

**DUQUESNE LIGHT STATEMENT NO. 3-SR**

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Petition Of Duquesne Light Company :  
For Approval Of Default Service Plan :           Docket No. P-2014-2418242  
For The Period June 1, 2015 Through :  
May 31, 2017 :**

**SURREBUTTAL TESTIMONY OF  
NEIL S. FISHER**

**Dated: August 15, 2014**

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1 **I. Introduction**

2 **Q. Are you the same Neil S. Fisher who sponsored direct and rebuttal testimony in this**  
3 **proceeding?**

4 A. Yes, I submitted direct testimony (Duquesne Light Statement No. 3) on April 24, 2014,  
5 with the Company's initial filing in this proceeding, and I submitted rebuttal testimony  
6 (Duquesne Light Statement No. 3-R) on August 1, 2014.

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

9 A. I will respond to rebuttal arguments made by various interveners regarding the power  
10 procurement methods and the supply product portfolios used in Duquesne Light's  
11 proposed default service plan ("DSP VII" or "DSP VII Plan"). Specifically, I will respond  
12 to rebuttal comments regarding price stability and the development of competitive markets  
13 made by the Retail Energy Supply Association ("RESA") witness Hudson and the  
14 Pennsylvania Office of Consumer Advocate ("OCA") witness Estomin, as they relate to  
15 the term lengths of the products in the default service supply portfolio for the Residential  
16 class and RESA's proposal to inject "hard stops" in the supply procurement process. I  
17 also will respond to RESA's belief that default service should be a "plain vanilla service"  
18 that acts as a "backstop" to the competitive market. Finally, I will respond to RESA's  
19 characterization of Duquesne Light's Small Commercial and Industrial ("Small C&I")  
20 procurement proposal as a "step backwards."

21  
22 **Q. Please summarize your major conclusions.**

1 A. The following are my major conclusions:

2 1. RESA's Residential and Small C&I recommendation to shorten the product term  
3 lengths and inject "hard stops" of supplies would expose default service customers  
4 to unnecessary rate instability and risks, the ramifications of which RESA  
5 continues to ignore in its rebuttal testimony.

6 2. There is no convincing evidence that RESA's Residential and Small C&I  
7 recommendation to further shorten the term lengths of the default service products  
8 would better facilitate the development of the competitive retail market, and even if  
9 it were concluded that more market responsive rates could increase customer  
10 switching, RESA's sole focus on enhancing the retail market ignores other  
11 important responsibilities of the Commission in setting default service rates. For  
12 example, while the Commission clearly has an interest in the development of the  
13 retail competitive market, the Commission has explicitly acknowledged that price  
14 stability is an important consideration in developing a default service plan. Default  
15 service still plays a valuable role in providing stable rates at market-based levels,  
16 especially to Residential and Small C&I customers.

17 3. RESA's characterization of Duquesne Light's Small C&I procurement proposal as  
18 a "step backwards" is without merit. The Company has proposed a continuation of  
19 the 12-month laddered supply contracts started in DSP VI, which is essentially the  
20 same approach used in the Company's initial DSP VI proposal and the revised plan  
21 included in the Company's most recent DSP VI filing.

22 Each of these conclusions is supported in the subsequent sections of my surrebuttal  
23 testimony.

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**II. RESA’s Residential and Small C&I Recommendation to Shorten the Product Term Lengths and Inject “Hard Stops” of Supplies Would Expose Default Service Customers to Unnecessary Rate Instability and Risks, the Ramifications of which RESA Continues to Ignore in its Rebuttal Testimony**

**Q. Did RESA consider in its rebuttal testimony the ramifications with respect to default service rate volatility and risks associated with its recommendations to shorten the term lengths of the supply products in the Residential and Small C&I customers’ default service supply portfolios?**

A. No. RESA does not appear to be concerned with its proposed increase in default service rate volatility and risks in either its direct or rebuttal testimony. In discovery, RESA acknowledges that the Commission may choose to consider price stability as one of the factors used to evaluate a default service procurement plan,<sup>1</sup> but does not provide any analysis of the ramifications with respect to rate volatility and risks associated with its recommendations.

**Q. Does RESA acknowledge that its supply portfolio recommendation for Residential and Small C&I customers would introduce more price volatility in default service rates?**

A. Not that I can see in this proceeding, but as recently as last month, RESA witness Hudson admitted in testimony in another Pennsylvania default service supply proceeding that,

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<sup>1</sup> RESA discovery response to Duquesne Light Set I-14.

1 “Quarterly contracts, by their very nature, introduce more price volatility, as compared to  
2 longer term, fixed price contracts.”<sup>2</sup>

3  
4 **Q. Did Mr. Hudson express any concerns about introducing more price volatility in**  
5 **default service rates for Residential and Small C&I customers?**

6 A. No. Mr. Hudson simply claims in his testimony that the Commission was well aware of  
7 this when it issued the Default Service End State Order, but made its recommendation  
8 anyway.<sup>3</sup> It appears that RESA assumes that no or little consideration of price stability  
9 benefits is necessary at this time given the Commission’s Default Service End-State Order.

10  
11 **Q. Do you agree that given the Commission’s Default Service End-State Order that no**  
12 **or little consideration of price stability benefits is necessary at this time?**

13 A. No, I do not. In the Default Service End-State Order, the Commission recognized that  
14 some of its proposed changes may require amendments to existing legislation. The  
15 Commission acknowledged that procuring only a 90-day default service product for  
16 Residential and Small C&I customers may require a change to the existing statutory  
17 procurement standard, and in any event a legislative change was desirable for a variety of

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<sup>2</sup> See Exhibit NSF-3. Surrebuttal Testimony of Richard Hudson, Jr., *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, July 9, 2014, p.3. In my rebuttal testimony, I noted that RESA did not respond to Duquesne Light’s discovery questions on time. In particular, I have been advised by counsel that pursuant to the discovery rules adopted in this proceeding, RESA’s responses were due on July 28, 2014. However, Duquesne Light did not receive answers to 13 of the 14 questions contained in Set I until July 31, 2014, the day before rebuttal testimony was due. In addition, the referenced attachment (RESA Attachment RJII-DLC-2) was inadvertently omitted by RESA and was not received by the Company until August 6, 2014, after I submitted my rebuttal testimony.

<sup>3</sup> Exhibit NSF-3.

1 reasons. The Commission also stated that any necessary legislative changes would need to  
2 be made in 2013 to establish June 1, 2015, as the implementation date for its proposed  
3 end-state default service model.<sup>4</sup> The Commission obviously made a conscious choice not  
4 to implement or require the supply portfolio recommendations contained in the Default  
5 Service End-State Order at this time without legislative action. To date, such changes  
6 have not been adopted by the General Assembly. Therefore, I believe that the benefits of  
7 price stability should be considered when determining a prudent mix of supply contracts.

8 However, it is important to recognize that the Company did consider the  
9 Commission's Default Service End-State Order in the development of its DSP VII Plan.  
10 Specifically, the Company has proposed to move toward more frequent default service  
11 supply rate changes and more market responsive rates for the Medium C&I and  
12 Residential customers. Per the Commission's guidance in the Default Service End-State  
13 Order, the Company also made a conscious effort not to include the use of longer-term  
14 contracts than those supply products already in place in DSP VI and not to include spot  
15 energy products that create the potential for significant over- or under-collections.<sup>5</sup> At the  
16 same time, the Company also considered the benefits of price stability for default service  
17 customers in light of the current statutory requirements as well as the market conditions  
18 facing each procurement class.

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<sup>4</sup> *Default Service End-State Order*, pp. 16, 41, 43, 45-46, 48.

<sup>5</sup> 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.

1 **Q. What are the primary concerns with respect to rate volatility and risks associated**  
 2 **with RESA’s recommendations related to the Residential and Small C&I customers’**  
 3 **default service supply portfolios?**

4 A. RESA’s proposed supply portfolio recommendation for Residential and Small C&I  
 5 customers would shorten the term of the default service supply products and inject “hard  
 6 stops” of supply within the DSP VII period as well as at the end of the DSP VII period.  
 7 Both of which would expose default service customers to unnecessary rate instability and  
 8 risks.

