ESC Statement No. 1

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of PECO Energy Company for	:	
Approval of Its Default Service Program	:	
for the Period From June 1, 2021 Through	:	Docket No. P-2020-3019290
May 31, 2025	:	

DIRECT TESTIMONY OF

TRAVIS KAVULLA

ON BEHALF OF THE ELECTRIC SUPPLIER COALITION

TOPICS:

General Observations About Competitive Retail Market
Default Service Provider Role
Time-of-Use Rates
Ten-Year Contracts for Solar Alternative Energy Credits
Recovery of Network Integration Transmission Costs
Existing and Proposed Retail Market Enhancement Programs

JUNE 16, 2020

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Travis Kavulla and I am Vice President, Regulatory Affairs for NRG Energy, Inc. ("NRG"). My business address is 804 Carnegie Center, Princeton, NJ 08540.

Q. HOW LONG HAVE YOU BEEN IN THIS POSITION?

A. I have been in this position since September 2019.

Q. WHAT ARE YOUR KEY RESPONSIBILITIES IN THIS POSITION?

A. In my current role, I lead a team of lawyers, economists and engineers to ensure that energy markets continue to deliver value for electricity consumers.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. My professional experience as well as my educational background are fully described in Exhibit TK-1. However, I wish to highlight some of this prior experience and background as it pertains to this proceeding. Most recently, I led the R Street Institute's energy program, and wrote and commented extensively on public utility regulation, including on matters of intra- and intercompany cost allocation. Prior to my time at R Street, I served eight years as a Commissioner at the Montana Public Service Commission ("MT PSC"), during which time I served as the Chairman of the MT PSC from 2011-2012 and as Vice Chairman from 2015-2019. While serving on the MT PSC, I was also the President of the National Association of Regulatory Utility Commissioners ("NARUC") and a member of the advisory council of the Electric Power Research Institute. In addition, I have served on the governing body of one of North America's largest real-time electricity markets, the Western Energy Imbalance Market. I received my Bachelor's degree in History from Harvard University and a Master's degree, also in

History, from the University of Cambridge, where I was a Gates Scholar. More details are set forth in Exhibit TK-1, which is attached.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION?

A. No.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE OTHER REGULATORY COMMISSIONS, COURTS OR LEGISLATIVE BODIES?

A. I have provided testimony before both the U.S. Senate Energy and Natural Resource Committee and the U.S. House Energy and Commerce Committee, as well as a number of state legislative committees. I have testified on behalf of NARUC and the MT PSC at technical conferences of the Federal Energy Regulatory Commission. I have filed comments before various state regulatory commissions, including those of California, Minnesota, New Jersey, and Rhode Island.

Q. ON WHOSE BEHALF IS THIS DIRECT TESTIMONY OFFERED?

A. This Direct Testimony is offered on behalf of NRG, Direct Energy Services LLC, Interstate Gas Supply, Inc. d/b/a IGS Energy, Vistra Energy Corp., Shipley Choice LLC, ENGIE Resources LLC and WGL Energy Services, Inc. (collectively, the "Electric Supplier Coalition" or "Coalition" or "ESC"). The members of the Coalition either directly or through affiliates or subsidiaries hold licenses issued by the Pennsylvania Public Utility Commission ("PUC" or "Commission") as electric generation suppliers ("EGSs") to supply generation services to retail consumers in the service territory of PECO Energy Company ("PECO").

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my Direct Testimony is to offer the perspectives of the Electric Supplier Coalition on various aspects of the Petition of PECO Energy Company for Approval of its Default Service Program from June 1, 2021 through March 31, 2025 ("PECO DSP V Petition"). Specifically, my Direct Testimony addresses the following issues:

- General Observations About Competitive Retail Market Today
- PECO Transitioning Out of Default Service
- Time-of-Use Rates
- Ten-Year Contracts for Solar Alternative Energy Credits
- Recovery of Network Integration Transmission Costs
- PECO's Existing and Proposed Retail Market Enhancement Programs

Q. DO YOU HAVE SPECIFIC RECOMMENDATIONS IN EACH OF THESE AREAS?

A. Yes. My recommendations can be summarized as follows:

- The Commission should recognize the need to make structural changes to the competitive retail market so that competitive retail offerings will flourish, drive significant investment, or result in innovative product offerings;

- The Commission should transition PECO out of the default service provider role and make default service a true backstop provided by electric generation suppliers;

- In tandem with allowing PECO to offer a time-of-use rate, the Commission should approve it as the standard default rate, establish a framework under which electric generation suppliers may offer supplier consolidated billing, and should make other modifications that are either legally required or in the public interest;

- The Commission should deny PECO's proposal to enter into 10-year solar alternative energy credit contracts, or limit such contracts to the proposed default service plan program period;

- The Commission should reject PECO's proposed handling of network integration transmission services costs that is harmful to shopping customers and instead create a level playing field for all customers by incorporating transmission costs into PECO's nonbypassable charge;

- In examining the components of PECO's default service rate, PECO has failed to allocate identifiable costs related to its default service to its default service rate, which consequently is artificially low and which must be rectified by allocating a portion of overhead costs to that rate; and

- The Commission should modify certain aspects of the existing standard offer program and the proposed low-income customer shopping program so that they result in more meaningful retail market enhancements.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes. Below is a table of the exhibits I am sponsoring. All are attached to my Direct Testimony.

TABLE OF EXHIBITS

Exhibit TK-1	Kavulla Resume
Exhibit TK-2	Lacey Article – Public Utilities Fortnightly
Exhibit TK-3	Lacey Article – The Electricity Journal
Exhibit TK-4	PECO Response to ESC-I-8
Exhibit TK-5	PECO Response to ESC-I-6
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Exhibit TK-16	PECO Response to ESC-IV-12
Exhibit TK-17	PECO Response to ESC-I-14
Exhibit TK-18	PECO Response to ESC-I-1
Exhibit TK-19	PECO Response to ESC-II-8 and 8(a)

Q. IN REACHING YOUR CONCLUSIONS AND DEVELOPING YOUR RECOMMENDATIONS, PLEASE IDENTIFY WHAT YOU HAVE REVIEWED.

A. I have reviewed PECO's Petition, as well as the Direct Testimony of John J. McCawley, P.E.,[1] Joseph A. Bisti,[2] Carol Reilly,[3] and Scott G. Fisher,[4] and the accompanying

[1] PECO Energy Company Statement No. 1.

[2] PECO Energy Company Statement No. 2.

[3] PECO Energy Company Statement No. 3.

[4] PECO Energy Company Statement No. 4.

exhibits. I have also reviewed PECO's responses to discovery propounded by the Coalition and some responses provided at the request of other parties in this proceeding. In addition, I have familiarized myself with the provisions in Pennsylvania's Electricity Generation Customer Choice and Competition Act ("Competition Act")[5] that pertain to default service, along with the Commission's default service regulations[6] and policy statement governing default service.[7] Further, I have reviewed NARUC's "Electric Utility Cost Allocation Manual" ("NARUC CAM")[8] and NARUC's Guidelines for Cost Allocation and Affiliate Transactions ("NARUC Guidelines").[9] Additionally, I have examined a report released earlier this year by the Wind Solar Alliance, which was authored by Rob Gramlich and Frank Lacey.[10] Finally, I have studied an article authored by Frank Lacey entitled "Default Service Pricing Has Been Wrong All Along – Allows Utilities to Maintain Dominance in Markets," which was published in Public Utilities Fortnightly in January 2019,[11] and another article authored by Mr. Lacey called "Default service pricing – The flaw and the fix: Current pricing practices allow utilities to maintain

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5 66 Pa. C.S. §§ 2801-2815.

