

**PECO ENERGY COMPANY  
STATEMENT NO. 3-R**

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

DOCKET NO. P-2014-2409362

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REBUTTAL TESTIMONY

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WITNESS: SCOTT G. FISHER

SUBJECT:     DEFAULT SERVICE PROCUREMENT

DATED: JUNE 26, 2014

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1 **4. Q. Please summarize your major conclusions.**

2 A. RESA witness Richard Hudson’s recommendations to shorten the term lengths of the  
3 supply products in the default service supply portfolios for the Residential and Small  
4 Commercial customer classes, and to incorporate a “hard stop” with regard to the  
5 supply products at the end of the DSP III period, should be rejected because they  
6 would expose customers to unnecessary rate instability and risks. In fact, my analysis  
7 indicates that the degree of rate instability for Residential default service customers  
8 would double if the type of Residential supply portfolio to which Mr. Hudson  
9 recommends transitioning were approved, and maintaining the product term lengths  
10 that PECO has proposed should facilitate the development of the competitive retail  
11 market. I also conclude that Mr. Hudson’s proposed “hard stop” for all of the default  
12 service supply products on June 1, 2017, is not needed to facilitate possible changes  
13 in default service policy by the Commission, as PECO’s proposed DSP III already  
14 includes a reasonable degree of flexibility to accommodate the possibility of future  
15 changes in the default service supply approach and the possibility of new retail  
16 market initiatives.

17 In addition, I conclude that OCA witness Hahn’s analysis regarding the relative cost  
18 of a default service supply approach involving the procurement of block energy  
19 products and spot market purchases should not be relied on by the Commission,  
20 because it does not consider the broad universe of potential market scenarios that can  
21 occur.

22 All of these conclusions are supported in detail below.

1       **II. THE COMMISSION SHOULD REJECT RESA’S PROPOSAL TO SHORTEN**  
2       **THE TERM LENGTHS OF THE RESIDENTIAL AND SMALL COMMERCIAL**  
3       **DEFAULT SERVICE SUPPLY PRODUCTS AND REQUIRE A “HARD STOP”**  
4       **AT THE END OF THE DSP III PERIOD**

5   **5. Q. Mr. Fisher, what does RESA witness Hudson recommend with regard to**  
6       **PECO’s default service supply portfolios for the Residential and Small**  
7       **Commercial customer classes?**

8       A. For the Residential default service supply portfolio, Mr. Hudson recommends phasing  
9       out reliance on contracts with delivery periods longer than one year and transitioning  
10      to a greater reliance on 3-month contracts.<sup>1</sup> Specifically, Mr. Hudson recommends  
11      that PECO transition to a portfolio in which the fixed-price full requirements  
12      (“FPFR”) products, which represent the vast majority (approximately 96%) of the  
13      supply, consist of 40% 3-month products, 22% 6-month products, 17% 9-month  
14      products, 20% 12-month products, and less than 2% 24-month products.<sup>2</sup> He also  
15      recommends that a “hard stop” be incorporated with regard to these customers’  
16      default service supply products at the end of the DSP III period, so that none of the  
17      supply products have delivery periods extending beyond the end of the DSP III period

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<sup>1</sup> RESA Statement No. 1, p. 11. Mr. Hudson also recommends eliminating the 53-month contracts, which represent 3.2% of the supply; I do not directly respond to this recommendation, as it is addressed by PECO witness John McCawley in his rebuttal testimony.

<sup>2</sup> See RESA Exhibit RJH-2. Under Mr. Hudson’s proposal, by the end of the DSP III period, the 60 tranches of residential FPFR products would consist of 24 tranches (40%) of 3-month products, 13 (22%) tranches of 6-month products, 10 tranches (17%) of 9-month products, 12 tranches (20%) of 12-month products, and 1 tranche (<2%) of a 24-month product. In total, the 60 tranches represent approximately 96% of the default service supply for the Residential class. Mr. Hudson appears to propose that the remaining 4% of the supply be procured through spot market purchases.