9  
 10 **Q. Please summarize the positions of the parties regarding a “hard stop” and the**  
 11 **laddering of supply contracts for Residential and Small C&I customers.**

12 A. Duquesne Light’s DSP VII Plan would procure 12-month laddered fixed-price, full  
 13 requirements supply products, with 50% of the Residential and Small C&I supply  
 14 purchased every six months.<sup>6</sup> The Company’s DSP VII Plan avoids purchasing 100% of  
 15 the supply at one point in time or within a short, few-month period of time.

16 **Company’s DSP VII Proposal (Residential and Small C&I)**

Procurement Dates	2015						2016						2017					Post POLR VII Plan												
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Oct-14 (50%)	6 months																													
Mar-15 (50%)	12 months																													
Sep-15 (50%)												12 months																		
Mar-16 (50%)											12 months																			
Sep-16 (50%)																			12 months											

17  Supply obtained in DSP VI.

<sup>6</sup> Separate RFPs are conducted for Residential supply and Small C&I supply.

1           In contrast, RESA’s recommended plan (see RESA Exhibit RJR-6) would subject  
2 Residential and Small C&I customers to a “hard stop” with regard to their supply products  
3 at the end of the DSP VII period, requiring all of the Residential and Small C&I default  
4 service supply for delivery starting in June 2017 to be procured in a short period of time  
5 near the end of the DSP VII period. In addition, RESA’s proposal for Residential and  
6 Small C&I customers would inject another “hard stop” within the DSP VII period,  
7 requiring the Company to procure 100% of the default service supply in March 2016 for  
8 contracted supply to be delivered beginning June 1, 2016.<sup>7</sup>

9           In RESA’s rebuttal testimony, RESA adds that coming to a “hard stop” of supply  
10 would not be a new circumstance as Duquesne Light bid out 100% of its supply twice in  
11 the recent past – in DSP VI, 100% of the Residential default service procurement contracts  
12 began in June 2013 and expired in May 2014, when new contracts began. Mr. Hudson  
13 supports his position by arguing that, “While no one can predict where energy prices will  
14 be at any specific moment in time, it is incorrect to imply that a ‘hard stop’ will  
15 automatically result in price shock.”<sup>8</sup>

16           OCA witness Estomin supports the concept of laddering of supply contracts stating  
17 in his rebuttal testimony that:

18           There is a significant benefit to residential customers from avoiding the  
19 need for Duquesne to enter into a full suite of new contracts with  
20 deliveries set to commence on June 1, 2017. The “overhang” of 50  
21 percent of the contracts provides a degree of pricing continuity between

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<sup>7</sup> RESA discovery response to Duquesne Light I-3, RESA Attachment RJH-DLC-1.

<sup>8</sup> RESA Statement No. 1, Rebuttal Testimony, p. 5.

1 the plan period ending May 31, 2017 and the plan period that would begin  
2 June 1, 2017.<sup>9</sup>

3 Similarly, the Office of Small Business Advocate (“OSBA”) supports Duquesne  
4 Light’s laddered supply portfolio for the Small C&I class, arguing that, “In the OSBA’s  
5 view, the use of laddered, twelve-month supply contracts will provide Small C&I  
6 customers a reasonable level of price stability over the 2015-2017 default service period.”<sup>10</sup>  
7

8 **Q. What is your response?**

9 A. I discuss the importance of avoiding “hard stops” for Residential and Small C&I  
10 customers at length in my rebuttal testimony.<sup>11</sup> In general, I do not believe it is in the  
11 Residential and Small C&I customers’ interests to completely “stop” all supplies and  
12 “start” purchases all over again – whether it is within the DSP VII period or at the  
13 conclusion of the default service period every two years. To the extent the Commission  
14 and/or Pennsylvania Legislature want to implement a different default service structure  
15 going forward, this can be readily accomplished within the framework proposed by  
16 Duquesne Light.

17 Furthermore, I find little comfort in RESA’s rebuttal testimony statement that  
18 while no one can predict where energy prices will be at any specific moment in time, it is  
19 incorrect to imply that a “hard stop” will automatically result in price shock. RESA

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<sup>9</sup> OCA Statement No. 1, Rebuttal Testimony, p. 5. In addition, the OCA continues to recommend that the Company include 24-month supply contracts in the portfolio in order to further enhance price stability of Residential default service rates.

<sup>10</sup> OSBA Statement No. 1, Direct Testimony, p. 2-3.

<sup>11</sup> Duquesne Light Statement No. 3-R, pp. 14-18.

1 misses the point. I agree with RESA that is incorrect to imply that a “hard stop” will  
2 automatically result in price shock. The real problem is that a “hard stop” can result in  
3 significant rate shock, and it is unnecessary for Residential and Small C&I customers to  
4 assume this risk on a going forward basis.

5  
6 **Q. What about RESA’s statement that Duquesne Light bid out 100% of its supply twice**  
7 **in the recent past without incident?**<sup>12</sup>

8 A. Requiring Residential and Small C&I customers to assume the risk of Duquesne Light  
9 buying 100% of its supply at a particular point in time or over a short period of time in the  
10 future is unnecessary. The possibility of future market turbulence is very real, as  
11 evidenced by the recent market price events that resulted from the Winter 2014 Polar  
12 Vortex. The fact that Duquesne Light managed to bid out 100% of its supply twice in the  
13 recent past without incident is not sufficient to justify RESA’s position. Even if your home  
14 did not burn down last week, having some form of home/fire insurance is still a good idea.

15  
16 **Q. Did Duquesne Light propose a “hard stop” of supplies in DSP VI?**

17 A. No. RESA notes in its rebuttal testimony that the Commission ruled on this issue in  
18 Duquesne Light’s last default service plan proceeding, when it rejected the Company’s  
19 plan to procure contracts that extended beyond the end of the plan period.<sup>13</sup> But as  
20 explained by Mr. Habberfield, the Commission’s DSP VI decision to reject the Company’s

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<sup>12</sup> RESA Statement No. 1, Rebuttal Testimony, p. 5.

<sup>13</sup> RESA Statement No. 1, Rebuttal Testimony, p. 5.

1 proposed overhang contracts in DSP VI was based on the Commission's assumption at  
2 that time that amendments to Act 129 were going to be made:

3 Essentially, we are assuming that the Competition Act will be amended to  
4 change the default service responsibilities of the EDCs, and that the  
5 prudent course would be to impose a hard stop on Duquesne's  
6 procurements to provide for a clean transition to another default service  
7 plan at the end of DSP VI.<sup>14</sup>

8 The Competition Act, however, has not been amended to change the default service  
9 responsibilities of the EDCs.

10  
11 **Q. Given this, does the Company have a plan to enhance price stability benefits for**  
12 **customers during the transition from DSP VI to DSP VII?**

13 A. Yes. In order to avoid the unnecessary exposure to potential market price events, the  
14 Company recently filed a petition for approval to procure in October 2014 a portion of the  
15 default service requirements of its Residential and Small C&I customers for the first six  
16 months of the DSP VII period.<sup>15</sup>

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<sup>14</sup> See Petition of Duquesne Light Company for Approval of a Default Service Program and Procurement Plan for the Period June 1, 2013 through May 31, 2015, Docket No. P-2012-2301664 (Order entered January 25, 2013), pp. 80-81.

<sup>15</sup> The proposal to procure 50% of the supply in October 2014 would eliminate the February 2015 procurement and reduce the exposure to adverse market-related events by avoiding the procurement of all of the default service supply for the commencement of DSP VII during a short period of time. Eliminating the February procurement also would result in one less round of RFP results for review by the Commission since the Company already must conduct a solicitation later this year under its DSP VI plan. See Duquesne Light Petition filed on June 5, 2014 in Docket No. P-2012-2301664.