6 52 Pa. Code §§ 54.181-54.190.

7 52 Pa. Code §§ 69.1801-69.1817.

8 https://pubs.naruc.org/pub.cfm?id=53A20BE2-2354-D714-5109-3999CB7043CE

9 http://pubs.naruc.org/pub/539BF2CD-2354-D714-51C4-0D70A5A95C65

10 Rob Gramlich & Frank Lacey, "Who's the Buyer: Retail Electric Market Structure Reforms in Support of Resource Adequacy and Clean Energy Deployment," *Grid Strategies* (prepared for Wind Solar Alliance) (March 2020). ("Wind Solar Alliance Report"). https://windsolaralliance.org/wp-content/uploads/2020/03/WSA-Retail-Structure-Contracting-FINAL.pdf (accessed June 8, 2020).

11 Frank Lacey, Default Service Pricing Has Been Wrong All Along – Allows Utilities to Maintain Dominance in Markets, Public Utilities Fortnightly, January 2019, Pages 40-44. A copy is attached to my Direct Testimony as Exhibit TK-2.

market dominance in deregulated markets," which was published in the Electricity Journal in April 2019.[12]

II. GENERAL OBSERVATIONS ABOUT COMPETITIVE RETAIL MARKET TODAY

Q. DO YOU HAVE ANY GENERAL OBSERVATIONS ON THE COMPETITIVE RETAIL MARKET THAT EXISTS IN PENNSYLVANIA TODAY, AND SPECIFICALLY IN PECO'S SERVICE TERRITORY?

A. I do. Pennsylvania historically has been a leader in opening its market to competition, for the benefit of consumers. When I led the nation's association of state utility regulators as president of NARUC, Pennsylvania's reputation in that regard was widely known. But, today, the unfortunate reality is that competition in Pennsylvania's electric market is stagnating.

Q. WHAT DO YOU POINT TO IN SUPPORT OF THAT OBSERVATION?

A. According to PECO's responses to Coalition discovery requests, shopping by residential customers has stagnated, with less than one-third of the residential customers in PECO's service territory shopping – a dynamic that has not changed the past several years. Indeed, the number of active and pending EGS customers in PECO's service area peaked in March 2017 at 507,005 and has recently declined with the number in February 2020 reaching a new low of 425,215 since November 2012 when the number of shopping customers was 419,176.[13] Without structural changes to improve the market, it is not realistic to expect that competitive retail offerings will flourish, drive significant generation investment, or result in innovative product offerings. In essence, Pennsylvania

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12 Frank Lacey, Default service pricing – The flaw and the fix: Current pricing practices allow utilities to maintain market dominance in deregulated markets, The Electricity Journal, Volume 32, Issue 3, 2019, Pages 4-10. A copy is attached to my Direct Testimony as Exhibit TK-3.

13 Exhibit TK-4 (PECO Response to ESC-I-8).

has a choice—either to let PECO and other utilities continue to monopolize the market, or to leverage the competitive market to its original, intended purposes.

Q. DOESN'T PECO DESCRIBE ITS "BASIC DEFAULT SERVICE MODEL" AS SUPPORTING THE "COMPETITIVE RETAIL ELECTRICITY MARKET"?

A. Yes, through the Direct Testimony of Mr. Fisher, PECO describes its "basic default service model" as supporting the "competitive retail electricity market."[14] However, the rationale offered by Mr. Fisher for this statement is that 102 EGSs currently serve PECO customers. When taken in a vacuum, 102 EGSs may seem like a robust group of market participants. However, this data point needs to be viewed from the lens of the number of PECO residential customers that are shopping for electric supply. Under the most recent data available for the month ending April 28, 2020, PECO had 1,511,836 residential customers on its distribution system and only 423,314 were either actively being served by EGSs or were to be switched to EGSs in the next 3 days.[15] What this means is that PECO is providing generation service to 72 percent of the customers on its distribution system, while 102 EGSs are supplying generation to the remaining 28 percent of the customers. The average market share for each EGS serving customers on PECO's distribution system is roughly 0.27% of the overall residential electric market. These statistics clearly demonstrate the dominant market share that PECO continues to enjoy in the provision of generation service to customers on its distribution system.

Q. WHAT ARE THE REASONS FOR THE STAGNANT MARKET?

A. The reasons are the structural flaws in the design of the retail market, which after an initial burst of enthusiasm and investment, have left it only a shadow of what it could be.

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[14] PECO Statement No. 4 at 4.

[15] Exhibit TK-5 (PECO Response to ESC-I-6).

The Wind Solar Alliance Report released earlier this year explores these flaws at some length. They boil down to the presence of a domineering default service provider ("DSP") and a persistently unlevel playing field between the DSP and EGSs. That unlevel playing field is evinced in the inability of EGSs to have a direct relationship with their customers, through monthly consolidated bills. That unlevel playing field also arises in the persistent cross-subsidization that causes distribution customers, including those who have chosen a product other than PECO default service, to nevertheless pay for costs related to PECO's default service. Indeed, the very presence of a DSP that is also the local transmission-and-distribution monopoly—a provider-of-first resort arrangement that has come to be accepted as inevitable, even though it was not inevitable in the design the authors of Pennsylvania's competition statute conceived[16]—biases customers toward the entity that physically meters them and bills them.

Q. WHAT ARE THE NEGATIVE CONSEQUENCES OF THIS?

A. The Wind Solar Alliance Report focuses on one negative consequence, namely the lack of long-term contracts that are signed to supply customers in Pennsylvania and other states that have a similar, domineering DSP. Simply put, EGSs are reluctant to make longer term investments in the market if its main competition—the DSP—both dominates the market by a default arrangement that consistently directs customers back to it *and* enjoys a regulatory model of assured cost recovery. For an EGS that must work to earn its customer and stake its own capital at risk, the model is not a feasible one to drive meaningful investments over the long term. In the presence of a dominant utility DSP, the EGS market is destined primarily to consist of shorter-run arrangements that undercut

[16] 66 Pa.C.S. § 2807(e).

the DSP. Likewise, without the ability to bill its customers directly, EGSs are put at a disadvantage in establishing meaningful, long-term relationships with their customers—further undermining the case for long-term investments, and also damaging the prospects of offering innovative products that cannot be conveyed in the small space that EGSs are afforded on PECO's bill.

Ironically, these negative developments then invite further tinkering with the default service to solve what the market does not seem to be offering. In this proceeding, PECO has proposed a long-term solar purchase—something a well-designed competitive retail market can amply provide. As the Wind Solar Alliance scorecard for Pennsylvania suggests, there is much room for improvement.[17] In my testimony, I propose several improvements in line with those detailed in that report.