1 on May 31, 2017.<sup>3</sup> In comparison, PECO has proposed a portfolio that transitions the  
2 same portion of the supply to a product portfolio consisting of 40% 12-month  
3 products and 60% 24-month products, with some supply product delivery periods  
4 extending beyond May 31, 2017.<sup>4</sup>

5 Mr. Hudson also recommends a Small Commercial default service supply portfolio  
6 that contains significantly shorter-term supply FPFR products than those which  
7 PECO has proposed. As Mr. Hudson explains, his proposal involves a transition to a  
8 portfolio consisting of 75% 3-month products and 25% 12-month products by the end  
9 of the DSP III period, with none of the supply product delivery periods extending  
10 beyond May 31, 2017, the end of the DSP III period.<sup>5</sup> In comparison, PECO has  
11 proposed to continue its current portfolio approach for Small Commercial customers,  
12 which consists of 12-month products in which half of the products are replaced every  
13 six months and with some supply product delivery periods extending beyond May 31,  
14 2017.<sup>6</sup>

15 **6. Q. What is Mr. Hudson's rationale for shortening the term lengths of the supply**  
16 **products in the Residential and Small Commercial customers' default service**  
17 **supply portfolios?**

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<sup>3</sup> RESA Statement No. 1, p. 15; RESA Exhibit RJH-2.

<sup>4</sup> PECO Statement No. 3, p. 24.

<sup>5</sup> RESA Statement No. 1, p. 16; RESA Exhibit RJH-2.

<sup>6</sup> PECO Statement No. 3, p. 24.

1 A. Mr. Hudson explains that his recommendation to shorten the delivery periods of the  
2 products is designed to “transition to a more market-based and market-responsive  
3 default service supply portfolio.”<sup>7</sup> He contends that his proposed portfolio is more  
4 “market responsive,” so it would better support “sustainable” retail competition, and  
5 therefore it would better satisfy the “least cost” requirement of Act 129 than PECO’s  
6 proposal.<sup>8</sup>

7 **7. Q. Has the Commission already opined on this interpretation of the “least cost”**  
8 **requirement of Act 129?**

9 A. Yes. The Commission has previously expressed its disagreement with Mr. Hudson’s  
10 premise. Specifically, in its *Second Default Service Rulemaking Order*, the  
11 Commission stated:

12 Finally, we disagree with RESA’s assertion that the “least cost” standard  
13 mandates that a default service plan be reasonably likely to result in a  
14 “market-reflective and market-responsive” service rate that recovers all  
15 costs related to providing default service. We interpret this standard, not  
16 contained in either the Competition Act or Act 129, to mean a preference  
17 for short term and spot price supplies which ignore both the Act 129  
18 concerns of price stability and a “prudent mix” of products. We do not  
19 believe that adoption of RESA’s suggested standard is consistent with the  
20 “least cost” standard contained in Act 129 and would not adequately  
21 protect retail customers from volatility and risks inherent in the energy  
22 market. Price stability benefits are very important to some customer  
23 groups, so an interpretation of “least cost” that mandates subjecting all  
24 default service customers to significant price volatility through general

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<sup>7</sup> RESA Statement No. 1, pp. 3-4.

<sup>8</sup> RESA Statement. No. 1, pp. 3, 5, 6, 7, 8-10.

1 reliance on short term pricing is inconsistent with Act 129's objectives.<sup>9</sup>

2 **8. Q. Mr. Fisher, didn't the Commission propose in the *Default Service End State***  
3 ***Order*<sup>10</sup> that residential and small commercial customers be supplied entirely**  
4 **with 90-day products similar to the products Mr. Hudson suggests?**

5 A. Yes, it did. However, as I noted in my direct testimony, the Commission also  
6 concluded that some of the changes it proposed in the *Default Service End State*  
7 *Order*, including a general directive to use such short-term products, may require  
8 amendments to existing law.<sup>11</sup> The Commission therefore determined that it would  
9 be "well-served to ensure that the General Assembly is supportive of our overall  
10 policy direction on matters as important as the retail market for electricity."<sup>12</sup>

11 **9. Q. Would adoption of Mr. Hudson's recommendations to shorten the term lengths**  
12 **of the supply products in the Residential and Small Commercial customers'**  
13 **default service supply portfolios expose default service customers to unnecessary**  
14 **rate instability and risks?**

15 A. Yes. The generally shorter-term products would unnecessarily increase these  
16 customers' exposure to substantial price fluctuations, resulting in less stable rates  
17 over time.