1 **Q. In DSP VII, couldn't the Commission provide Duquesne Light a similar option to**  
2 **request approval of "overhang" contracts closer to the end of the plan period as**  
3 **RESA suggests in its rebuttal testimony?**<sup>16</sup>

4 A. This poses several problems. First, it adds the administrative time and effort of yet another  
5 filing concerning default service supply products. As it is, the Company, intervening  
6 parties, and the Commission must revisit the default service supply portfolio every two  
7 years. Additional default service filings generally are unnecessary in the absence of  
8 changes in the statute, so it does not make sense on a going-forward basis to adopt default  
9 service plans that effectively require additional filings if the statute is not amended in the  
10 future.<sup>17</sup> Second, the timing to implement and obtain the necessary approvals for this  
11 process is constrained. RESA argues that supply should not be purchased "too far" in  
12 advance of delivery in order to increase the probability that default service rates will be  
13 more reflective of current market conditions at the time default service is delivered.<sup>18</sup> The  
14 Company addresses RESA's concern in its DSP VII Plan for Residential and Small C&I  
15 customers by procuring laddered supply products every six months within three months of  
16 the start of delivery. The ability to buy with shorter lead times can be compromised in  
17 situations in which efforts are being made to avoid a previously implemented "hard stop."  
18 For example, in order to avoid buying 100% of the Residential supply over a short period  
19 of time for delivery beginning on June 1, 2015 (the start of the DSP VII period), the

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<sup>16</sup> RESA Statement No. 1, Rebuttal Testimony, p. 5.

<sup>17</sup> In PECO's DSP II proceeding, the Commission approved PECO's procurement of supply contracts extending past May 31, 2015 for Residential and Small Commercial default service customers, in part, because "PECO's use of laddered contracts of various durations creates a viable contingency plan that can be redesigned if changes in PECO's default service responsibility do arise." October 2012 Order, p. 31; see also Default Service Policy Statement, §69.1805(1) (stating that default supply contracts "should be laddered to minimize risk" for Residential and Small Commercial customers).

<sup>18</sup> RESA Statement No. 1, Rebuttal Testimony, pp. 4-5.

1 Company has requested to purchase 50% of the supply in October 2014, well in advance  
2 of the “normal” lead time of Duquesne Light’s other supply purchases. Alternatively, in  
3 order to avoid longer lead times, Duquesne Light would have had to petition the  
4 Commission and obtain the necessary regulatory approvals to extend the term of the 12-  
5 month Residential product obtained in April 2014. Even if the Company were to ask for  
6 expedited approval, this would have required a filing no later than early December 2013,  
7 approximately six months into its DSP VI plan.<sup>19</sup> Yet another option would be to have two  
8 procurements close together (e.g., February and March 2015) prior to the start of DSP VII.  
9 This option is unpopular with consumer advocates since it exposes customers to  
10 unnecessary risks and requires an “out-of-cycle” RFP with additional administrative costs.  
11 In sum, this process of making an additional regulatory filing within the two-year default  
12 service period is more complicated than it may sound, and frankly, is unnecessary.

13  
14 **Q. You mentioned earlier that RESA does not appear to be concerned with its proposed**  
15 **increase in default service rate volatility and risks in either its direct or rebuttal**  
16 **testimony. Did the Company consider the ramifications with respect to rate volatility**  
17 **and risks associated with RESA’s and the Company’s recommendations for the**  
18 **supply portfolio to serve Residential and Small C&I default service customers?**

19 **A.** Yes. In my rebuttal testimony, I stated that the shorter-term products proposed by RESA  
20 (including the associated “hard stops” in supply) would unnecessarily increase Residential  
21 and Small C&I customers’ exposure to substantial price fluctuations, resulting in less

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<sup>19</sup> In DSP VII, Duquesne Light would have to file a petition in early 2016 and ask for expedited approval to extend the contract being solicited in the September 2016 RFP if it wanted to avoid the extra and unnecessary administrative costs of conducting an “out-of-cycle” RFP.

1 stable rates over time. I also presented the results of an analysis of historical market price  
2 movcments that indicates that the degree of rate instability for Residential and Small C&I  
3 default service customers would double if the type of supply portfolio to which Mr.  
4 Hudson recommends transitioning were approved.<sup>20</sup>

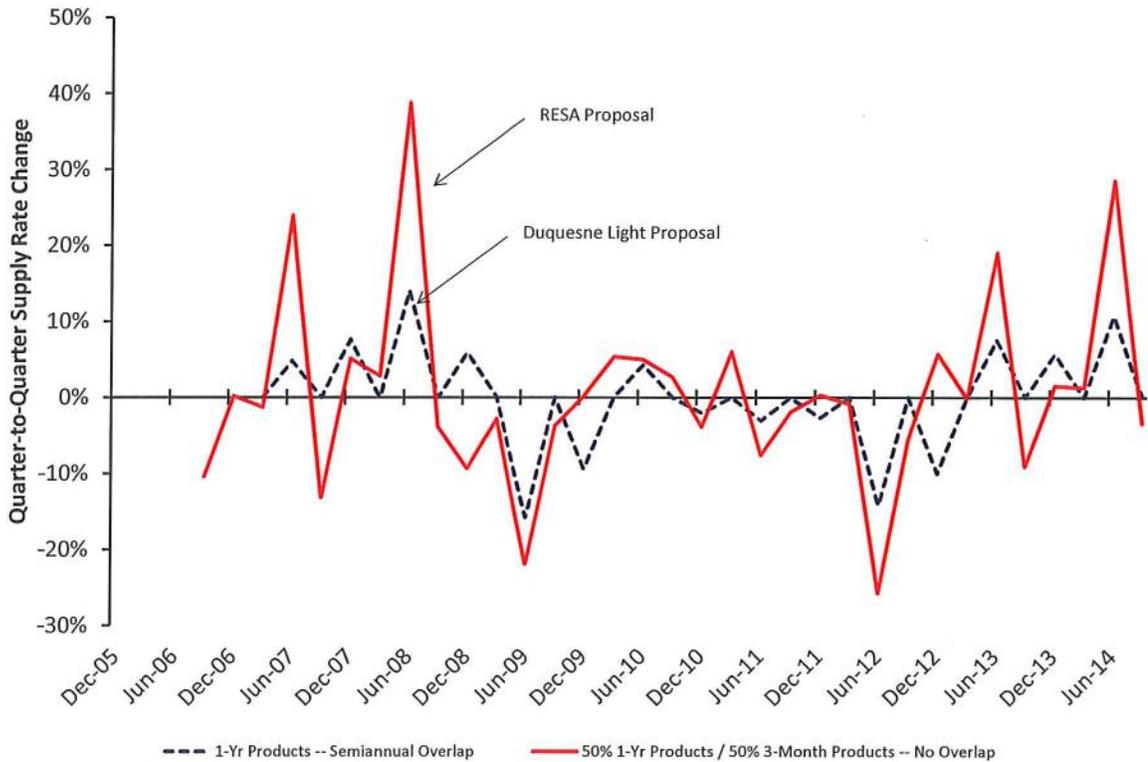
5  
6 **Q. Briefly describe the analysis you conducted.**

7 A. I compared the rate instability for the supply portfolio to which RESA would like to  
8 transition, namely 50% 3-month and 50% 12-month products, to that associated with the  
9 Company's proposed supply portfolio of 100% laddered 12-month products. In both  
10 cases, rates were calculated for a given supply product over time based on actual market  
11 forward energy prices (purchased three months in advance of the start of delivery),  
12 capacity prices, class-specific load profiles, basis differentials, and other supply costs. For  
13 each supply portfolio, product prices were evaluated beginning in September 2005 through  
14 June 2014. Based on this historical market price information, I calculated the quarter-to-  
15 quarter supply rate changes that would have occurred under the two different supply  
16 portfolios over time. Figure 6 clearly indicates that RESA's recommended supply  
17 portfolio does indeed result in significantly increased rate instability. This increased rate  
18 instability is due primarily to the inclusion of short-term products and "hard stops" in  
19 supply.