Q. BUT ISN'T INVESTMENT IN GENERATION OCCURRING IN PENNSYLVANIA AND THROUGHOUT PJM?

A. Yes. But those investments are mostly a function of wholesale market design, including PJM's regional capacity market, where market administrators forecast forward demand and hold a competitive auction to procure it. Ideally, much of the heavy lifting currently left to the PJM capacity auction would instead be done by a diverse group of buyers seeking to cover their retail positions. In the highly competitive Texas market, for example, only 10-20% of total energy volumes transacted in the wholesale ERCOT market were unhedged by a bilateral contract.[18] This demonstrates that in a truly competitive retail market, a significant incentive faces EGSs to cover the positions they are contractually obligated to serve, or that they expect to serve in the future given

[17] Wind Solar Alliance Report, p. 19.

[18] Potomac Economics, acting as ERCOT Independent Market Monitor, *Review of Summer 2019*, p. 23. https://interchange.puc.texas.gov/Documents/49852_6_1036679.PDF

expectations of their market share. This obligation drives investment in generating resources and, in particular, creates a virtuous cycle for renewable development, as many of those hedges take the form of renewable power purchase agreements.

Q. WHAT SPECIFIC IMPROVEMENTS HAVE YOU IDENTIFIED?

A. I propose a number of specific improvements including: (i) taking steps to transition PECO out of the default service role; (ii) adopting PECO's proposed time of use rate in tandem with implementing the ability of suppliers to issue consolidated bills to customers and requiring PECO to make several modifications to this product; (iii) rejecting PECO's proposal to solicit new ten-year contracts for solar alternative energy credits; (iv) rejecting PECO's proposal for the recovery of network integration transmission service costs; (v) making changes to PECO's proposed rate design for default service so that it contains all of the cost components incurred to provide default service; (vi) rather than simply continuing the existing Standard Offer Program ("SOP"), seizing an opportunity to implement improvements that might encourage greater participation by suppliers and consumers; and (vii) avoiding structuring PECO's proposed plan for shopping by low-income customers in a way that is unduly restrictive and contains elements that would create new challenges for suppliers in their interactions with consumers.

III. TRANSITION PECO OUT OF DEFAULT SERVICE

Q. WHAT DO YOU BELIEVE NEEDS TO OCCUR IN ORDER FOR PENNSYLVANIA TO REALIZE THE INTENDED BENEFITS OF THE COMPETITION ACT?

A. Pennsylvania law requires a DSP to supply non-shopping customers, or customers whose EGS has defaulted or otherwise not performed.[19] However, the law's requirement that

[19] 66 Pa.C.S. § 2807(e)(3.1).

PECO fill this role at the conclusion of the company's restructuring plan, when its retail generation rate caps expired in 2010.[20] The Commission for a decade has had the statutory ability to designate an "alternative supplier" of default service in the PECO territory.[21] A reformed DSP could be truly a provider of last resort, as the law intended, and not the first resort and dominant supplier in the market. To that end, it is critical that the Commission resume its discussions from 2012 and lay the groundwork to transition Pennsylvania's retail electricity market so that all customers are shopping for electricity and "default service" becomes a true backstop service provided by EGSs.[22]

In 2012, former Commissioner Cawley aptly explained that the "fundamental problem with the current default supply structure is that the majority of consumers will not make a proactive decision to choose an energy supplier when they are provided a default supplier if they do not choose one."[23] He pointed out that this "is especially so when customers are accustomed to receiving complete service from their electric utility."[24] Using an example in the service territory of Duquesne Light Company where multiple supplier offers were available that would be more than 20% lower than the utility's prices, Commissioner Cawley noted the lack of shopping and concluded that

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20 66 Pa.C.S. § 2807(e)(1); *Petition of PECO Energy for Approval of Its Default Service Program and Rate Mitigation Plan*, Docket No. P-2008-2062739 (Order entered June 2, 2009).

21 66 Pa.C.S. § 2803, definition of "default service provider."

22 *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952 (Secretarial Letter dated March 2, 2012). http://www.puc.state.pa.us/electric/pdf/RetailMI/RMI-SecLtr_Staff_Doc_EnBanc_Hearing030212.pdf

23 *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237952 (Concurring and Dissenting Statement dated September 27, 2012) at 1. http://www.puc.pa.gov/pcdocs/1192963.pdf

24 *Id.*

"mass market customers, including residential and small commercial customers, often will not make affirmative choices for their supplier unless they are required to."[25]

In making these observations, Commissioner Cawley was voicing what has in the years since become widely accepted: that government regulation establishes a "choice architecture"[26] that drives consumers to make—or, as here, not make—choices, even in a market that may seem unconstrained and fully competitive. Or as the Nobel laureate in economics Daniel Kahneman puts it about the positive choices that a consumer might make, but does not: "The default option is naturally perceived as the normal choice. Deviating from the normal choice is an act of commission, which requires more effortful deliberation, takes on more responsibility, and is more likely to evoke regret than doing nothing."[27]

Q. WHAT ARE SOME KEY BENEFITS OF REMOVING THE UTILITY FROM THE ROLE AS DEFAULT SERVICE PROVIDER?

A. The reasons offered in the above section where I make observations about the stagnation of the retail competitive market are also relevant here. If the Commission does not take action, it should expect the competitive retail market to further stagnate, to the ultimate disadvantage of consumers amidst the re-emergence of a monopoly that either lacks a strong incentive for innovation or efficiency, or which may face perverse incentives, necessitating constant scrutinizing by the Commission. In addition, there are several other benefits to not having a dominant DSP serving the vast majority of the market, especially a company that is an EDC.

[25] *Id.* at 2.

[26] Richard Thaler, Cass Sunstein, and John Balz, "Choice Architecture," Ch. 25, *The Behavioral Foundations of Public Policy*, ed. Eldar Shafir (2013).

[27] Daniel Kahneman, *Thinking, Fast and Slow* (2011), p. 413.

First, having the EDC exit the default service role will enable the EDC to focus on its core competencies and obligations for safe, reliable and adequate distribution service. Second, the selection process of an "alternative supplier" for DSP could have competitive characteristics that would allow the Commission to avoid the worst parts of regulating the EDC-as-DSP. Specifically, I would expect the Commission to ask aspirants to provide DSP service to participate in a competitive-offer process similar to what companies now do in vying to be wholesale suppliers to PECO's DSP. Instead of bidding for tranches that are then passed-through at cost, together with other costs that require the kind of litigation present in this proceeding, the companies bidding to be the DSP would present rival plans that the Commission and an independent evaluator would select from using a transparent methodology. In either case, the terms of the engagement could largely be fixed in advance, with the Commission approving "reasonable costs" that are collared by a competitive process.[28] This stands favorably in contrast to the status quo, where the Commission must make *ad hoc* decisions on conceptual topics within DSP design, such as the solar procurements that PECO proposes (Section V) or the allocation of the EDC's overhead costs (Section VII) and NITS charges (Section VI) that I raise, and watch as the cost consequences of those decisions accrue to consumers under an automatic adjustment provision.[29] Third, the DSP could be institutionally responsible for administrating the "choice architecture" that leads customers to more actively choose, while currently

[28] This is to say the Commission would define "reasonable costs" through the solicitation process, limiting the DSP's ability to collect higher costs after the fact, and providing an incentive to obtain further efficiencies that could be reflected in the next DSP phase. 66 Pa.C.S. § 2807(e)(3.9).

