



COMMONWEALTH OF PENNSYLVANIA

September 4, 2014

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Re: 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-2014-2409362**

Dear Secretary Chiavetta:

I am enclosing for filing today the Reply Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Elizabeth Rose Triscari".

Elizabeth Rose Triscari
Deputy Small Business Advocate
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Enclosures

cc: Parties of Record

Brian Kalcic

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of PECO Energy Company for :
Approval of Its Default Service Plan for the : **Docket No. P-2014-2409362**
Period from June 1, 2015 through May 31, 2017 :

CERTIFICATE OF SERVICE

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

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Petition of PECO Energy Company for :
Approval of Its Default Service Plan for the : Docket No. P-2014-2409362
Period from June 1, 2015 through May 31, 2017 :**

**REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

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Dated: September 4, 2014

TABLE OF CONTENTS

I. Introduction and Procedural History..... 1

II. Joint Petition for Partial Settlement Does Not Settle Issue of Medium
Commercial Procurement..... 3

III. OSBA’s Reply to RESA With Respect to Medium Commercial
Procurement..... 4

IV. Conclusion.....13

TABLE OF AUTHORITIES

Cases

Popowsky v. Pa. PUC,
71 A.3d 1112, 1113 (Pa. Commw. 2013), *appeal denied*,
2013 Pa. LEXIS 3288 (Pa., Dec. 31, 2013) (“Pike Decision”).....8

Default Service and Retail Electric Markets,
Docket No. L-2009-2095604 (Order entered October 4, 2011)
 (“Final Default Service Rulemaking Order”).....5

*Investigation of Pennsylvania’s Retail Electricity Market: End State of
Default Service*,
Docket No. I-2011-2237952 (Joint Statement of Chairman Robert F. Powelson and Vice
Chairman John F. Coleman, Jr. (February 14, 2013)).....5

*Joint Petition of Metropolitan Edison Co., Pennsylvania Electric Co.,
Pennsylvania Power Co., and West Penn Power Co. for Approval of their
Default Service Programs*,
Docket Nos. P-2013-2391368, P-2013-2391372, P-2013-2391375,
and P-2013-2391378
(Order entered July 24, 2014).....10

Statutes

66 Pa. C.S. § 2807(e)(3.2).....9

I. INTRODUCTION AND PROCEDURAL HISTORY

On March 10, 2014, PECO Energy Company (“PECO” or “the Company”) filed with the Pennsylvania Public Utility Commission (“Commission”) the Petition of PECO Energy Company for Approval of Its Default Service Program for the Period From June 1, 2015 Through May 31, 2017 (“Petition”). The Petition sought approval of PECO’s proposed third Default Service Program (“DSP III”) to secure default service supply for the Company’s customers for the period from June 1, 2015, through May 31, 2017.

On March 28, 2014, the Office of Small Business Advocate (“OSBA”) intervened and filed an Answer in this proceeding in order to protect the interests of the Company’s small business customers.¹

Answers were also filed by the Office of Consumer Advocate (“OCA”) and the Coalition for Affordable Utility Service and Energy Efficiency in Pennsylvania (“CAUSE-PA”) on April 1, 2014.

Petitions to Intervene were filed by CAUSE-PA, NextEra Power Marketing, LLC (“NextEra”), Philadelphia Area Industrial Energy Users Group (“PAIEUG”), FirstEnergy Solutions Corp. (“FES”), Interstate Gas Supply, Inc. (“IGS”), Direct Energy Services, LLC (“Direct Energy”), Retail Energy Supply Association (“RESA”), Noble Americas Energy Solutions LLC (“Noble”), and PECO Energy Suppliers Group (“PESG”).

¹ PECO’s non-residential procurement groups are defined on the basis of peak load, rather than by rate class. The Small Commercial procurement group is defined as all non-residential customers with peak demands less than 100 kW. The Medium Commercial procurement group is defined as all non-residential customers with peak demands greater than or equal to 100kW, but less than 500 kW. For the purposes of this proceeding, the OSBA considers customers in PECO’s Small Commercial and Medium Commercial procurement groups to constitute small business customers whose interests the OSBA is authorized and directed to protect.

This matter was assigned to Administrative Law Judge (“ALJ”) Cynthia Williams Fordham who held a telephonic prehearing conference on April 10, 2014, at which time a procedural schedule and discovery modifications were established, all petitions to intervene were granted, and PECO’s motion for a protective order was granted.

The OSBA submitted the Rebuttal Testimony and Surrebuttal Testimony of Brian Kalcic on June 26, 2014, and July 9, 2014, respectively.