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<sup>20</sup> Duquesne Light Statement No. 3-R, pp. 13-14.

1 **Figure 6 Rate Instability for Residential and Small C&I Default Service Customers**  
 2 **Would Double if the Type of Supply Portfolio to which RESA Recommends**  
 3 **Transitioning Were Approved**



4  
5  
6 **Q. Does your analysis capture all the potential rate volatility and risks?**

7 A. No. Actual future outcomes could exceed those experienced in the past, as there certainly  
 8 are potential outcomes even more extreme than what has already occurred in recent years.  
 9 The doubling of the rate instability and risks shown in my analysis that would result from  
 10 the type of Residential and Small C&I supply portfolio to which Mr. Hudson recommends  
 11 transitioning is significant, but it is important to recognize that actual future rate instability

1 could be even greater than what I show in my analysis based on actual market prices  
2 experienced in recent years.

3  
4 **Q. In his rebuttal testimony, OCA witness Estomin also states that RESA's supply**  
5 **portfolio recommendations to further shorten the product term lengths a) would**  
6 **serve to erode price stability, and b) not unambiguously help the competitive market.**  
7 **What is your response?**

8 A. First of all, I find it interesting that Dr. Estomin continues to recommend the inclusion of  
9 5% spot energy in the Residential supply portfolio when he is concerned about price  
10 stability. For all the reasons described in my rebuttal testimony, the OCA's proposal to  
11 include spot market priced supply in the Residential supply mix should be rejected.<sup>21</sup>

12 Second, Dr. Estomin states that,

13 Rather than improving the overall characteristics of the portfolio, Mr.  
14 Hudson's recommendations would serve to erode price stability and result  
15 in a residential Default Service portfolio that is characterized by more  
16 price instability than the portfolio proposed by the Company. Further, the  
17 competitive market is not unambiguously helped by "market responsive"  
18 Default Service prices. The competitive market for retail residential  
19 service also benefits from stability in Default Service prices. Price  
20 stability provides a basis for residential consumers to effectively evaluate  
21 competitive offers under prices that are not seen as fluctuating. This  
22 enables customers to have confidence that the relationship between the  
23 competitive price and the Default Service price would be reasonably  
24 consistent over a substantial portion of the competitive contract period.

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<sup>21</sup> Duquesne Light Statement No. 3-R, pp. 31-37.

1                   Consequently, increased price stability within the residential Default  
2                   Service portfolio can help EGSs attract residential load.<sup>22</sup>

3                   Dr. Estomin's rebuttal testimony highlights two fundamental flaws with RESA's proposed  
4                   recommendation to shorten the term of the default service supply products for Residential  
5                   and Small C&I customers and to inject "hard stops" of supply. First, it would  
6                   unnecessarily erode price stability benefits for customers, and second, it is not at all clear  
7                   that it will help the development of the competitive market; in fact, it could have  
8                   detrimental effects on the competitive market by making it more difficult for customers to  
9                   confidently evaluate competitive offers and make service decisions.<sup>23</sup> Further, I would add  
10                  that even if it were concluded that more market responsive rates could increase customer  
11                  switching, as RESA argues, there are other goals and objectives that I believe should be  
12                  considered by the Commission as a matter of good public policy, including the benefits of  
13                  price stability in default service rates. RESA's proposed supply portfolio recommendation  
14                  for Residential and Small C&I customers fails to address adequately the important public  
15                  policy goal of price stability.

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<sup>22</sup> OCA Statement No. 1, Rebuttal Testimony, pp. 3-4.

<sup>23</sup> I made similar arguments in my rebuttal testimony as well. Duquesne Light Statement No. 3-R, pp. 11-27.

1 **III. There Is No Convincing Evidence that RESA’s Residential and Small C&I**  
2 **Recommendation to Further Shorten the Term Lengths of the Default Service**  
3 **Products Would Better Facilitate the Development of the Competitive Retail Market,**  
4 **and Even If It Were Concluded That More Market Responsive Rates Could Increase**  
5 **Customer Switching, RESA’s Sole Focus on Enhancing the Retail Market Ignores**  
6 **Other Important Responsibilities of the Commission in Setting Default Service Rates**

7 **Q. Regarding the second issue raised by Dr. Estomin in his rebuttal testimony, namely**  
8 **that the competitive market is not unambiguously helped by “market responsive”**  
9 **default service rates, has RESA addressed this concern in its rebuttal testimony?**

10 A. No. As I stated in my rebuttal testimony, the fundamental premise that competition for  
11 small customers is enhanced by shorter supply products that underlies RESA’s supply  
12 portfolio recommendations is unsubstantiated.<sup>24</sup> This has not changed with RESA’s filing  
13 of its rebuttal testimony. There is no convincing evidence that further shortening the term  
14 lengths of the default service products would better facilitate the development of the  
15 competitive retail market for Residential and Small C&I customers. Contrary to RESA’s  
16 claims in this case, market data indicate that EGSs will enter markets and serve customers  
17 when they are able to provide attractive service offerings for customers, even if default  
18 service rates are fixed for periods of time similar to or even longer than that proposed by  
19 Duquesne Light, and regardless of the associated possibility of future divergences between  
20 default service rates and contemporaneous market prices.<sup>25</sup> In short, EGSs have proven to  
21 be very willing to compete for customers when the default service supply portfolios have  
22 product term lengths similar to, or even longer than, those proposed by Duquesne Light.

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<sup>24</sup> Duquesne Light Statement No. 3-R, pp. 19-27.

<sup>25</sup> In my rebuttal testimony, I highlight the experience Duquesne Light has had with offering fixed default service rates, as well as the experiences at PECO and PPL. Duquesne Light Statement No. 3-R, pp. 19-25.

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**Q. Mr. Fisher, isn't it true that Large C&I customers tend to have more market responsive rates and higher levels of customer switching to competitive suppliers than do Residential and Small C&I customers?**

A. Yes, but this does not indicate that more market responsive rates will result in greater retail competition for Residential and Small C&I customers. State regulators have recognized for many years important differences between Large C&I customers and small mass market customers (i.e., Residential and Small C&I). For example, Large C&I customers tend to be more sophisticated about energy options, and in some cases have dedicated staff to consider and evaluate electricity service offerings and to execute electricity supply purchases. Also, the potential dollar savings associated with switching to an EGS for Large C&I customers is typically much higher for Large C&I customers than for Residential customers. Accordingly, Large C&I customers tend to have a higher propensity to make informed electricity supply decisions and to switch to EGSs that provide attractive offerings and, as a result, Large C&I customers generally have much higher customer switching levels across the United States.<sup>26</sup> Therefore, the need for price stability in Large C&I customer default service rates is diminished.<sup>27</sup>

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<sup>26</sup> As I discuss later in my testimony, from an EGS perspective, the costs and risks of providing fixed-price service to weather-sensitive Residential and Small C&I customers is relatively higher than providing fixed-price service to Large C&I non-weather sensitive customers, as has become more evident in the aftermath of the Polar Vortex.

<sup>27</sup> In Pennsylvania, the Commission has supported the use of tailored supply portfolios for each customer class. Specifically, in its Second Default Service Rulemaking Order, in its discussion of the "prudent mix" requirement under Act 129, the Commission stated: "The Commission notes there was substantial unanimity on this point and agrees with the parties that the "prudent mix" standard should be interpreted to allow for a class-specific product mix that best matches the needs of each DSP customer class." *Second Default Service Rulemaking Order*, p. 69.

1 **Q. Mr. Fisher, do you believe that a competitive electricity market benefits consumers in**  
2 **terms of providing lower prices and a variety of products?**

3 A. Yes. My sense is that RESA and I generally agree on this issue. However, I disagree with  
4 RESA on the best method to achieve that outcome for Residential and Small C&I  
5 customers.