[29] *Id.*

PECO's programs have not resulted in a substantial increase in shopping, as evidenced by the slowing traffic now seen in the SOP described below (Section VIII).

Q. WHAT CAN THE COMMISSION DO ABOUT THESE PROBLEMS WITHIN PECO'S DEFAULT SERVICE PROCEEDING?

A. The Coalition recognizes that the Commission would likely prefer to address changes to the default service structure model on a statewide basis. However, the fact remains that each EDC files its own default service plan, which does not lend to such an approach. The evidence in the record in this proceeding shows a need for Commission action. Nonetheless, understanding that it is not realistic to expect PECO to submit a compliance filing in this proceeding that begins the process of moving it out of the DSP role, the Coalition suggests instead that the Commission direct PECO to hold a series of workshops with stakeholders commencing within 120 days following entry of a final order and to submit a report to the Commission within 120 days thereafter summarizing the alternative default service models identified by the stakeholders. Alternatively, the Commission could convene its own Office of Competitive Market Oversight-led collaborative following a similar timeline and approach. The point is that the default service model needs to change in order to allow the competitive market to function effectively. That will not happen unless the Commission embraces these concepts and displays a leadership role returning Pennsylvania to its status as a national leader in competitive energy markets. In addition to kickstarting this important change, there are a number of issues that have to be addressed regardless of which entity serves as DSP—as well as some that have to be resolved in this proceeding because PECO serves as DSP. I now turn to those topics.

IV. TIME-OF-USE (“TOU”) RATES

Q. WHAT DOES PECO PROPOSE WITH RESPECT TO TOU RATES?

A. Through Direct Testimony, Mr. Bisti describes the key features of PECO’s proposed TOU Rates, which would “differentiate prices across three periods (peak, off-peak and super off-peak) that remain constant year-round based on price multipliers designed to motivate shifting of usage from the higher-cost peak period to lower-cost peak periods.”[30] He further explains that the TOU pricing periods are identical for the Residential and Small Commercial Classes. As he notes, the “proposed TOU rate design is structured to establish a rate premium above PECO’s standard, fixed-price default service rate for usage during the peak period and rate discounts from this baseline price for usage during two off-peak periods.”[31]

Q. WHAT IS YOUR VIEW OF THE OPPORTUNITY FOR AND BARRIERS TO MORE CUSTOMERS IN THE PECO SERVICE TERRITORY RECEIVING SERVICE UNDER TOU RATES?

A. It is an important and overdue development. PECO began its smart-meter rollout in 2012, and between the beginning of that year to the end of 2019 PECO’s rate base associated with meters grew nearly $125 million, from $195 million to $320 million, at an approximately 8% annual average rate of growth.[32] The roll-out has resulted in smart-meter technology being nearly ubiquitous for PECO’s residential and small-commercial customers who will be eligible for the proposed TOU rate, with 99.5% and 98.0% of

30 PECO Statement No. 2 at 14.

31 PECO Statement No. 2 at 15.

32 Put another way, PECO’s meter rate base has grown 64% over eight years. Figure calculated by subtracting the difference between the end of year plant balance for 2019 and beginning of year plant balance for 2012 in FERC Account 370-Meters. Exhibit TK-6 (Response to ESC-IV-9).

those classes respectively being served with a smart meter.[33] One of the often-promised benefits of smart meters is their ability to create an enhanced retail experience, including time-varying rates that better reflect the cost of energy at wholesale and the opportunity for demand to participate in response to a more dynamic price signal. As then-Commissioner Robert Powelson opined in his characteristically forward style when the Commission first implemented Act 129 providing for smart-meter technology, “To be frank, it is pointless to have smart meters if you are still going to have ‘dumb’ rates.”[34] And yet, even as PECO customers have paid handsomely for this investment, a decade later they have little to show for it—at least as regards “smart” rates. According to PECO, they still won’t, at least not through the DSP, even if the present filing is approved. That is because PECO proposes its TOU rate as only an opt-in, rather than a default product, and consequently “PECO expects enrollment in its proposed TOU rates to be small relative to the overall default service customer base.”[35]

It does not have to be this way. Obviously, Pennsylvania telecommunications customers who once received a uniform service under a regulated rate structure today experience something very different. Depending on their provider, they are today able to track their data, enjoy free access to certain data as part of their subscription, and enjoy a variety of different rate and plan offerings that suit their needs. That is the ideal of the retail electric market—but we are far from accomplishing it. Indeed, today’s electric market is structured in such a way that whatever competitive offering a customer might

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33 Exhibit TK-7 (PECO Response to ES-I-45).

34 *In re Smart Meter Procurement and Installation*, Docket No. M-2009-2092655 (Statement of Commissioner Powelson dated June 18, 2009).

35 Exhibit TK-6.

subscribe to, he or she would still receive the bill from Ma Bell. Indeed, in the Pennsylvania competitive retail market, even programs that have the purpose of introducing customers to this competition are branded as "PECO" programs.[36] At the same time the Commission considers an innovative product like TOU, it must think in tandem about the competitive structure of the market that should serve a marketplace whose customers want and need differentiated products.

Q. YOU SAY 'IT DOESN'T HAVE TO BE THIS WAY.' DO YOU HAVE A REAL-WORLD EXAMPLE IN THE ELECTRIC POWER SECTOR TO PROVIDE IN THIS REGARD?

A. Yes. In Texas, NRG's largest market, electric customers enjoy a wide variety of product offerings. Importantly, 1.25 million out of 7.45 million customers have voluntarily elected a price-responsive demand product—nearly a 17% adoption rate.[37] By contrast, the nationwide average for adoption of time-of-use rates by residential customers is a mere 1.7%.[38] This diversity of offerings, especially of TOU and like products, would not be possible if it were not for Texas allowing EGSs to directly bill their customers.

PECO has indicated that it will use its customers' bills by "depicting the time-of-use blocks and associated charges," which will inform customers how their usage fell into the on-peak, off-peak, and super-off-peak periods.[39] While it has not provided an

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36 See, e.g., Exhibit TK-8 (PECO Response to ESC-I-3). This discovery response contains the script that PECO uses to introduce customers to the Standard Offer Program, which is fully funded by EGSs, but yet is repeatedly referred to as the "PECO Smart Energy Choice Program."

37 Wind Solar Alliance Report, p. 4.

38 Ryan Hledik et. al., *The National Landscape of Residential TOU Rates: A preliminary summary*, Brattle Group (Nov. 2017), http://files.brattle.com/files/12658_the_national_landscape_of_residential_tou_rates_a_preliminary_summary.pdf.

39 Exhibit TK-9 (PECO Response to ESC-IV-14).

example of what this will look like.[40] PECO's approach in this regard is obvious. It would be absurd to serve a customer under a complex rate and not attempt to straightforwardly represent the charges associated with the time-variable elements of that rate.