An evidentiary hearing was held in Philadelphia on July 17, 2014 (the “Hearing”). PECO presented oral rejoinder testimony and certain witnesses for the parties were cross-examined. The parties agreed to waive cross-examination of other witnesses prior to the hearings and they were excused from appearing. The testimony and exhibits of the parties were entered into the record.

The OSBA filed its Main Brief on August 5, 2014, pursuant to the procedural schedule. Briefs were also filed by PECO, RESA, OCA, PAIEUG, Noble, and NextEra.

Subsequent to the filing of Main Briefs, the parties engaged in further settlement discussions and were able to agree on a partial settlement, reserving only two issues for litigation, Medium Commercial procurement and recovery of certain PJM charges. On August 18, 2014, the parties notified ALJ Fordham of the partial settlement-in-principle and requested that the date for reply briefs be extended until September 4, 2014.

A Joint Petition for Partial Settlement (“Joint Petition”) was filed on August 28, 2014.²

The OSBA files this Reply Brief with respect to the issue of Medium Commercial procurement in response to arguments made in RESA’s Main Brief, primarily its dogged reliance

² PECO, OCA, OSBA, CAUSE-PA, RESA, and NextEra were signatories to the Joint Petition. Direct Energy, FES, IGS, PESG, and Noble, which are also parties to this proceeding, did not oppose the partial settlement. PAIEUG opposes the partial settlement. However, the issues raised by PAIEUG have been reserved for litigation.

on the End State Order to the exclusion of relevant statutes and prior Commission Orders regarding default service.

II. JOINT PETITION FOR PARTIAL SETTLEMENT DOES NOT SETTLE ISSUE OF MEDIUM COMMERCIAL PROCUREMENT

Paragraph 25 of the Joint Petition explicitly reserves for litigation the issue of Medium Commercial procurement. The OSBA unwaveringly maintains that PECO's original proposal to procure Medium Commercial default service supply through 6-month, fixed-price full requirements ("FPFR"), load following contracts without overlap should be approved.³ The OSBA's support of the partial settlement should in no way imply agreement with or adoption of RESA's proposal with respect to Medium Commercial class procurement (*i.e.*, 3-month FPFR contracts for customers without interval meters with a transition to 100% hourly pricing as interval meters are installed).

Paragraphs 26 through 28 of the Joint Petition merely outline the timing and logistics agreed upon by the parties for implementation of hourly pricing if, and only if, the Commission directs that hourly pricing for Medium Commercial customers be implemented. However, Paragraphs 26 through 28 are rendered obsolete if the Commission agrees with the OSBA and determines that hourly pricing for Medium Commercial customers is contrary to the statutory default service standard and prior Commission orders.

Although the OSBA strongly objects to hourly pricing for Medium Commercial customers, if the Commission directs hourly pricing to be implemented, the OSBA has agreed that it should be done in a feasible manner. However, 3-month products and a transition to

³ In connection with the partial settlement, PECO has agreed to support the implementation of hourly priced default service for Medium Commercial customers in accordance with certain provisions. Joint Petition at ¶¶25-28.

hourly pricing for Medium Commercial customers should in no way be considered to be a foregone conclusion. The OSBA's agreement on timing and logistics in the case of a hypothetical outcome it does not support should in no way prejudice its position with respect to Medium Commercial procurement.

III. OSBA'S REPLY TO RESA WITH RESPECT TO MEDIUM COMMERCIAL PROCUREMENT

RESA argues in its brief that 3-month contracts should be introduced into the Residential default service supply portfolio and claims that the OSBA opposes that proposal, citing to OSBA witness Brian Kalcic's rebuttal testimony.⁴ To clarify, the OSBA has taken no position on Residential default service supply procurement. However, the OSBA does oppose RESA's similar recommendation to use 3-month products in the Medium Commercial default service supply portfolio. RESA rejects PECO's original proposal to supply all Medium Commercial load with 6-month FPFR contracts, and instead has proposed 3-month products for those Medium Commercial customers without interval meters, hourly pricing for those customers with interval meters, and a transition of all customers to hourly pricing as meters are installed.

RESA states that its reasons in support of 3-month contracts can be found in Section I.A.1.b of its Initial Brief, which does not exist, despite being referenced throughout the brief. For the purposes of this Reply Brief, the OSBA is assuming that RESA intended to refer to Section II.B.1.b, which sets forth RESA's arguments in favor of shorter term contracts.⁵

⁴ RESA Brief at 9.