6  
7 **Q. In rebuttal testimony, RESA states that as a general policy matter, RESA believes**  
8 **that default service should be a “plain vanilla” service that acts as a backstop to the**  
9 **competitive market.<sup>28</sup> Do you agree?**

10 A. I generally agree that EDC default service should be a “plain vanilla” service. However, I  
11 believe default service still plays a valuable role in providing stable rates at market-based  
12 levels, especially for Residential and Small C&I customers. RESA’s supply portfolio  
13 recommendations are heavily focused on shortening the length of supply contracts in the  
14 portfolio. In my view, RESA is attempting to inject short-term supply products in the  
15 portfolio in an effort to make default service rates as volatile and as unattractive as  
16 possible for default service customers (what RESA refers to as a “backstop” service),  
17 against the objections of the OCA and OSBA. I, on the other hand, support establishing  
18 market-based default service supply rates for Residential and Small C&I customers taking  
19 into account the benefits of price stability.<sup>29</sup> I also believe that competition can succeed

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<sup>28</sup> RESA Statement No. 1, Rebuttal Testimony, p. 16.

<sup>29</sup> As shown in Exhibit NSF-1, Small C&I customers (with peak demands less than 25 kW) have customer switching levels more similar to Residential customers than larger Medium C&I customers.

1 with stable, market-based default service supply rates for Residential and Small C&I  
2 customers.

3 It is important to recognize that customers may switch to competitive suppliers for  
4 a variety of reasons, including:<sup>30</sup>

- 5 a. Customer assignment (e.g., customers were assigned to the EDCs' retail  
6 affiliates in Texas;<sup>31</sup> customers were assigned to retail suppliers in opt-out  
7 aggregation programs in Ohio, and customers were assigned to a retail  
8 supplier in an opt-out retail aggregation program at Pike County Power &  
9 Light<sup>32</sup>),<sup>33</sup>
- 10 b. Customer savings (e.g., EGSs offer dollar savings to electricity customers  
11 and customers affirmatively elect EGS service),
- 12 c. Value-added services (e.g., EGSs offer "green" supply options, affinity  
13 programs, etc. and customers affirmatively elect EGS service), or

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<sup>30</sup> It is also important to remember that some customers may actively choose not to switch for a variety of reasons.

<sup>31</sup> During the Price-to-Beat period in Texas, there were extended periods of time when default service rates exceeded contemporaneous market prices (commonly referred to as "headroom") due to the fuel factor natural gas "ratchet" mechanism. This allowed EGSs to enter the market and offer customer savings off of the default service rate provided by the retail affiliates of EDCs.

<sup>32</sup> Pike County Power & Light's experience represents an unusual set of circumstances for a relatively small number of customers (approximately 4,500). Pike County conducted an RFP for 100% of its default service supply in October 2005 soon after Hurricane Katrina, resulting in a 129% increase in generation rates and an overall rate increase of 70% in January 2006. After market prices dropped, Direct Energy filed a petition in March 2006 to offer an opt-out retail aggregation program that would "unwind" the Commission-approved RFP result and provide some immediate rate relief to Pike County customers. The Commission approved the opt-out retail aggregation program one month later in April 2006.

<sup>33</sup> I generally am aware that statutory provisions and regulations exist in Pennsylvania that prevent unauthorized switching of retail customers, or "slamming" without a customer's direct oral confirmation or written evidence of the consent.

1 d. Volatile default service rates (e.g., customers are exposed to default service  
2 rates that are unnecessarily volatile, and as a result they consider the rates  
3 to be unattractive so they seek alternative options from EGSs).

4 Furthermore, customer-specific attributes (e.g., education, income, electricity  
5 usage, age, spare time, etc.) also may impact the propensity of certain customers to switch  
6 to a competitive supplier. For example, economic research suggests that Residential  
7 customers, and in particular lower income Residential customers, may be less likely to  
8 switch to a competitive supplier.

9 The competitiveness of various markets can be determined in part by the  
10 class hurdle rate for new investments. No research has been undertaken  
11 on consumer hurdle rates for telecommunications services. On energy  
12 savings expenditures, however, the residential class has a significant and  
13 generally recognized higher hurdle rate than commercial customers.  
14 Moreover, even within a customer class, hurdle rates may differ. Most  
15 empirical research on consumer discount rates has examined the effects of  
16 income on the discount rate. Universally, the research shows that discount  
17 rates fall as income increases [Cambridge Systematics 1984, 34]. Lower  
18 income households generally have less education than higher income  
19 households. Not surprisingly, Cambridge Systematics found that low-  
20 income households were more likely to respond "I don't know" to the  
21 question, "How much would you have to be able to save in energy costs  
22 per year before you would be willing to invest \$100 in an energy saving  
23 device." According to the report, "low-income households are generally  
24 estimated to have higher discount rates because a larger proportion of  
25 them are unable or unwilling to determine whether an investment is  
26 advantageous."<sup>34</sup>

27 In general, I believe Residential and Small C&I customers are interested in  
28 reducing their electricity costs, but they currently do not have the same interest as Large

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<sup>34</sup> Journal of Economics Issues, *Consumer Information and Workable Competition in Telecommunications Markets*,  
Roger D. Colton, September 1993, p.10.

1 C&I customers to research the market and make efficient service decisions, especially  
2 given their equally-competing interests to earn a living, raise children, and tend to home  
3 needs. Furthermore, they generally have a lesser understanding of the benefits and risks  
4 associated with accepting one potential service offer versus another, and a lesser ability to  
5 engage in frequent and consistent “market checks” to ensure that their electricity price is  
6 sufficiently competitive or is stable.

7 It should be obvious that many factors can influence customer switching levels. It  
8 is not all about the length of default service supply contracts, as RESA’s testimony  
9 implies. Duquesne Light has achieved relatively high levels of customer switching in its  
10 service area as compared to other electric utilities in Pennsylvania and elsewhere in the  
11 United States without exposing small customers to significant rate increases, without the  
12 use of opt-out customer assignment programs, and without exposing small customers to  
13 short-term market price volatility.

14  
15 **Q. Why do you believe default service still plays a valuable role in providing stable rates**  
16 **at market-based levels, especially for Residential and Small C&I customers?**

17 A. I believe EDC default service for Residential and Small C&I customers should continue to  
18 be designed in a manner that provides reasonable, stable rates and represents a service that  
19 mass market customers may actually want. A key question for policymakers is what type  
20 of default service is appropriate for Residential and Small C&I customers, who for  
21 whatever reason, do not choose an EGS over the next two years. For instance, what type  
22 of default service would you want your 90-year old grandmother on with a fixed income?  
23 Or what type of default service would you want a low-income customer on who is working

1 three jobs to make ends meet? To the extent that a customer has the time and energy to  
2 select an EGS in search of savings or some tailored product that better suits their needs, I  
3 whole-heartedly support that form of competition. But I do not support the objective of  
4 trying to make default service as “ugly” as possible in order to force mass market  
5 customers to switch to an EGS.

6 Presumably, RESA believes that EGSs should provide stable rates to retail  
7 customers, not EDC default service. I do not believe that it is good public policy to rely  
8 on EGSs to provide stable rates to Residential and Small C&I customers at this time for a  
9 variety of reasons. As described above, there are many reasons why customers may  
10 choose to switch to an EGS, choose to remain on default service, or simply choose to do  
11 nothing. Furthermore, I am particularly troubled with the proposition of relying on EGSs  
12 to provide reasonable, stable rates to relatively weather-sensitive Residential and Small  
13 C&I retail customers in the aftermath of the Polar Vortex. Many retailers, including two  
14 large EGSs in Duquesne Light’s service area, have reconsidered their retail businesses and  
15 have decided to exit the business of making direct sales to mass market customers.

