 that EGSs will enter markets and serve customers when they are able to offer
10 attractive service offerings for customers, regardless of whether the supply product
11 term lengths present a possibility of “bust” periods in the future. These market data
12 are especially compelling because they are from a time after EGSs actually
13 experienced a period that the Commission has cited as a “bust” period (which
14 occurred during the time of the Pennsylvania EDCs’ “transition periods” in which
15 default service rates were frozen for a long period of time).⁷² Notwithstanding this
16 experience, EGSs have proven to be very willing to compete for customers in the
17 retail market when the default service supply portfolios have product term lengths
18 similar to (or even somewhat longer than) those proposed by PECO.

19 The first example of such market data pertains to PECO’s service area. In PECO’s
20 first default service plan, the default service supply portfolio for residential customers

⁷² “...a [bust] scenario is likely to drive EGSs out of the market, as occurred in 2001.” (*Default Service End State Order*, p. 24).

1 included a mix of 29-month, 24-month, 17-month, and 12-month FPFR supply
2 products, some of which were procured over a year-and-a-half before delivery of the
3 product began. During that default service plan period, the percentage of residential
4 load in PECO's service area being served by EGSs grew from 0.2%⁷³ to 34%,⁷⁴ and
5 by the end of that default service plan period there were 70 EGSs serving PECO's
6 residential load.⁷⁵

7 As another example, Duquesne Light Company recently completed a default service
8 plan period in which its residential default service rate was fixed for 29 months.
9 During this time, the percentage of residential load being served by EGSs grew to
10 approximately 44%,⁷⁶ which is one of the highest residential customer switching
11 percentages in the United States. Furthermore, even before this default service period
12 was over, Duquesne Light Company reported that the number of active EGSs serving
13 its residential load had grown to 34.⁷⁷

14 Finally, the most significant growth in PPL Electric Utilities Corporation's ("PPL")
15 residential customer switching occurred during 2010, when residential default service
16 customers were supplied through 12-month calendar year 2010 FPFR products that

⁷³ Pennsylvania Office of Consumer Advocate, "Pennsylvania Electric Shopping Statistics – October 1, 2010."

⁷⁴ Source: PECO. Data is for the week ending May 28, 2013, and includes customers who will be switched to EGSs within 45 days. Percentage of load is based on peak load contribution ("PLC") values.

⁷⁵ Source: PECO. Data is for the week ending May 28, 2013.

⁷⁶ Pennsylvania Office of Consumer Advocate, "Pennsylvania Electric Shopping Statistics – April 1, 2013."

⁷⁷ Duquesne Light Company Statement No. 8-R (Rebuttal Testimony of Scott G. Fisher) in Docket No. P-2012-2301664. *Petition Of Duquesne Light Company For Approval Of Default Service Plan For The Period June 1, 2013 Through May 31, 2015*, p. 41.

1 were procured over time during the three-year period leading up to the 2010 delivery
2 period. By the end of 2010, the percentage of PPL’s residential load served by EGSs
3 had already reached approximately 40%,⁷⁸ making PPL’s percentage one of the
4 highest in the United States.

5 In all three of these Pennsylvania service areas, the term lengths (procurement lead
6 time plus delivery period) of the default service products were in line with or were
7 even longer than the term lengths that PECO is proposing for its residential default
8 service supply products in DSP III. Yet, in all of these cases, large numbers of EGSs
9 concluded that they should invest and compete to provide value for customers despite
10 any alleged concerns about the possibility of future “bust” periods.

11 **34. Q. Is it necessary to shorten the term lengths of the default service supply products**
12 **to reduce the likelihood of over- and under-collections?**

13 A. No. PECO’s proposed DSP III will reduce the likelihood of over- and under-
14 collections by phasing out the block-and-spot component of the default service supply
15 portfolio and by relying on FPCR products for effectively all of the small customer
16 default service supply instead. Over- and under-collections are related to the degree
17 to which actual costs during a given period may vary from the retail rates that were
18 set for that period. If there is significant uncertainty about the all-in dollar-per-
19 megawatt-hour default service supply cost for an upcoming rate period when the

⁷⁸ Pennsylvania Office of Consumer Advocate, “Pennsylvania Electric Shopping Statistics – January 1, 2011.”

1 default service retail supply rate for that period is set, then the likelihood of
2 significant over- and under-collections is increased. This is the case when a block-
3 and-spot supply component is included in the portfolio, because under the block-and-
4 spot approach the EDC must forecast future default service loads and spot prices, and
5 actual outcomes may deviate significantly from the forecasted values.⁷⁹ However, in
6 both the residential portfolio proposed in the *Default Service End State Order* and
7 PECO's proposed DSP III residential portfolio (after the phase-out of the remaining
8 block-and-spot component), roughly 99% or more of the supply portfolio is
9 composed of FPCR products. Consequently, there will be very little uncertainty about
10 the default service supply costs on a dollars-per-megawatt-hour basis for any given
11 upcoming rate period at the time that the default service retail rate for that period is
12 set, so both portfolios should be similarly effective in reducing the potential for
13 significant over- or under-collections.⁸⁰ As a result, it is unnecessary to shorten the
14 term lengths of the default service supply products in order to reduce the likelihood of
15 over- and under-collections. PECO's proposed DSP III is designed to accomplish
16 this objective.

17 **35. Q. Mr. Fisher, is PECO's Plan designed to support the competitive retail market?**

18 A. Yes. Under PECO's proposed DSP III, the block-and-spot component of the default

⁷⁹ The Commission cites "instances when the EDC's PTC fails to reflect the actual cost of service due to inaccurate customer migration projections, certain accounting practices or inaccurate spot market price projections. These inaccuracies can lead to the inclusion of significant reconciliation costs within the PTC that have little or no relationship to the present market for energy and, therefore, can potentially further move the PTC away from market conditions at the time of delivery." (*Default Service End State Order*, pp. 23-24.)

⁸⁰ With either portfolio, over- and under-collections also can occur due to billing cycle lag.

1 service supply portfolio will be completely phased out and the replacement FPFR
2 products will result in a more stable and transparent residential price-to-compare
3 benchmark against which customers can compare competing retail offers. The
4 associated reductions in over- and under-collections also will enhance rate
5 transparency for retail supply decisions. Furthermore, as discussed by PECO
6 witnesses Brian Crowe (PECO Statement No. 1) and John McCawley (PECO
7 Statement No. 2), PECO will be completing the implementation of “seamless moves”
8 and “instant connect” programs during DSP III, and will continue its existing
9 Standard Offer Program through May 31, 2017. Finally, as in previous PECO default
10 service plans, EGSs will compete against market-based default service rates, as the
11 default service rates will be based on the prices for supply products obtained through
12 competitive solicitations in which multiple bidders compete to sell the products solely
13 on the basis of price.

14 IV. CONCLUSION

15 36. Q. Does this conclude your direct testimony?

16 A. Yes, it does.