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<sup>9</sup> *Default Service and Retail Electric Markets*, Docket No. L-2009-2095604 (Order entered October 4, 2011) ("*Second Default Service Rulemaking Order*"), p. 41 (emphasis added).

<sup>10</sup> *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (Order entered February 15, 2013) ("*Default Service End State Order*").

<sup>11</sup> PECO Statement No. 3, p. 33. (citing *Default Service End State Order*").

<sup>12</sup> *Default Service End State Order*, pp. 45-46.

1 **10. Q. Have you performed an analysis of the increased rate instability for Residential**  
2 **customers if PECO were to adopt a portfolio with product term lengths like**  
3 **those to which Mr. Hudson advocates transitioning in DSP III?**

4 A. Yes.

5 **11. Q. Please describe how your analysis assesses the risks associated with different**  
6 **default service supply procurement approaches.**

7 A. My analysis involves the application of different default service approaches to 5,000  
8 different, but equally likely, market scenarios<sup>13</sup> that reflect complex real-world  
9 market dynamics, consistent with the volatilities, correlations, and mean reversion of  
10 market price and load changes observed historically. Each default service approach  
11 that is analyzed is applied to each of the 5,000 scenarios, procuring products and  
12 setting rates as appropriate.<sup>14</sup> In order to develop insight regarding the risks  
13 associated with any given default service approach, the performance of the approach  
14 across the scenarios can be assessed against various predetermined “metrics” that  
15 characterize aspects of risks that are of concern. The metrics include:

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<sup>13</sup> In this context, a “scenario” is a potential state-of-the-world that may unfold. Each scenario includes a trajectory for how forward prices for energy may vary over time, what spot prices might result, how customer load may vary, and what the cost to serve customers will be. In order to provide a clear comparison of the performance of various procurement approaches, the scenarios are calibrated to general forward price levels, and various supply procurement approaches are analyzed in a “steady-state” procurement cycle, unencumbered by legacy or shorter-term plan transition contracts; as such, the analysis is not designed to provide a precise forecast of the absolute level of supply cost in any given future year.

<sup>14</sup> Consistent with recent forward energy market prices for PJM Western Hub and capacity prices in PJM, the scenarios to which each default service approach is applied reflect an average ATC energy price of \$45 per megawatt-hour and an average capacity price of \$12 per megawatt-hour.

1           1) Default Service Rate Shock – Distribution of maximum rate change over a  
2           given period of time (e.g., looking across a year, what is the largest increase  
3           in the rate versus what it was six months earlier).

4           2) Default Service Supply Cost Surprise – Distribution of difference between  
5           actual (ex-post) and forecasted (ex-ante) supply costs (e.g., how do actual  
6           supply costs over a twelve-month period compare to expectations three  
7           months before that period began).

8           We can then compare the risks of various default service approaches by studying how  
9           each performs against these metrics. This overall analytical approach is very similar  
10          to the approach that was presented in my rebuttal testimony in PECO’s DSP II  
11          proceeding, which was used to develop the analysis of the relative costs and risks of  
12          the FPCR product approach and the block-and-spot procurement approach.<sup>15</sup>

13 **12. Q. Which default service approaches did you analyze in order to assess Mr.**  
14 **Hudson’s recommended Residential default service supply portfolio?**

15          A. I analyzed two representative default service approaches. First, I analyzed an  
16          approach that is representative of the general mix of products to which PECO’s  
17          proposed Residential portfolio transitions by the end of the DSP III period  
18          (“Representative PECO Approach”). In this approach, 60% of the supply comprises  
19          two-year products, and 40% comprises one-year products, with semiannual

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<sup>15</sup> PECO Statement. No. 3-R (Rebuttal Testimony of Scott G. Fisher), Docket No. P-2012-2283641 (*Petition of PECO Energy Company for Approval of Its Default Service Program*), pp. 16-25.