As an example of a customer relationship around such a product looks like, I am sponsoring Exhibit TK-10, which is an example of a customer bill that retail provider Reliant, an NRG company, uses for its Reliant Free Weekends[SM] 12 in the Texas ERCOT market. In Pennsylvania generally and in PECO's service territory specifically, EGSs do not have the ability to send such a bill to their customers. Instead, we are limited to 4 lines with 80 characters of text on PECO's bill.[41] We also do not have the luxury of sending customers a bill insert at all, much less at those customers' expense, as PECO proposes to do for its TOU product.[42] The barriers that prevent EGSs from billing customers directly should come down, in tandem with a Commission order allowing PECO as a DSP to offer any TOU product.

Q. WHAT WILL LIKELY HAPPEN IF THE COMMISSION DOES NOT ADOPT A RETAIL MARKET ENHANCEMENT ALLOWING SUPPLIER CONSOLIDATED BILLING AT THE SAME TIME THAT PECO TOU RATES ARE IMPLEMENTED?

A. Several harms will occur. First, the retail market will become more uncompetitive. It will result in a situation where only PECO is allowed to offer time-varying rates effectively. The Commission has noted both the challenges faced by EDCs in offering TOU rates and

[40] *Id.*

[41] Exhibit TK-11 (PECO Response to ESC-III-1).

[42] Id.

the importance of relying on retail EGSs to offer TOU products,[43] but this will not occur if EGSs lack the same billing model that would allow the PECO TOU product to be effective.

Second, the competition that will exist will tend toward a race to the bottom, further converging on time-limited offers for a low commodity cost, rather than on evolving the retail market and the EGS business model to a next-generation industry that leverages Pennsylvanians' investment in smart meters.

Third, it will cement incentives that are already misaligned with the presence of a dominant default supplier that enjoys pass-through recovery of its "reasonable" (often meaning, all) costs. When an EGS sells energy supply products, it is the EGS that takes the risk around the divergence between the rate charged to customers and the EGS' actual costs to supply those customers. In a similar vein, the EGS takes the risk around whether the TOU product will in an economically efficient manner shape a customer's demand.[44] PECO as a DSP takes no such risk. Indeed, PECO is proposing to socialize this risk not just to TOU customers—but to all its customers.[45] The answer to the question "who bears the risk?" is profoundly different when it comes to the utility in its DSP role versus an EGS's offering of TOU products. The Commission should want as many properly incentivized actors in the market offering TOU products so that they—and not customers—wear the risk of getting the retail price structure aligned to the actual value of

[43] *Investigation of Pennsylvania's Retail Electricity Market: Recommended Directives on Upcoming Default Service Plans*, Docket No. I-2011-2237952 (Tentative Order entered October 14, 2011) at 7.

[44] These trade-offs are evident, for example, when PECO describes why it is proposing a year-round TOU product rather than a seasonal one, as the Commission previously advised and which might have a stronger link to the wholesale market dynamics that TOU rates are intended to reflect. PECO Statement No. 2 at 17.

[45] PECO Statement No. 2 at 20-21.

energy supply at particular time periods balanced with the acceptability of these plans to customers.

These three harms are substantial, but they can be minimized or remedied if the Commission requires PECO to adopt supplier-consolidated billing ("SCB") at the same time or before PECO implements its time-variable rates. Of note, PECO already has SCB provisions in its Electric Generation Supplier Coordination Tariff.[46] Yet these provisions are ineffective because they have never been operationalized. No electronic data interchange process is in place and PECO would not at the moment be able to execute SCB were an EGS to request it. Additionally, various EGSs have asked the Commission to implement SCB and to enable EGSs to manage their bad debt on the same terms as apply to the EDC as the DSP.[47] Nevertheless, the tariff provisions represent a starting point for full SCB implementation and a Commission decision in this matter directing them to be resolved prior to TOU implementation is an appropriate resolution of the outstanding barriers to the EGS business model, especially as regards innovative products.

Q. SO DO YOU OPPOSE PECO'S PROPOSAL TO OFFER TOU RATES?

A. On the contrary, there is much to support in it. I have been advised by counsel that as a DSP, PECO has a legal obligation to offer such a rate to essentially all customers with smart meter technology.[48]

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[46] Supplement No. 27 to Tariff Electric Pa. P.U.C. No. 1 S, First Revised Page Nos. 97-101. https://www.peco.com/SiteCollectionDocuments/current_elec_supplier_tariff_eff_Sept082016.pdf

[47] *See, e.g., Notice of En Banc Hearing on Implementation of Supplier Consolidated Billing*, Docket No. M-2018-2645254 (Comments of the Electric Generation Supplier Coalition for Consolidated Billing dated May 4, 2018).

[48] 66 Pa. C.S. § 2807(f)(5); *DCIDA v. PUC*, 123 A.3d 1124 (Pa.Cmwlth. 2015), rehearing denied, 2015 Pa. Commw. LEXIS 472 (Oct. 30, 2015), appeal denied, 2016 Pa. LEXIS 1131 (Pa., June 1, 2016).

While PECO has offered its TOU rate as an opt-in for residential and commercial customers, it should be the default rate and instead allow customers to opt-out to real-time pricing or to an EGS product. The default rate should be a rate structure that better reflects underlying market-price dynamics. This is especially so because part of the rationale for the investment in ubiquitous smart-meter technology was a retail rate structure that took advantage of this investment, as Commissioner Powelson's opinion quoted above denotes. The current default standard rate does not take advantage of this substantial investment in smart meter technology. As Mr. Bisti observes, PECO's opt-in TOU pilot program delivered measurable load reductions, especially at peak, and saved the vast majority of enrolled customers money.[49]

Regardless of whether the DSP's TOU rate is opt-in or opt-out, however, the Commission should first ensure a level playing field for time-varying rate products offered by the DSP and EGSs in order to ensure that harms I have identified above are minimized. In addition, I have a handful of concerns about PECO's proposal itself.

Q. WHAT IS YOUR FIRST CONCERN WITH THE DETAILS OF PECO'S PROPOSAL?

A. It is the budget and timeline along which PECO proposes to offer its TOU rate. PECO proposes only $900,000 in expenses for customer communications around its TOU offering, and provides relatively few details around this program.[50] PECO suggests that the rate will be available in approximately a year from when the Commission approves the TOU rate in an order.[51] Based on my familiarity with TOU programs and my review

49 PECO Statement No. 2 at 11-12.

50 PECO Statement No. 2 at 23-24.

51 *Id.* at 24.

of a recent report by Barbara Alexander of another public utility's implementation of more complex rate plans, it seems appropriate to expect a larger budget and a longer time horizon to implement a TOU rate that is intended to be widely adopted.[52] Of course, this is especially the case if the TOU rate is the default rate under DSP.

Q. WHAT IS YOUR NEXT CONCERN?

A. To the degree capital investments are proposed for the DSP program, they should be funded throughout the life of the DSP period. PECO estimates it will make $2.9 million in capital investments associated with the TOU rate's implementation.[53] Since these capital investments are intended to benefit DSP customers throughout the DSP period, it is appropriate that these be amortized over the period. The Generation Supply Adjustment ("GSA") portion of the PTC should begin reflecting those when the rate is first reset at the beginning of the DSP period in 2021 on amortization schedule equal to the 4-year DSP.