16 **FirstEnergy backs out of residential markets.** FirstEnergy Solutions is  
17 withdrawing from the competitive residential and small commercial  
18 electric markets in six states as the company scrambles to adjust its  
19 generation to fit retail sales in the face of market volatility...‘What we’re  
20 planning on doing is exiting the mass market channel, the individual  
21 residential as well as smaller business market. Essentially what we’re  
22 doing is de-risking our business.’...‘What we’ve seen, especially coming  
23 out of the polar vortex’ in January, ‘is that volatility of the electric market  
24 is reducing our ability to offer long-term stable pricing to customers,’  
25 Francis said. ‘And it’s also increasing our risk of serving retail load.’  
26 ...‘Unlike large industrials and some large commercial customers whose  
27 usage is mostly are unaffected by weather, small ‘retail customers are very

1 weather sensitive,' Francis noted. 'As a result, FES intends to focus its  
2 efforts more on large industrials...'<sup>35</sup>

3  
4 **Dominion's exit from retail electric business illustrates risks of**  
5 **market.** The polar vortex that slammed the eastern half of the nation in  
6 early January may have been the last straw for Dominion Resources Inc.,  
7 the Richmond, Va.-based energy company that on Jan. 31 abruptly said it  
8 would sell its unregulated retail electric business as soon as possible,  
9 preferably by the end of the first quarter... 'Pursuing the sale is consistent  
10 with our strategy of de-risking Dominion by reducing our exposure to  
11 commodity sensitive businesses...' While large retail suppliers such as  
12 Dominion, FirstEnergy and Exelon have the deep pockets to weather  
13 adverse financial results in the retail market, most retail suppliers are small  
14 by comparison, and their very existence can be challenged by continued  
15 high costs to procure electricity.<sup>36</sup>

16 Furthermore, ConEdison Solutions, the firm that employs Mr. Hudson recently  
17 released a white paper entitled the "2013-2014 Winter Polar Vortex," which states that a  
18 number of smaller, less-financially stable competitive suppliers went out of business as a  
19 result of this winter's events – and customers served by such suppliers lost their EGS  
20 contracts and were dropped back to their utility's default service.<sup>37</sup> This situation of both  
21 large, well-funded EGSs and less financially stable EGSs exiting the retail business to sell  
22 products directly to mass market customers highlights the continued importance of default  
23 service supply rate stability for Residential and Small C&I customers.

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<sup>35</sup> Excerpts from MW Daily article, August 11, 2014. Entire article included in Exhibit NSF-4.

<sup>36</sup> Excerpts from Energywire article. Entire article included in Exhibit NSF-4.

<sup>37</sup> *2013-2014 Winter Polar Vortex*, ConEdison Solutions, July 2014, p. 4.

1 **Q. Even if more market responsive rates make default service rates less attractive for**  
2 **customers and could increase overall customer switching levels, would this suggest**  
3 **that more market responsive rates for Residential and Small C&I customers would**  
4 **be appropriate at this time?**

5 A. No. The goal should not be to force customers to switch to an EGS no matter what. A  
6 reasonable balance between competing objectives is needed.<sup>38</sup> While the Commission  
7 clearly has an interest in the development of the retail competitive market, the  
8 Commission has explicitly acknowledged that price stability is an important consideration  
9 in developing a default service plan:

10 In implementing default service standards, the Commission must be  
11 concerned about rate stability as well as other considerations such as  
12 ensuring a “prudent mix” of supply and ensuring safe and reliable service.  
13 In our view, a default service plan that meets the “least cost over time”  
14 standard should not have, as its singular focus, the achievement of the  
15 absolute lowest cost over the default service plan time frame but rather a  
16 cost for power that is both relatively stable and also economical relative to  
17 other options.<sup>39</sup>

18 Finally, we disagree with RESA’s assertion that the “least cost” standard  
19 mandates that a default service plan be reasonably likely to result in a  
20 “market-reflective and market-responsive” service rate that recovers all  
21 costs related to providing default service. We interpret this standard, not  
22 contained in either the Competition Act or Act 129, to mean a preference  
23 for short term and spot price supplies which ignore both the Act 129  
24 concerns of price stability and a “prudent mix” of products. We do not  
25 believe that adoption of RESA’s suggested standard is consistent with the

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<sup>38</sup> As I stated in my direct testimony, a key question for policymakers is how often utility default service rates should adjust to changes in market prices. The optimal frequency depends upon a number of factors, including customer sophistication, market price volatility, the number of competitive service alternatives, what customers are accustomed to, and the costs and benefits associated with exposing customers to greater price volatility. Duquesne Light’s Plan tailors its default service for each customer group taking into account these considerations.

<sup>39</sup> *Default Service and Retail Electric Markets*, Docket No. L-2009-2095604 (Order entered October 4, 2011) (“*Second Default Service Rulemaking Order*”), p. 40.

1 “least cost” standard contained in Act 129 and would not adequately  
2 protect retail customers from volatility and risks inherent in the energy  
3 market. Price stability benefits are very important to some customer  
4 groups, so an interpretation of “least cost” that mandates subjecting all  
5 default service customers to significant price volatility through general  
6 reliance on short term pricing is inconsistent with Act 129’s objectives.<sup>40</sup>

7

8 **IV. RESA’s Characterization of Duquesne Light’s Small C&I Procurement Proposal as a**  
9 **“Step Backwards” is Without Merit – the Company has Proposed a Continuation of**  
10 **the 12-Month Laddered Supply Contracts Started in DSP VI, Which Is Essentially**  
11 **the Same Approach Used in the Company’s Initial DSP VI Proposal and the Revised**  
12 **Plan Included in the Company’s Most Recent DSP VI Filing**

13 **Q. The OSBA’s testimony states that the Company’s proposed Small C&I procurement**  
14 **plan is “unchanged from the procurement approach that was approved by the**  
15 **Commission in Duquesne’s previous (i.e., DSP VI) default service filing,”<sup>41</sup> while**  
16 **RESA in its rebuttal testimony claims that Duquesne Light’s proposal for the Small**  
17 **C&I class is a “step backwards” in terms of market responsiveness.<sup>42</sup> What is your**  
18 **position?**

19 **A. RESA’s testimony creates confusion on this issue. Let me try to add some clarity. In DSP**  
20 **VI, the Company proposed an initial six-month contract followed by laddered 12-month**  
21 **contracts as shown in the chart below:**

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<sup>40</sup> *Second Default Service Rulemaking Order*, p. 41. (emphasis added)

<sup>41</sup> OSBA Statement No. 1, Direct Testimony, p.3.

<sup>42</sup> RESA Statement No. 1, Rebuttal Testimony, p. 6.

1

### Company's DSP VI Proposal (Small C&I)

Procurement Dates	2013												2014												2015					Post POLR VI Plan																		
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec																	
Nov-12* (50%)	6 months																																															
Apr-13 (50%)	12 months																																															
Nov-13 (50%)													12 months																																			
Apr-14 (50%)																									12 months																							
Nov-14 (50%)																																					12 months											

2

\* Or within one month after PUC approval of the POLR VI Plan, whichever is later.

3

As noted earlier, the Commission's DSP VI Order truncated the last 12-month contract to be six months to eliminate the "overhang" of supply as follows.

4

### Commission DSP VI Order (Small C&I)

Procurement Dates	2013												2014												2015					Post POLR VI Plan																		
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec																	
Mar-13* (50%)	6 months																																															
Apr-13 (50%)	12 months																																															
Nov-13 (50%)													12 months																																			
Apr-14 (50%)																									12 months																							
Nov-14 (50%)																																					6 months											

5

\* This may be delayed and combined with the April 2013 solicitation, depending upon when the plan is approved.

6

However, this order assumed that the Competition Act would be amended to change the default service responsibilities of the EDCs and, as RESA acknowledges, the Commission allowed Duquesne Light the option to request approval of "overhang" contracts closer to the end of the plan period.<sup>43</sup> Recently (June 5, 2014), the Company exercised that option and filed with the Commission for approval to extend by six months the contract term of the final Small C&I procurement under the DSP VI Plan and move up the solicitation date from November 2014 to October 2014 in order to establish the Price-To-Compare ("PTC") 45 days in advance, essentially making the revised DSP VI plan

<sup>43</sup> RESA Statement No. 1, Rebuttal Testimony, p. 5.

1 identical to the Company's proposed DSP VI Plan.<sup>44</sup> (See Revised Company's DSP VI  
 2 Proposal below as compared to the Company's initial DSP VI Proposal).