1 overlapping of the delivery periods.<sup>16</sup> This product mix is consistent with the basic  
2 supply portfolio underlying PECO's DSP III proposal for Residential customers. The  
3 second portfolio that I analyzed is representative of the general mix of products to  
4 which Mr. Hudson's proposed Residential portfolio transitions by the end of the DSP  
5 III period ("Representative RESA Approach"). As I explained previously, Mr.  
6 Hudson explicitly designed his portfolio to transition to a greater reliance on 3-month  
7 contracts, with 40% of the FPCR products having delivery periods of three months by  
8 the end of the DSP III period. With the exception of one tranche of 24-month product  
9 (less than 2% of the portfolio), the rest of the product mix at the end of the DSP III  
10 period under Mr. Hudson's plan consists of products with delivery periods that are no  
11 longer than 12 months. Consequently, the Representative RESA Approach consists  
12 of a portfolio comprised 40% of 3-month contracts that are all renewed every three  
13 months, and the remaining 60% of the portfolio is comprised of 12-month contracts,  
14 in which one quarter of the 12-month contracts are renewed every three months.<sup>17</sup> I  
15 could have elected a mix of generally shorter-term products for the portion of the  
16 supply that is not comprised of 3-month products in the Representative RESA  
17 Approach in order to reflect the fact that the delivery periods of such products in Mr.  
18 Hudson's actual proposal are, by the end of the DSP III period, generally shorter than  
19 12 months, but my representation is simpler and it tends to err on the side of

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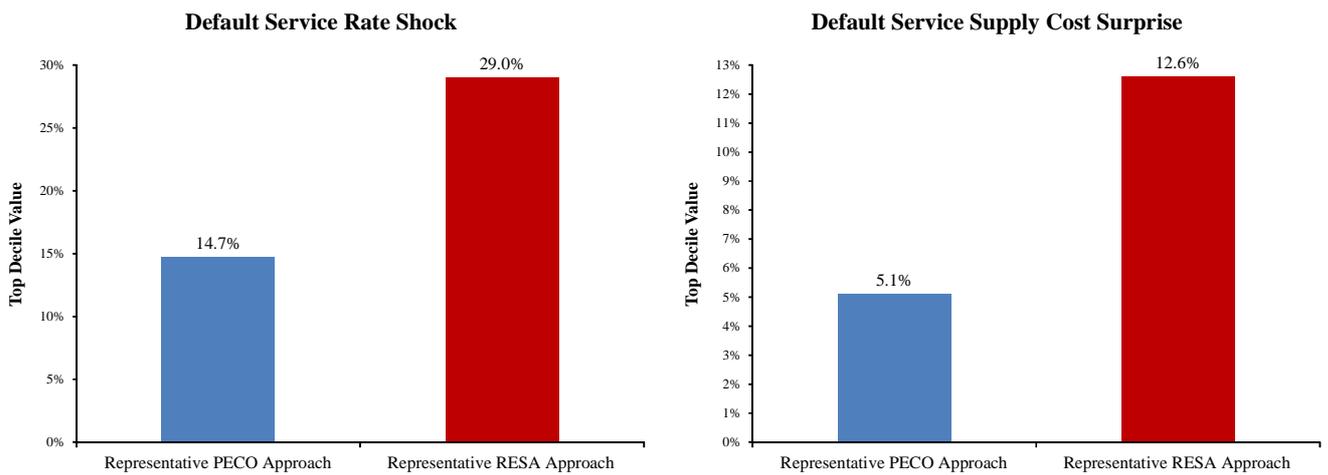
<sup>16</sup> For modeling purposes, solicitations for products with deliveries beginning in June are held at the end of January, and solicitations for products with deliveries beginning in December are held at the end of September.

<sup>17</sup> For modeling purposes, solicitations for products with deliveries beginning in March are held at the end of November, solicitations for products with deliveries beginning in June are held at the end of January, solicitations for products with deliveries beginning in September are held at the end of May, and solicitations for products with deliveries beginning in December are held at the end of September.