Q. DO YOU HAVE OTHER CONCERNS?

A. I do. PECO proposes two restrictions in their application that seem to run afoul of statutory requirements. The first concerns real-time price service.[54] Larger customers may take real-time price service under PECO's DSP.[55] However, Mr. Bisti does not propose to make this service available to residential and small commercial customers. PECO has

52 Barbara Alexander, "An Evaluation of Arizona Public Service Company's Customer Education and Its Implementation," (May 19, 2020), prepared on behalf of the Staff of the Arizona Corporation Commission. Docket Nos. E-01345A-19-0236 and E-01345A-19-0003. Available online at https://docket.images.azcc.gov/E000006584.pdf (accessed June 8, 2020).

53 PECO Ex. JAB-6.

54 I use that term within its Pennsylvania statutory meaning of "a rate that directly reflects the different cost of energy during each hour," in which sense the PECO DSP's day-ahead hourly energy product qualifies. *See* 66 Pa. C.S. § 2806(m).

55 PECO Statement No. 2 at 7.

confirmed that it has not included such a proposal in its DSP V filing.[56] Secondly, Mr. Bisti also proposes that "residential customers enrolled in PECO's [Customer Assistance Program] will not be eligible for the residential TOU Rate at this time."[57] This is not consistent with Pennsylvania law, in my understanding.

Q. HOW IS PECO'S OMISSION OF OFFERING REAL-TIME PRICING TO CERTAIN RETAIL CUSTOMERS INCONSISTENT WITH LAW?

A. The law states "the default service provider shall offer the time-of-use rates *and* real-time price plan to all customers that have been provided with smart meter technology."[58] With respect to customers' preferences, the law provides that "residential or commercial customers may elect to participate in time-of-use rates *or* real-time pricing."[59] It seems clear that when PECO acts in its role as a DSP, that it must offer at least one TOU rate structure and one real-time price plan. In other words, if PECO makes a filing for TOU rates without also providing for real-time pricing, as it has done in this proceeding, then the proposal appears to be inconsistent with state law. The real-time pricing that PECO is required to offer should also be incorporated into PECO's implementation campaign and associated expenditures should be estimated and priced into the GSA.

Q. DO YOU HAVE ANY VIEWS ON PECO'S SUGGESTED PROHIBITION ON CAP CUSTOMERS' ELIGIBLITY FOR TOU RATES?

A. The statute, and not PECO or the Commission, defines the set of customers to which default service providers like PECO must offer both TOU and real-time products. This

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56 Exhibit TK-12 (PECO Response to ESC-I-2).

57 PECO Statement No. 2 at 15.

58 66 Pa. C.S. § 2807(f)(5) (emphasis added).

59 *Id.* (emphasis added).

includes all customers who have a smart meter, except in certain limited circumstances associated with how and when the smart meter was first installed.[60]

Q. HAVE YOU FOUND ANY OTHER OMMISSION IN PECO'S PROPOSAL?

A. Yes. The law requires a DSP with Commission-approved TOU rates and real-time price plans to "submit an annual report to the price programs and the efficacy of the programs in affecting energy demand and consumption and the effect on wholesale market prices."[61] It does not appear that PECO, as part of its proposal in this proceeding, proposed a process for making such reports to the Commission, or the form they will take, the information they will convey, or the likely expense of making such reports. However, in response to Coalition discovery, PECO suggests it will make a filing on its TOU plan annually.[62]. It should, and the costs of doing so should appropriately be allocated to the DSP.

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60 *Id.* In referring to § 2807(f)(2)(iii) as the group of customers to whom the requirement to offer a TOU rate and a real-time price applies, the Legislature in enacting § 2807(f)(5) contemplated that if a customer had a smart meter installed a smart meter at his or her own option pursuant to § 2807(f)(2)(i) prior to the smart meter roll-out, or as part of new construction pursuant to § 2807(f)(2)(ii), that the default service provider would not be under this obligation for that customers. Presumably, this was to relieve a DSP of offering a boutique rate that was not available to the majority of customers. Meanwhile, since it is my understanding that the Commission approved widescale smart meter deployments with depreciation schedules of 15 years or less, as contemplated in § 2807(f)(2)(iii), that a requirement therefore exists for the DSP to offer TOU and real-time price plans to all customers who receive service through such a meter. *In re Smart Meter Procurement and Installation*, Docket No. M-2009-2092655, Implementation Order entered Jun 18, 2009 at 14-15 and Ord. ¶ 6.

61 66 Pa. C.S. § 2807(f)(5).

62 Notably, PECO has not submitted reports on its real-time price plan, even though that offering appears to fall within the statutory obligation to file such reports, nor does it propose to include information on those products in the context of the reports it proposes to file on TOU. The Commission should require PECO to file reports consistent with the law. Exhibit TK-13 (PECO Response to ESC-IV-13).

Q. WHAT DO YOU RECOMMEND THE COMMISSION DO WITH RESPECT TO PECO'S TOU PROPOSAL?

The law suggests that the Commission must either "approve or modify" a DSP's proposal for TOU and real-time pricing.[63] I recommend the Commission adopt a retail market enhancement that permits EGSs the practical ability to market and bill TOU and like products to customers at the same time or before PECO itself is allowed to do so.[64] The approval of the PECO proposal should be contingent upon the implementation of this enhancement.

Additionally, the Commission should make a number of modifications to the PECO proposal:

1. It should approve the TOU rate as the standard default rate, allowing customers to shop if they would prefer a different rate, to promote the effective use of PECO's smart-meter investment and to make the default rate more reflective of underlying market conditions.
2. It should require PECO to submit a more robust customer education campaign on a realistic timeline.
3. It should require PECO to offer a real-time price plan to residential and small commercial customers, consistent with the law.
4. It should require PECO to offer these rates to all residential and small commercial customers who received a smart meter as part of the utility's rollout of those investments.

[63] *Id.*

[64] As noted previously, this recommendation entails the implementation of SCB at the same time or before PECO's TOU product becomes available to customers.

5. It should require PECO to appropriately allocate TOU-related costs to DSP customers, including by making a full and appropriate cost allocation and by depreciating capital expenditures over the DSP plan period.
6. It should require PECO to include in its tariff the annual reports contemplated by law by DSPs' offering TOU rates and real-time price plans.

V. TEN-YEAR CONTRACTS FOR SOLAR ALTERNATIVE ENERGY CREDITS

Q. HOW DOES PECO PROPOSE TO COMPLY WITH PENNSYLVANIA'S ALTERNATIVE ENERGY PORTFOLIO STANDARDS ("AEPS") ACT?

A. PECO proposes a two-part approach to ensure that it complies with AEPS Act[65] requirements that PECO acquire and retire alternative energy credits ("AECs") in quantities equal to a percentage of their total retail sales of electricity to all of their retail electric end-use customers for each reporting period. For Tier I and Tier II AECs, PECO will require wholesale default service suppliers to transfer the amount based on the portion of default service load served by the wholesale default service supplier.[66] Separately, and by contrast, PECO proposes to contract directly for fixed-price, ten-year agreements to purchase up to 16,000 Tier I Solar AECs ("SAECs") annually through two solicitations (in 2021 and 2022). This would double the amount of SAECs that PECO directly procures under contract. PECO will employ a two-phase annual procurement process involving a competitive bid phase (the RFP) followed by a Standard Offer To Purchase ("SOTP") phase.[67] The SAECs to be procured through the long-term contracts are expected to satisfy approximately 25% of PECO's SAEC requirements during the

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65 73 P.S. §§ 1648.1-1648.8.