3 **Revised Company's DSP VI Proposal (Small C&I)**

Procurement Dates	2013												2014												2015					Post POLR VI Plan											
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec										
Mar-13 (50%)	6 months																																								
Apr-13 (50%)	12 months																																								
Nov-13 (50%)													12 months																												
Apr-14 (50%)													12 months																												
Oct-14 (50%)																									12 months																

4  
 5 It is my understanding that the OCA subsequently filed comments in support of the  
 6 Company's June 5, 2014 filing and no party at this time has filed comments in opposition.

7 Now in DSP VII, the Company plans to continue with laddered 12-month supply  
 8 contracts, with the initial 6-months of supply procured in October 2014 pursuant to its  
 9 DSP VI plan.

10 **Company's DSP VII Proposal (Small C&I)**

Procurement Dates	2015												2016												2017					Post POLR VII Plan											
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec										
Oct-14 (50%)	6 months																																								
Mar-15 (50%)	12 months																																								
Sep-15 (50%)													12 months																												
Mar-16 (50%)													12 months																												
Sep-16 (50%)																									12 months																

11  Supply obtained in DSP VI.

12 In his rebuttal testimony, Mr. Hudson makes two arguments to support his claim  
 13 that Duquesne Light's proposal for the Small C&I class is a "step backwards" in terms of  
 14 market responsiveness. First, he argues that Duquesne Light's proposal transitions Small  
 15 C&I customers to 12-month procurement contracts exclusively by December 2015.

<sup>44</sup> See Duquesne Light Petition filed on June 5, 2014 in Docket No. P-2012-2301664.

1 Second, Mr. Hudson observes that those 12-month contracts would be laddered products,  
2 with the PTC being an average of the newly acquired product and the existing product.<sup>45</sup>

3 As can be seen in the charts above, the Company's DSP VII proposal is a  
4 continuation of the 12-month laddered contracts started in DSP VI, and is essentially the  
5 same as the Company's initial DSP VI proposal and the revised plan included in the  
6 Company's most recent DSP VI filing.<sup>46</sup> Contrary to Mr. Hudson's position, the use of  
7 laddered contracts is not new, nor is the concept of transitioning to 12-month contracts.  
8 There is little difference between the Company's initial DSP VI proposal, the Company's  
9 most recent revised DSP VI filing, and the proposed DSP VII supply portfolio for Small  
10 C&I customers. All rely on laddered one-year, fixed-price full requirements, load-  
11 following contracts. RESA's claim that Duquesne Light's proposal for the Small C&I  
12 class is a step backwards in terms of market responsiveness is without merit and should be  
13 rejected.

14  
15 **V. Conclusion**

16 **Q. Does this conclude your surrebuttal testimony?**

17 **A. Yes, it does.**

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<sup>45</sup> RESA Statement No. 1, Rebuttal Testimony, p. 6.

<sup>46</sup> Note that the initial 6-month contract in DSP VI was used only to start the laddering process. A similar 6-month contract would not be needed at the start of DSP VII if Duquesne Light's Petition filed on June 5, 2014 in Docket No. P-2012-2301664 is approved. Otherwise, an initial 6-month contract will be necessary in DSP VII to restart the laddering process once again.

# Exhibit NSF-3

From RESA Attachment RJH-DLC-2.

Surrebuttal Testimony of Richard Hudson, Jr., *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, July 9, 2014, p.3.

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of PECO Energy Company for :  
Approval of its DEFAULT Service Program : Docket No. P-2014-2409362  
for the Period from June 1, 2015 Through :  
May 31, 2017 :  
:

**SURREBUTTAL TESTIMONY**

**OF**

**RICHARD J. HUDSON, JR.**

**On Behalf of**

**Retail Energy Supply Association**

**Topics Addressed:  
Procurement Plan Design  
Treatment of Various NMB Charges  
Customer Referral Program**

July 9, 2014

**Q. DO THESE ARGUMENTS AMOUNT TO A REJECTION OF THE COMMISSION'S WELL-REASONED PROCUREMENT RECOMMENDATIONS IN THE END STATE ORDER?**

A. Yes. Collectively, these arguments essentially amount to a collateral attack on the Commission's directives in the End State Order. Apparently, PECO has no intention of transitioning to the Commission's desired End State for default service either as part of DSP III or, very likely, as part of any future DSP. If PECO's arguments prevail, then the Commission's preferred default service procurement approach from the End State Order would never be adopted. The arguments raised by PECO will always exist. Quarterly contracts, by their very nature, introduce more price volatility, as compared to longer-term, fixed price contracts. I believe the Commission was well aware of this when it issued the End State Order, but made the recommendation anyway. The introduction of such 3-month contracts, will necessarily require more frequent procurement events. Moving more customers with interval meters into the hourly priced procurement group will necessitate systems and process changes, whether done now, or once AMI meters are fully deployed. These barriers that PECO identifies will be present with any procurement plan that adopts the Commission's recommendations in the End State Order. These issues, which PECO portrays as insurmountable obstacles, are not so; they are the necessary by-products of change. The question in this proceeding for the Commission to decide is whether its recommendations in the End State Order are valid, or whether they can be set aside at the discretion of each EDC. RESA believes now is the appropriate time to begin the transition towards the default service policy articulated in the End State Order.

## Exhibit NSF-4

## **Megawatt Daily (11-Aug-14)**

### **FirstEnergy backs out of residential markets**

FirstEnergy Solutions is withdrawing from the competitive residential and small commercial electric markets in six states as the company scrambles to adjust its generation to fit retail sales in the face of market volatility.

"We're no longer acquiring new customers in those channels," Diane Francis, spokeswoman for FES, said Friday. "What we're planning on doing is exiting the mass market channel, the individual residential" as well as smaller business market. "Essentially what we're doing is derisking our business."

The strategic pullback affects customers in Illinois, Michigan, Pennsylvania, New Jersey, Maryland and Ohio, the latter of which is where a majority of FES' 2.7 million customers are located. That total includes about 2.1 million residential customers, according to Francis.

Like some other utility parent companies, FirstEnergy for months has been placing more emphasis on its regulated operations at the expense of its competitive businesses.

Just two years ago, FES unveiled a long-term, fixed price for customers that was thought to be unprecedented in the retail sector. The offer provided for a fixed 6.75 cents/kWh for seven years and was made available to the more than 400,000 electric customers served by the Cleveland-based Northeast Ohio Public Energy Council, a government aggregation, as well as customers in the Ohio service territories of Duke Energy Ohio and Dayton Power & Light.

Now, FirstEnergy is looking to pull in its horns on the competitive side.

"What we've seen, especially coming out of the polar vortex" in January, "is that volatility of the electric market is reducing our ability to offer long-term stable pricing to customers," Francis said. "And it's also increasing our risk of serving retail load."

In the past few months, FES has taken other steps to lower risk exposure. "We included a risk premium in our pricing," something new for FES, she said. "Basically, what we would do in the past is that we would take all the risks and offer customers low, fixed pricing. Our competitors would offer customers variable pricing. In the past few months, we included risk premium pricing."

It is essential, Francis added, that FirstEnergy properly balance its retail book with its generation portfolio. "Over the years, as the amount of our generation capacity has decreased, we're going to better size our retail book to our generation. We're also making our retail book a little less weather-sensitive."

Unlike large industrials and some large commercial customers whose usage is mostly unaffected by weather, small "retail customers are very weather sensitive," Francis noted. As a result, FES intends to focus its efforts more on large industrials and will continue to serve government aggregation customers, primarily in Ohio.

In addition to NOPEC, FirstEnergy also serves customers who participate in the Northwest Ohio Aggregation Coalition, a government aggregation based in Toledo.

In Illinois, Francis said FES included risk premiums in its aggregation renewal bids earlier this year, "and a lot of those [aggregation] communities went back" to their incumbent utility, in particular Commonwealth Edison.

Ohio and Illinois are the only two states where FES is "really into government aggregation," Francis said, although it serves a "handful" of such customers in New Jersey.