1 overstating the rate stability of the actual product mix to which Mr. Hudson  
2 recommends transitioning. Both of the representative approaches are analyzed in a  
3 steady-state cycle of procurements, utilizing the product mixes that I have described.

4 **13. Q. What are the principal findings from your analysis?**

5 A. As illustrated in the following charts, my analysis indicates that the degree of rate  
6 instability for Residential default service customers would double if the type of  
7 Residential supply portfolio to which Mr. Hudson recommends transitioning were  
8 approved.



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10 Specifically, the top decile value for the Default Service Rate Shock is 29.0% under  
11 the Representative RESA Approach, versus only 14.7% under the Representative  
12 PECO Approach.<sup>18</sup> Furthermore, the top decile value for the Default Service Supply  
13 Cost Surprise is 12.6% under the Representative RESA Approach, versus only 5.1%

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<sup>18</sup> The “top decile” value is the average value across the ten percent of scenarios, or equivalently the 500 scenarios, with the highest values.

1 under the Representative PECO Approach.<sup>19</sup> Furthermore, the actual outcomes with  
2 regard to these two risk metrics could exceed these quoted values, as there certainly  
3 are potential outcomes even more extreme than the top decile values. Also, the  
4 possibility exists of market events which previously have not been experienced, as  
5 evidenced by the “Polar Vortex” in January 2014, which could cause additional rate  
6 volatility that is not captured in the model. In short, the doubling of the rate  
7 instability and risks that would result from the type of Residential supply portfolio to  
8 which Mr. Hudson recommends transitioning is significant.

9 **14. Q. Mr. Hudson claims that adoption of his recommendations to shorten the delivery**  
10 **periods of the supply products will better support sustainable retail**  
11 **competition.<sup>20</sup> Does actual market evidence support Mr. Hudson’s suggestion**  
12 **that PECO’s proposed default service supply portfolios will be deficient in**  
13 **supporting retail competition?**

14 A. No. In fact, actual market evidence indicates that the default service models used by  
15 PECO in DSP I and DSP II have supported growth in the competitive retail market, as  
16 I explained in my direct testimony and which Mr. Hudson does not address.<sup>21</sup> This is  
17 an especially relevant point, because PECO’s proposed DSP III portfolio contains a  
18 mix of FPFR products that is much more akin to the mix in DSP I and DSP II than it

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<sup>19</sup> I note that the top decile values likely are understated because the analysis omits consideration of the additional rate volatility due to billing lag, which is described by PECO witness Alan Cohn in his direct testimony and which is in part driven by changes in the underlying supply costs under a given procurement approach. PECO Statement. No. 5, pp. 7-8.

<sup>20</sup> RESA Statement. No. 1, pp. 3, 14.

<sup>21</sup> PECO Statement No. 3, pp. 8-9.

1 is to Mr. Hudson's proposed product mix. Since DSP I delivery began, the  
2 competitive retail market in PECO's service area has grown considerably. There has  
3 been substantial and continuous growth in the number of EGSs competing in PECO's  
4 service area over the DSP I and DSP II periods. The number of EGSs licensed and  
5 certified to serve customers in PECO's service area has more than doubled over the  
6 DSP I and DSP II periods, with 106 EGSs currently licensed and certified to serve  
7 customers.<sup>22</sup> Similarly, the number of EGSs serving PECO customers has more than  
8 doubled since the DSP I period began, as has the number of EGSs serving PECO  
9 residential customers.<sup>23</sup> Furthermore, 62% of PECO's total customer load is  
10 currently being served by an EGS.<sup>24</sup>

11 Mr. Hudson voices a specific concern that, if the products in the default service  
12 supply portfolios are not shortened as he suggests, then market prices may diverge  
13 from default service rates for longer periods of time, and the potential for such  
14 divergences would discourage EGS participation in the market, leaving customers  
15 with "few or no competitive options" even in situations in which default service  
16 supply rates are high compared to contemporaneous market prices.<sup>25</sup> However, as I  
17 explained in my direct testimony, based on market data from PECO's service area as  
18 well as from other large Electric Distribution Companies' ("EDC") service areas in

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<sup>22</sup> Source: PECO. Data is for the week ending June 24, 2014.