66 PECO Statement. No. 1 at 27-28.

67 PECO Ex. JJM-10 at 1.

DSP V plan period.[68] PECO will apply the remaining 16,000/year SAECs to be acquired pursuant to the process to future default service plan periods.

Q. DOES THE ELECTRIC SUPPLIER COALITION SUPPORT PECO'S SAEC PROCUREMENT PROPOSAL?

A. No. Entering into 10-year contracts, which extend six years beyond the proposed DSP program plan period, is not reasonable. The presence of these long-term contracts will impede the ability of the Commission to remove PECO as the default service provider and approve an alternative default service provider—a barrier that would be present for 10 years. Moreover, the use of long-term contracts by PECO places PECO's captive ratepayers at risk because they will be required to pay for the costs of contracts that may end up being uneconomic over their life. Finally, when default service providers are permitted to use the threatened lack of solar development as a reason for them to enter the market with a supply agreement to "correct" it, the willingness and ability of EGSs to undertake these projects (relying on private investment) is hampered.

Q. WHAT IS YOUR RECOMMENDATION?

A. PECO should require wholesale default service suppliers to deliver the full amount of PECO's AEPS requirements and not pursue the proposed 10-year SAEC contract. Alternatively, the 10-year SAEC proposal should be reduced to match the DSP four-year plan period.

Q. PLEASE EXPLAIN YOUR OBJECTIONS TO APPROVING PECO'S PROPOSED LONG-TERM CONTRACTS WITHIN THE CONTEXT OF THIS DSP PLAN PERIOD.

A. I do not object to long-term contracts generally. It is sometimes rational for a party to enter into one when it is risking its own capital and expects to have load to serve in an

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[68] PECO Statement. No. 1 at 28-29.

economically efficient way over that period of time. However, the program period for this default service plan is four years. While PECO has served as the default service provider since the expiration of generation rate caps, both the statute and the Commission's regulations contemplate the possibility of the default service provider role being shifted to an alternative default service provider such as an EGS.[69] It would be improper in this proceeding to take any action that either forecloses that possibility or creates future stranded costs that would unduly burden the potential for that important reform.

Furthermore, the Commission has previously directed EDCs not to enter into energy contracts that extend past the end date of the default service plan period and to limit the proportion of long term contracts that make up the default service energy plan portfolio.[70] Mr. McCawley cites to the Commission's regulations that he suggests shows that contracts can extend beyond the life of the DSP.[71] But this rule applies only to contracts for "electric power"; SAECS are not "electric power" and are instead part of the "electric generation supply" product.[72] Indeed, the fact that a similar rule does not exist for SAECs suggests they, in particular, should not be procured on a longer time horizon than the plan period.

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[69] 66 Pa.C.S. §§ 2803; 2807(e)(5); 52 Pa. Code § 54.183.

[70] *Investigation of Pennsylvania's Retail Electricity Market: Recommended Directives on Upcoming Default Service Plans*, Docket No. I-2011-2237952 (Tentative Order entered October 14, 2011) at 4-5.

[71] PECO Statement No. 1 at 21.

[72] *Compare* 52 Pa. Code § 54.186(b)(1), defining the mix of instruments for a prudent procurement of "electric power" and 52 Pa. Code § 54.185(e)(1), associating the AEC requirement as part of "electric generation supply."

Q. ARE THERE OTHER REASONS WHY APPROVING PECO'S PROPOSED LONG TERM SOLAR CONTRACTS SHOULD BE REJECTED?

A. Yes. Entering into long term contracts, as PECO proposes here, places PECO's captive ratepayers at risk because they will be required to pay for the costs of contracts that may end up being uneconomic over their life. If PECO risked its own capital—as do EGSs—on a venture that could turn it a profit or loss, then the Commission should be supportive of long-term engagements. That, however, is not the case here, because PECO will be made whole via captive ratepayer dollars regardless of the outcome. As such, there is no financial incentive to execute a contract that is advantageous to PECO's consumers. Indeed, in the SOTP proposal PECO makes, it suggests it bid the *average successful offer price* from the RFP phase of the procurement to those who have SAECs available to sell it.[73] In other words, it is content to get the average of better prices—and not the best price. This is not consistent with how a normal, properly incentivized buyer would conduct solar procurements, in my view.

Q. SINCE PECO AS A DSP MUST ACQUIRE AECS, INCLUDING FOR THE SOLAR CARVE-OUT, WHAT DO YOU PROPOSE?

A. The simplest approach to this issue is to require the DSP's wholesalers incorporate their estimated cost of AEC/SAEC procurement into the bids they make as part of their tranched offers. This is what happens already with the vast majority of AEC procurements, and PECO gives no particular reason why, in effect, a portion of a subset of its AEC requirement—25% of its SAEC procurement requirement—should be procured in this way, unlike the manner in which it procures essentially everything else. This more standard approach would have the salutary effect of retaining a level playing

[73] PECO Statement No. 1 at 33.

field, because the wholesale suppliers face in effect the same business model as EGSs do, having to estimate the likely cost of AEPS compliance and factoring it into the offers they make to the PECO DSP and to their individual customers, respectively.

Q. ARE THERE REASONS TO WORRY THAT NOT ENOUGH SOLAR WILL BE AVAILABLE IN PENNSYLVANIA FOR THE MARKET TO MEET ITS MANDATED PROCUREMENT REQUIREMENT?

A. Mr. McCawley offers a report by the Commission about the state's AEPS compliance, which suggests an uptick in construction of in-state solar facilities will be needed for enough SAECs to be available to meet the legal requirement.[74] He also suggests that PECO's expanded procurement of solar "is consistent with the express policies of a variety of stakeholders in PECO's service territory, including the City of Philadelphia."[75] I find Mr. McCawley's reference to the City of Philadelphia interesting, because the city government's recent deal with ENGIE, a member of the Coalition I represent, is a positive example of what the EGS market can do on solar development when EGSs are given a chance. That deal includes an 80-MW solar facility in Adams County, which will according to a city news release will provide 22% of the city's electricity.[76] Unfortunately, when default supply utilities are allowed to use the threatened lack of solar development as a reason for them to enter the market with a supply agreement to "correct" it, it hampers the willingness and ability of EGSs to undertake these projects themselves. As I noted earlier, and as the authors of the Wind Solar Alliance report observe, EGSs that must stake their own capital at risk are going to be unwilling to make long-term investments if they forecast a persistently unlevel playing field where their

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74 PECO Statement No. 1 at 29.

75 *Id.*

76 https://www.phila.gov/2020-02-06-city-and-engie-announce-power-purchase-agreement-staffing-plans/

competition is a rate-regulated utility with the ability to recover all its costs, even on bad deals. While PECO's previous solar PPAs were small, the ones it proposes here are double in size. It is time to establish confidence for investment by EGSs by adopting more significant reforms, which will do more over the long term to promote confidence and investment in renewables, including in-state solar needed to comply with the AEPS.