⁵ *Id.* at 9-15.

While RESA's brief is now deciphered, its arguments still fail. RESA argues that the OSBA's concerns about rate volatility are "overreaching," explaining that Chairman Powelson and Vice Chairman Coleman believed at the time of the End State Order that 3-month default service products would "likely decrease the volatility felt by customers."⁶ The Joint Statement of Chairman Powelson and Vice Chairman Coleman rejected the argument that 90-day contracts would harm customers by subjecting them to price volatility.⁷ However, despite what the Commissioners may have believed at the time, RESA's own witness admitted in surrebuttal testimony that they were incorrect, testifying that "Quarterly contracts, by their very nature, introduce more price volatility, as compared to longer-term, fixed price contracts."⁸ In summary, RESA alleges that the OSBA should not be concerned about rate volatility because the Commission believes 3-month products will *decrease* rate volatility, but its witness testifies that the Commission must be wrong, because in fact, 3-month products introduce *more* price volatility.

RESA also ignores the Commission's Final Default Service Rulemaking Order, which recognizes that price stability should remain an important consideration when designing a default service procurement plan.⁹ As the OSBA explained in its Main Brief, the Commission has explicitly rejected RESA's argument that the "least cost" standard of Act 129 mandates that default service prices be "market-reflective" and "market-responsive" and has explicitly

⁶ RESA Cross Exam Exhibit No 2 at 3, *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952, Joint Statement of Chairman Robert F. Powelson and Vice Chairman John F. Coleman, Jr. (February 14, 2013).

⁷ RESA Cross Exam Exhibit No. 2 at 3.

⁸ RESA Statement No. 1-SR at 3.

⁹ *Default Service and Retail Electric Markets*, Docket No. L-2009-2095604, Order entered October 4, 2011 ("Final Default Service Rulemaking Order") at 39-40.

recognized that price stability should remain an important consideration when designing a default service procurement plan.¹⁰

In contrast to RESA's recommendation, PECO's original proposal appropriately takes price stability into account. PECO witness Scott Fisher testified that customers would experience "increased rate instability" if PECO were to adopt 3-month contracts.¹¹ In response, RESA argues that Mr. Fisher's testimony "misses the point" and "merely shows that RESA's proposal would permit the underlying commodity price to move up or down on a quarterly basis consistent with the market price."¹² Isn't that the very definition of rate volatility, *i.e.*, a rate moving up and down? Moreover, RESA ignores the fact that Act 129 changed the default service procurement standard from "prevailing market prices" to a "prudent mix" of products designed to provide the "least cost to customers over time." While RESA is correct that its proposal would make default service rates more market-responsive and market-reflective, RESA's preferred outcome is not consistent with Act 129. RESA even goes so far as to claim that it is already settled that a default service plan must be reasonably calculated to produce a market-responsive, market-reflective rate.¹³ The OSBA acknowledges that the Commission has recommended a progression towards a more market responsive default service product, but disagrees with RESA that this recommendation is entirely consistent with the current statute or legislative intent, a concern that the Commission itself shared in the End State Order.¹⁴

¹⁰ OSBA Main Brief at 6-7.

¹¹ PECO Statement No. 3-R at 7-11.

¹² RESA Brief at 10.

¹³ *Id.* at 11.

¹⁴ End State Order at 45.

RESA argues that the Commission has no cause for concern because reliance on 3-month products with a transition to 100% hourly pricing for Medium Commercial customers is consistent with existing statutory default service standards.¹⁵ As support for this argument, RESA points to the fact that the Commission has found that hourly pricing for large commercial and industrial (“Large C&I”) customers of the major Pennsylvania EDCs, and a 100% spot market procurement plan for Pike County Power & Light (“Pike”), is consistent with the “prudent mix” standard. RESA also argues that the Commonwealth Court’s appellate decision in Pike affirming the Commission’s decision was issued after the End State Order, thus relieving any concerns the Commission might have about its recommendations.¹⁶

There are several flaws with RESA’s argument. As the OSBA stated in its Main Brief, the two examples that RESA cites (where the Commission deemed a 100% spot market product to meet the prudent mix standard) are distinguishable. First, Large C&I customers are different from Medium Commercial customers, and the circumstances in Pike are different from those in PECO’s service territory. The Commission must examine the question of what constitutes a prudent procurement mix designed to provide the least cost to customers over time on a case-by-case basis. Hourly pricing may be prudent for Large C&I customers, but that cannot be extrapolated to mean it is prudent for Residential, Small Commercial, or Medium Commercial customers. As Mr. Fisher testified at the Hearing:

I would say for the industrial customers, [hourly pricing] makes sense and would be a reason to facilitate the competitive market. Whether that’s fit for residential customers is a very different animal across the nation. You see the same thing, industrial and

¹⁵ RESA Brief at 14.