<sup>23</sup> Currently, 88 EGSs serve PECO customers, and 79 of these EGSs currently serve PECO residential customers. Source: PECO. Data is for the week ending June 24, 2014.

<sup>24</sup> Source: PECO. Data is for the week ending June 24, 2014, and includes customers who will be switched to EGSs within 45 days. Percentages of load are based on Peak Load Contribution ("PLC") values.

<sup>25</sup> RESA Statement No. 1, pp. 9-10.

1 Pennsylvania, there is no reason to believe that default service supply portfolios with  
2 product term lengths similar to (or even somewhat longer than) those proposed by  
3 PECO will reduce EGS participation in the market due to any concerns about the  
4 possibility of future divergences between default service rates and contemporaneous  
5 market prices.<sup>26</sup> In fact, market data indicate that EGSs will enter markets and serve  
6 customers when they are able to provide attractive service offerings for customers,  
7 regardless of whether the supply product term lengths present a possibility of such  
8 divergences in the future.

9 In short, EGSs have proven to be very willing to compete for customers when the  
10 default service supply portfolios have product term lengths similar to those proposed  
11 by PECO.

12 **15. Q. Mr. Fisher, how do you respond to Mr. Hudson’s assertions that his**  
13 **recommended portfolio, with its shorter product delivery periods, is “more**  
14 **market-based” than the portfolio that PECO has proposed?<sup>27</sup>**

15 A. Mr. Hudson’s assertions are invalid. As in previous PECO default service plans,  
16 under PECO’s DSP III, EGSs will compete against market-based default service  
17 rates, as the default service rates will be based on the prices for supply products  
18 obtained through competitive solicitations in which multiple bidders compete to sell  
19 the products solely on the basis of price. A longer-term product obtained through a

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<sup>26</sup> PECO Statement No. 3, pp. 37-39.

<sup>27</sup> RESA Statement No. 1, pp. 3, 11.

1 competitive solicitation is just as “market-based” as a shorter-term product obtained  
2 through a competitive solicitation.

3 **16. Q. Can you provide an example of why Mr. Hudson’s view of what constitutes a**  
4 **“market-based” supply product is flawed?**

5 A. Yes. Suppose that someone walks into a bank and obtains a mortgage. Using Mr.  
6 Hudson’s logic, that person would only obtain a “market-based” rate for his/her  
7 mortgage if he agreed to a very short-term mortgage, with rates that change  
8 frequently. Per Mr. Hudson’s logic, if the person were to obtain a 30-year, 15-year,  
9 10-year, or even 5-year fixed-rate mortgage, then that person would not be paying a  
10 market-based rate for his mortgage. Clearly, this is incorrect. All of these mortgage  
11 products can be readily obtained in a competitive market. All are “market-based.”

12 **17. Q. You previously mentioned that Mr. Hudson recommends that a “hard stop” be**  
13 **incorporated in the Residential and Small Commercial default service supply**  
14 **product portfolios at the end of the DSP III period, such that none of the supply**  
15 **products have delivery periods extending beyond the end of the DSP III period**  
16 **on May 31, 2017. Would adoption of this recommendation expose these**  
17 **customers to unnecessary rate instability and risks?**

18 A. Yes. Unlike PECO’s plan, which provides for a continuation of the established cycle  
19 of product procurements, Mr. Hudson’s proposed plan would substantially alter the  
20 product procurement cycle by cutting short the supply products that otherwise would  
21 have delivery periods that extend beyond May 31, 2017. Consequently, Mr.  
22 Hudson’s proposed plan would subject Residential and Small Commercial customers

1 to a “hard stop” with regard to their supply products at the end of the DSP III period,  
2 requiring all of the Residential and Small Commercial default service supply for  
3 delivery starting in June 2017 to be procured in a short period of time near the end of  
4 the DSP III period, exposing customers to magnified risks and rate instability.