— Bob Matyi

## **Dominion's exit from retail electric business illustrates risks of market**

Rod Kuckro, E&E reporter

EnergyWire: Friday, February 7, 2014

The polar vortex that slammed the eastern half of the nation in early January may have been the last straw for Dominion Resources Inc., the Richmond, Va.-based energy company that on Jan. 31 abruptly said it would sell its unregulated retail electric business as soon as possible, preferably by the end of the first quarter.

Analysts are pondering whether Dominion's decision, announced during its fourth-quarter and year-end 2013 earnings call, is a one-off indication of a business poorly managed or a signal that other large players in the competitive retail electric markets may be experiencing similar financial pressures. Already, some smaller retail providers have succumbed by defaulting, unable to raise the collateral needed to continue in business.

"Retailers can really get hurt by spiking power prices particularly if they lightened up on risk control hedging strategies after an extended period of benign power prices and efforts to preserve some profitability in a world of depressed margins," Credit Suisse analysts wrote in a note Jan. 30 on what the polar vortex means for power earnings.

Dominion was among a group of companies with retail operations including Consolidated Edison Inc., Exelon Corp., FirstEnergy Corp. and Centrica PLC cited by Credit Suisse as being at risk of an earnings hit.

Two distinct events of extreme weather over a large geographic region in January rattled electricity markets in the PJM Interconnection, ISO New England and the New York Independent System Operator as prices soared past \$1,000 per megawatt-hour for the first time. In PJM at times, even prices for power during off-peak hours ranged from \$250 per MWh to \$500 per MWh, well above the more seasonal prices in the \$40-\$50-per-MWh range.

The price spikes that continue to a lesser degree this week are largely due to constrained supplies of natural gas, which produces an ever-growing share of electricity in the Northeast and mid-Atlantic.

For the more than 600,000 customers of Dominion Retail in Texas, Illinois, Ohio, New York, Pennsylvania, Massachusetts, Connecticut, New Jersey, Maryland and Maine, there was no reason for alarm.

Customers held fixed-price contracts that required Dominion to deliver electricity no matter how much it would cost to procure when the supplier inevitably had to go to the open market to satisfy demand. In Maryland for example, as of yesterday Dominion was advertising contracts through December 2015 for 9.59 cents per kilowatt-hour. That means customers would get all the electricity they wanted for less than 10 cents per kWh, even if Dominion had to pay exponentially more for its supplies.

Precisely what prompted Dominion's decision is unclear. Spokesman C. Ryan Frazier declined a request to have an executive elaborate on the decision. "Pursuing the sale is consistent with our strategy of de-risking Dominion by reducing our exposure to commodity sensitive businesses, thereby relying less on commodity-based businesses in our asset mix. We are not in a position to provide further detail at this point," Frazier wrote in an email.

Dominion CEO Tom Farrell raised more questions with his comments during the earnings call. "We continue to fine-tune our business model," Farrell said, noting that "the sale process is underway."

"It's all you have seen from the lot of our colleagues in the industry that have these retail businesses," he said. "The margins in the electric side of business have been shrinking. And you see increased volatility happening. ... It just doesn't fit our business model."

## **'Load mismatch'**

Dominion is not exiting its retail natural gas business, which has more than 500,000 customers.

"Gas is a very different business," Farrell said. "Our products and services are a very different business because of where we sell the electricity in those regular retail markets and where we have assets -- you don't have a matching capability of any real significance."

That "matching capability" may refer to the ability -- of lack thereof -- of a retail supplier like Dominion to use a fleet of merchant generation plants to ramp up and provide electricity at a lower price than in the open market in times of high demand. Credit Suisse called it "load mismatch" in its report, defined as the difference between gross generation and retail sales.

As one Wall Street observer noted, Exelon and FirstEnergy "both have large generation assets to back their retail positions and are able to generate enough electricity from existing power plants to serve the incremental demand."

But the result for Dominion, said the observer, who would speak only on condition of anonymity, was that it likely "lost north of \$100 million" during the polar vortex. "They panicked" after buying power in the open market in excess of \$300 per MWh, the observer said, "and lost so much money already in January that they had no choice. You don't even have to have more than two [bad] days to lose \$100 million. That's the beauty of the retail business -- when it works it works, but when it doesn't, it can basically kill you in a couple of hours."

Todd Shipman, a utility analyst with Standard and Poor's, agreed that Dominion didn't have the merchant generation to balance its retail book.

Typically, retail suppliers "just ride those margins up and down. A lot of people that are in that business because they think they can make money over time, and they're not going to just leave all of a sudden because there was a bad year or two because it's a volatile business and they think over time they'll do fine," he said.

But for Dominion, which has been reducing its merchant fleet, "things are different in a sense that they had that offsetting strategy where they thought the retail business was a natural hedge against the merchant business," he said. But that natural hedge has disappeared.

## **'The writing was on the wall here more so than elsewhere'**

If Dominion "didn't like being in the retail business at all, they'd be getting out of gas as well as electric. It may just be that the electric retail side of things hasn't really taken off for them," Shipman added.

"The declining profitability of the electric retail business itself probably led management to a decision even prior to January given the very limited earnings profile of this business," said Julien

Dumoulin-Smith, executive director of equity research at UBS Securities. "Ultimately for them, if it's not profitable, that's not necessarily a business they want to be in that doesn't have a return on equity."

Integrus Energy Services' Melissa Lauderdale, president of the Retail Energy Supply Association, agreed the decision may not have been entirely driven by what happened in January. "My guess is that Dominion had been thinking about that before January. A large holding company like Dominion probably doesn't make that kind of decision on one week's worth of bad weather."

But "you certainly have seen margin compression, and that does force suppliers to be more efficient," she said.

As to who may buy Dominion's retail book, "that's the question to be asked right about now; I'm very curious myself. I think there's always going to be a bid at a certain price," said Dumoulin-Smith, speculating that a likely buyer might be a company less interested in earnings. "Maybe someone who cares about a different metric -- say, cash flow -- might have a different valuation in this business."

As to what Dominion's decision may say about other large retail suppliers, "I don't necessarily expect an en masse exit from the business," Dumoulin-Smith said. "Frankly, it's done a number of other companies well in recent years. I wouldn't necessarily say that this event would shake any other specific company out of the business, per se. The writing was on the wall here more so than elsewhere."

On Jan. 31's conference call, Dumoulin-Smith took a last stab at finding out more about the effects of the polar vortex on Dominion's retail unit, asking Farrell to elaborate on the effects of the volatility. "We are not going to quantify it for you, but it's extraordinary to watch," the CEO quipped.

## **Problem magnified in PJM**

While large retail suppliers such as Dominion, FirstEnergy and Exelon have the deep pockets to weather adverse financial results in the retail market, most retail suppliers are small by comparison, and their very existence can be challenged by continued high costs to procure electricity.

PJM on Tuesday notified its members that two retail load-serving entities had "not been able to fulfill their collateral calls and payment obligations." The two were Clean Currents LLC of Silver Spring, Md., and People's Power & Gas LLC of New Milford, Conn. Their potential net default charges, which would be allocated among remaining PJM members, are \$400,000 to \$600,000 and \$1.3 million to \$1.8 million, respectively. Neither is serving customers.

ISO New England has suspended five companies so far in 2014: Mega Energy Holdings LLC and People's Power & Gas on Jan. 29, OBE Electric LLC on Jan. 30, Statarb Investment LLC on Jan. 31, and Abest Power & Gas Co. on Tuesday. People's Power & Gas is still suspended. The other companies are currently meeting all their obligations "under the ISO's tariff," spokeswoman Lacey Girard said.

But in PJM, the threat of many other defaults looms based on data regarding the total dollar amount of collateral calls -- effectively a notice that a market participant is near or over its credit limit -- in January alone. For the month, calls exceeded \$2 billion, or "roughly four times the total dollar amount of the collateral calls for calendar year 2013," said PJM spokesman Ray Dotter.