¹⁶ *Id.*

residential are very different types of customers with very different understandings of the market.¹⁷

Similarly, in the case of Pike, where a majority of customers are not taking default service, 100% spot market prices may be prudent, but this obviously does not mean that 100% spot market purchases are prudent for all EDCs and all customer classes. Pike is anomalous to other Pennsylvania EDCs and as such, the Commonwealth Court's holding must be read fairly narrowly, *i.e.*, that 100% spot market purchases constitute a prudent mix in the specific and unique circumstances of Pike, but not necessarily in other situations.

As the Commonwealth Court noted in its decision upholding Pike's 100% spot market procurement plan, from Spring 2006, through Spring 2011, an Aggregation Program was in effect, under which most of Pike's customers became customers of Direct Energy and remained customers of Direct Energy after the end of the Aggregation Program.¹⁸ Pike's rationale for its proposed plan was that due to the small size of its default service customer base, it was difficult for Pike to estimate its default service requirements and to negotiate favorable long-term contracts.¹⁹ The OCA disagreed and argued that Pike's plan should include financial hedges.²⁰ The ALJ issued a recommended decision recommending that Pike's plan be approved as modified by the OCA's proposal of a fixed-price hedge contract for 1 MW or less of on-peak default service.²¹ The ALJ determined that the hedge contract would introduce greater price

¹⁷ Hearing Tr. p. 106, line 20 to p. 107, line 2.

¹⁸ *Popowsky v. Pa. PUC*, 71 A.3d 1112, 1113 (Pa. Commw. 2013), *appeal denied*, 2013 Pa. LEXIS 3288 (Pa., Dec. 31, 2013) ("Pike Decision").

¹⁹ *Id.* at 1114.

²⁰ *Id.*

²¹ *Id.*

stability into Pike's default service pricing and that the costs would not be excessive.²² The Commission rejected the ALJ's recommendation, finding that it placed too much emphasis on price stability at the expense of lower customer costs.²³ The Commission found that the costs of a fixed-price hedge might cost customers more than fluctuation in spot market prices.²⁴

The OCA appealed the matter to Commonwealth Court arguing that the Commission's concerns regarding a fixed price hedge were not supported by substantial evidence and that the Commission erred as a matter of law in approving a plan when it included only one source of electricity listed in Section 2807(e)(3.2) of the Competition Act.²⁵ The Commonwealth Court affirmed the Commission's decision, holding that it did have substantial evidence to support its finding with regard to the hedge.²⁶ The Court also held that a prudent mix of sources may include only one when this is the most prudent course and is likely to incur the least cost over time.²⁷ The Court found that the Commission had properly taken price stability into consideration and had acknowledged its importance and therefore gave deference to the Commission's decision that the additional benefits of a financial hedge would not be justified by the additional costs.²⁸

Notably missing from the Court's decision is any discussion of or reliance on the alleged importance of market-reflective or market-responsive default service rates. Rather, in

²² *Id.* at 1115.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*; see also 66 Pa. C.S. § 2807(e)(3.2).

²⁶ *Pike Decision* at 1116.

²⁷ *Id.* at 1117.

²⁸ *Id.* at 1117-1118

determining whether a certain default service product or products were prudent, the Court focused on cost to customers and price stability.

The circumstances surrounding PECO's procurement are entirely different than in Pike. PECO has a large number of default service customers and is able to estimate its default service requirements and negotiate favorable long-term contracts. Moreover, the "alternate" product at issue in Pike was a hedge-contract, not a FPFR load following contract like those proposed by PECO. A hedge contract is intended to ensure against large swings in market prices, but it comes at a cost and does not lock in supply at a fixed price like a FPFR contract.

The Commonwealth Court, if presented with the facts in PECO, would not be held to any sort of precedent set in the Pike Decision. The Pike case is distinguishable and gives little to no guidance on whether RESA's proposal to rely on 3-month products and ultimately on hourly pricing for Medium Commercial customers constitutes a "prudent mix."