5 The experience from this past winter illustrates some of the risks associated with this  
6 approach. As I explained in my direct testimony, various atypical factors were  
7 present which I believe materially affected supplier participation in the January 2014  
8 solicitation.<sup>28</sup> Consequently, the Commission rejected the bids for almost half of the  
9 Residential default service supply product tranches that were solicited in that  
10 procurement, leaving a portion of the supply position to be procured from the spot  
11 market.<sup>29</sup> Furthermore, even if replacement supply subsequently had been procured  
12 through an additional supply solicitation, or even if customers subsequently had tried  
13 to avoid the exposure to this open position by electing service from an EGS, forward  
14 market prices had already increased, indicating that the customer supply would need  
15 to be procured at a higher price.<sup>30</sup>

16 Fortunately for customers, PECO’s approved Residential DSP II portfolio was

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<sup>28</sup> PECO Statement No. 3, pp. 18-21.

<sup>29</sup> See <http://www.pecoprocurement.com/>. As stated on page 12 of the “Bidder Information Webcast Presentation – January 2014,” PECO sought bids for ten 12-month Residential supply tranches and seven 24-month Residential supply tranches in the January 2014 solicitation. As noted in the Commission’s “January 2014 Solicitation Approval Secretarial Letter,” the Commission approved the bid results for the 12-month Residential supply tranches but it rejected the bid results for the 24-month Residential tranches.

<sup>30</sup> For example, while the June 2014 – May 2015 NYMEX around-the-clock forward energy price for delivery at PJM Western Hub was \$36.93/MWH on December 31, 2013 (before the 2014 Polar Vortex), it increased to \$40.18/MWH by January 31, 2014, to \$42.33/MWH by February 28, 2014, and to \$47.99 by April 30, 2014. NYMEX prices were provided by Ventyx / Energy Velocity.

1 designed to mitigate the risks to customers from this type of situation. Specifically,  
2 PECO's plan involved a transition of much of its supply to a mix consisting of 60%  
3 24-month products and 40% 12-month products, much like the portfolio being  
4 proposed by PECO for DSP III; therefore, only a relatively small cross-section of the  
5 supply was solicited during any given short period of time. In the January 2014  
6 solicitation, less than 30% of the Residential supply was solicited, so the customer  
7 exposure was limited to a relatively small portion of the Residential supply.  
8 However, under Mr. Hudson's proposed plan, which includes a simultaneous  
9 termination of all of the supply contracts on May 31, 2017, all of the Residential and  
10 Small Commercial default service customer load would be exposed to the risks that I  
11 have described.

12 **18. Q. Do you agree with Mr. Hudson's suggestion that his proposed "hard stop" for all**  
13 **of the default service supply products is needed to facilitate possible changes in**  
14 **default service policy?**<sup>31</sup>

15 A. No. As I explained in my direct testimony, PECO's proposed DSP III already  
16 includes a reasonable degree of flexibility to accommodate the possibility of future  
17 changes in the default service supply approach and the possibility of new retail  
18 market initiatives.<sup>32</sup>

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<sup>31</sup> RESA Statement No. 1, pp. 15-16.

<sup>32</sup> PECO Statement No. 3, pp. 29-31.

1           **III. THE COMMISSION SHOULD NOT RELY ON OCA WITNESS HAHN’S**  
2           **ANALYSIS OF THE RELATIVE COST OF A DEFAULT SERVICE SUPPLY**  
3           **APPROACH INVOLVING THE PROCUREMENT OF BLOCK ENERGY**  
4           **PRODUCTS AND SPOT MARKET PURCHASES**

5 **19. Q. Is the OCA advocating for a block-and-spot procurement approach to supply**  
6           **PECO’s default service customers instead of using FPFR products as PECO has**  
7           **proposed?**

8           A. No. OCA witness Hahn explains that the Commission has approved the phase-out of  
9           block purchases, so he does not recommend that PECO continue to make such  
10           purchases.<sup>33</sup>

11 **20. Q. Despite the fact that the OCA is not recommending to procure any more block**  
12           **products, does Mr. Hahn present any analysis of the relative costs of a block-**  
13           **and-spot procurement approach versus a FPFR product approach?**

14           A. Yes. Mr. Hahn presents an analysis that compares the Residential default service  
15           supply costs, expressed in dollars per megawatt-hour, over the 24-month period of  
16           April 2012 through March 2014 for the portion of the supply covered by FPFR  
17           products versus for the portion of the supply procured pursuant to the block-and-spot  
18           approach.<sup>34</sup> Mr. Hahn concludes that the overall supply costs associated with the  
19           block-and-spot approach were 2% less.<sup>35</sup> Mr. Hahn further attests, “[H]ad the block

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<sup>33</sup> OCA Statement No. 1, p. 7.

<sup>34</sup> OCA Statement No. 1, pp. 6-7; OCA Exhibit RSH-2.

<sup>35</sup> OCA Statement No. 1, pp. 6-7.

1 purchases not been reduced [in January 2014, when spot market prices were high],  
2 the cost advantage of block and spot purchases would have been even greater than it  
3 actually was.”<sup>36</sup> Finally, Mr. Hahn contends that, by his analysis, the block-and-spot  
4 approach “has been shown to be a low cost supply option.”<sup>37</sup>

5 **21. Q. How do you respond to Mr. Hahn’s comparison of the historical costs of these**  
6 **two portions of PECO’s Residential default service supply portfolio and his**  
7 **associated conclusions?**

8 A. Since neither the OCA nor any other party is recommending that PECO purchase  
9 block products, I saw no need to review the calculations underlying Mr. Hahn’s  
10 quoted cost numbers, so I will not opine on the accuracy of his calculations.

11 However, a few important points about Mr. Hahn’s analysis and conclusions should  
12 be noted.

13 First, the Commission should be very cautious about drawing conclusions based on  
14 the type of historical analysis that Mr. Hahn has presented. The historical period that  
15 Mr. Hahn studied reflects a single market scenario. At any given time, there is a  
16 broad universe of potential market scenarios that can occur, and the relative  
17 performance of different procurement approaches can be very different under  
18 different potential market conditions. In fact, in PECO’s first default service  
19 proceeding, Mr. Hahn himself made this point when addressing a historical

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<sup>36</sup> OCA Statement No. 1, p. 7.

<sup>37</sup> OCA Statement No. 1, p. 7.

1 comparison that indicated that the rates to customers under a FPFR product approach  
2 were lower than the rates under a managed portfolio approach over a two-year  
3 historical period:

4 Q. In 2003 and 2004, MUNI power supply rates were higher than the  
5 IOU default service rates. Doesn't this mean that a managed  
6 portfolio is not a good approach?

7 A. Not at all. In a short period of time, different power procurement  
8 methods will produce different results, as no method can be  
9 guaranteed to produce the lowest results every year.<sup>38</sup>

10 Second, it is important to address Mr. Hahn's statement, "[H]ad the block purchases  
11 not been reduced [in January 2014, when spot market prices were high], the cost  
12 advantage of block and spot purchases would have been even greater than it actually  
13 was." While it is true that having greater quantities of block products would reduce  
14 costs if spot market prices turn out to be higher than the block product prices, it is  
15 also true that having greater quantities of block products would increase costs if spot  
16 market prices turn out to be lower than the block product prices. Furthermore, spot  
17 market prices are uncertain and, at the time that a block product is competitively  
18 procured, one cannot predict whether spot market prices during the block product's  
19 delivery period will be higher or lower than the block product's price.

20 Mr. Hahn also overlooked the fact that the quantity of FPFR products in the default  
21 service supply portfolio was increased in January 2014, when the quantity of block  
22 products was reduced. If the quantity of FPFR products had not increased, then the

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<sup>38</sup> OCA Statement No. 1 (Direct Testimony of Richard S. Hahn) in Docket No. P-2008-2062739 (*Petition of PECO Energy Company for Approval of its Default Service Program and Rate Mitigation Plan*), p. 33.