Furthermore, the Pike Decision provides no safe haven for implementation of the recommendations in the End State Order. The Commission appeared to recognize that fact in its recent Opinion and Order in the First Energy companies third default service proceeding when it chose not to mention the End State Order when describing the legal standard for default service, citing only to sections of the Public Utility Code, the Commission's default service regulations and policy statement, and other Retail Market Investigation Orders.²⁹

RESA's argument incorrectly focuses solely on whether one type of product can meet the "prudent mix" prong of the default service statutory standard. The OSBA certainly does not dispute that the Commission approved solely one-year FPFR contracts for Small Commercial

²⁹ *Joint Petition of Metropolitan Edison Co, Pennsylvania Electric Co., Pennsylvania Power Co. and West Penn Power Co. for Approval of their Default Service Programs*, Docket Nos. P-2013-2391368, P-2013-2391372, P-2013-2391375, and P-2013-2391378 (Order entered July 24, 2014) at 20-21.

customers and solely 6-month contracts for Medium Commercial customers in DSP II, and the OSBA supports PECO's proposal to keep those same procurement plans in DSP III. What the OSBA disputes is not the number of sources, but rather whether 3-month products with a transition to hourly pricing for PECO's Medium Commercial customers is prudent and designed to provide the least cost to customers over time.

It is possible for one product to meet this statutory standard, as it did in Pike, but RESA's testimony and brief provide no evidence or analysis of why the increased volatility of shorter term contracts and/or hourly pricing is prudent for PECO's Medium Commercial customers or that these products are designed to provide the least cost to customers over time. Rather, RESA rests its entire argument on the market-responsiveness of 3-month contracts and hourly pricing, a factor the legislature affirmatively removed from the statute when it replaced "prevailing market prices" with the current standard. It is RESA's dogged reliance on the market-responsiveness of default service rates rather than a prudent mix of sources designed to provide the least cost to customers over time that is overreaching. RESA's argument is simply inconsistent with the plain language of the statute and is clearly not what the legislature intended.

RESA also alleges that hourly pricing is a more appropriate default structure for Medium Commercial customers because they are more aligned with Large Commercial customers.³⁰ However, RESA has presented no evidence of the "alignment" of Medium Commercial and Large Commercial customers with respect to their level of shopping sophistication, economic interests, load profiles, numbers of attractive EGS offers received, etc.

Finally, RESA's brief takes a quote from OSBA witness Mr. Kalcic's testimony entirely out of context as follows:

³⁰ RESA Brief at 17.

OSBA appears to argue that RESA's proposal for Medium Commercial customers with interval meters would "effectively implement the Commission's End State Order" even though, according to OSBA witness Kalcic, the Commission in that same order concluded that legislative changes were a necessary precondition to such result.³¹

The OSBA testimony that RESA refers to was in response to RESA witness Mr. Hudson's suggestion that no legislative changes are needed in order to implement his procurement plan because his proposal would only begin a transition towards the Commission's desired default service end state.³² The question posed to Mr. Kalcic in rebuttal was whether it is accurate for Mr. Hudson to characterize RESA's Small Commercial and Medium Commercial procurement plans as a "transition towards" rather than an "implementation of" the Commission's preferred default service end state (as outlined in the End State Order).³³ Mr. Kalcic responded no, that RESA's proposal was not merely a transition towards, but rather "would effectively implement the Commission's End State Order."³⁴ Read in context, the intended meaning of Mr. Kalcic's testimony is clear. RESA's proposal would implement the recommendations in the Commission's End State Order, regardless of whether they are compliant with the statutory standard. Legislative changes are a necessary precondition for the End State Order's recommendations to comply with the Competition Act.

In conclusion, RESA's Medium Commercial procurement proposal is unnecessary to promote competitive retail market growth (as explained in the OSBA's Main Brief at p. 9), would result in unreasonable price volatility for the few remaining Medium Commercial default

³¹ RESA Brief at 18.

³² RESA Statement No. 1 at 13-14.

³³ OSBA Statement No. 1 at 5.

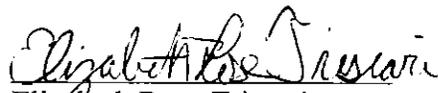
³⁴ *Id.*

service customers, and is not in compliance with the applicable statutory standards for default service. The Commission should reject it and, instead, approve PECO's original proposal to procure default service supply for the Medium Commercial Class through six-month, fixed price full requirements, load following contracts without overlap.

IV. CONCLUSION

For the reasons set forth in its Main Brief and those presented herein, the OSBA respectfully requests that the ALJ and the Commission approve PECO's original proposal to procure default service supply for the Medium Commercial Class through six-month, fixed price full requirements, load following contracts without overlap.

Respectfully submitted,


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Dated: September 4, 2014