VI. RECOVERY OF NETWORK INTEGRATION TRANSMISSION COSTS

Q. WHAT ARE NETWORK INTEGRATION TRANSMISSION SERVICES ("NITS")?

A. Network Integrated Transmission Service ("NITS") charges reflect a load serving entity's share ("LSEs") of the approved transmission service rate for a given transmission owner's zone. LSEs include both EGSs and wholesale default service providers. Accordingly, *all* customer load (including shopping and non-shopping customers) on an EDC's system is allocated a share of transmission service costs. Transmission rate changes are not a function of market fundamentals, but of a FERC regulatory process largely driven by transmission owners like PECO and what they decide to spend in upkeep and reinvestment in their system.

Q. ARE NITS THE ONLY PJM CHARGES THAT HAVE THESE CHARACTERISTICS?

A. No. There are a number of wholesale cost obligations assessed by PJM that all LSEs are required to pay including: Generation Deactivation/Reliability Must Run charges; Regional Transmission Expansion Plan charges; and, Expansion Cost Recovery charges (collectively, "Other PJM Charges"). NITS and Other PJM Charges are generally referred to a Non-Market Based ("NMB") charges.

Q. WHY DO NMB CHARGES PRESENT SUCH DIFFICULTY IN COMPETITIVE MARKETS?

A. NMB Charges present difficulty because they are not a function of market fundamentals and, therefore, can be subject to very significant changes over what can be reasonably anticipated. When any of these NMB Charges experience significant price fluctuations, LSEs either must absorb them or pass them on to consumers.

Q. ARE YOU AWARE OF WHETHER THE COMMISSION IS FAMILIAR WITH THE PROBLEMS PRESENTED BY NMB CHARGES?

A. Yes. I am advised by counsel that Commission Staff was directed to perform an informal review of NMBs and that a Secretarial Letter was issued to EDCs on May 1, 2015 requesting the EDCs to respond to specific questions set forth in the letter. According to the May 1, 2015 Secretarial Letter, the intent of the investigation was "to determine if there is a need to address these non-market based wholesale market charges in a more uniform and comprehensive way that would facilitate and enhance the retail electric market during future proceedings."[77] Neither the information provided by the EDCs in response to the May 1, 2015 letter nor any other result of the Staff's informal investigation was shared publicly. PECO, in response to discovery in this proceeding, indicated that "after a reasonable search . . . it was unable to locate the written informal comments" shared with Commission Staff.[78] Then, in April 2017, Commission Staff announced its intent to reopen the NMB informal investigation and requested any interested stakeholder to submit informal comments by July 2017. Like the earlier investigation, none of the informal information received in July 2017 nor any other result

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[77] The May 1, 2015 Secretarial Letter is included with the April 21, 2017 CHARGE Call Recap available on the Commission's website at http://www.puc.pa.gov/Electric/docs/OCMO/CHARGE_Recap042117.docx.

[78] Exhibit TK-14 (PECO Response to ESC-I-21).

of Staff's restarted investigation was publicly shared. No further information or action has occurred as a result of this Staff informal review.

Q. FOCUSING ON PECO, DOES PECO'S METHOD FOR RECOVERING COSTS FOR NITS AND OTHER PJM CHARGES SUFFER FROM THE INCONSISTENT APPROACH IDENTIFIED AS A CONCERN BY THE COMMISSION IN DIRECTING STAFF TO INVESTIGATION THE ISSUE?

A. Yes. PECO uses two very different methods of cost recovery depending on the specific NMB Charge. For NITS, PECO assumes the costs for *default service load only*. It passes through NITS price fluctuations to those default service customers through its Transmission Service Charge. Meanwhile, for the Other PJM Charges, PECO assumes the costs for *all* customers and recovers the costs from all customers (shopping and non-shopping) via the Non-Bypassable Transmission ("NBT") charge. PECO, within its own service territory, is applying two very different approaches. This matter can and should be addressed in this proceeding and the Commission should direct PECO to include recovery of NITS via the NBT charge so that the actual costs of all the NMB Charges are recovered from all customers.

Q. WHAT IS THE DIFFERENCE BETWEEN THE TWO COST RECOVERY METHODS UTILIZED BY PECO?

A. The difference between these two methods lies in how the LSEs have to factor in the costs of the NITS charges. EGSs bear the risk of estimating and pricing likely NITS charges. Meanwhile, PECO's wholesale default service suppliers and PECO itself pass that risk along to default service customers, who have their rates increased after the fact for any increase in NITS charges.

In contrast, for the Other PJM Charges, PECO socializes this risk of price fluctuation for all customers (shopping and non-shopping). In that situation, neither the wholesale default service suppliers nor the EGSs are required to factor in the costs of those charges.

Q. IS PECO'S APPROACH TO NITS REASONABLE?

A. No. PECO's approach creates an inherently unlevel playing field between it as the DSP and EGSs. In today's design, EGSs bear the risk of estimating costs—ironically, costs in part driven by PECO's managerial decisions on transmission investments and accounting decisions on how to estimate its future spending, which are not visible to EGSs—even while PECO is able to socialize any rate increases driven by its additional real and expected transmission costs to its DSP consumers after the transmission rate PECO has proposed to FERC has gone into effect. Moreover, if EGSs overestimate NITS costs or the risk that those costs will change during the term of its retail supply agreement, customers may end up paying more than if the NITS charges were passed through a nonbypassable charge like PECO's NBT charge after they are approved.

Q. ARE YOU RECOMMENDING THAT THE COMMISSION REQUIRE PECO TO ELIMINATE ITS CURRENT COST RECOVERY METHODOLOGY FOR NITS?

A. Yes. As I discussed above, PECO's current method is the worst possible approach to dealing with the unpredictable nature of the actual NITS costs to be assessed on all LSEs both because of the imparity with how PECO treats NITS for default supply customers and shopping customers and because having EGSs bear the cost of NITS may increase costs to customers.

Q. ARE YOU AWARE OF THE COMMISSION'S PREVIOUS DETERMINATIONS REGARDING THE COST RECOVERY OF NITS?

A. Yes. I have been advised by counsel that the Commission has rejected proposals requiring EDCs to be responsible for the costs of NITS for all LSEs citing a lack of evidence that the cost of NITS is volatile and unpredictable.[79]

Q. HAVE CIRCUMSTANCES CHANGED SINCE THE COMMISSION LAST REJECTED THESE PROPOSALS?

A. They have significantly changed. Most transmission owners in PJM now charge "formula" rates. This is a significant departure from traditional transmission ratemaking, and it promotes more frequent and sudden changes in NITS. That makes it harder for EGSs to estimate likely NITS costs over the term of the offers they make to the market.

Q. CAN YOU EXPLAIN MORE FULLY HOW THE COSTS THAT WILL BE ASSESSED TO ALL LSES FOR NITS ARE NOW DEVELOPED?

A. Yes. The annual revenue requirements for NITS are developed under either a "stated" or "formula" rate. Traditionally, utilities had to put on a rate case before FERC in order to justify their alleged cost of service in order to justify significant rate increases. These are "stated" rates—they are stated on the tariff sheet, and not subject to substantial change without rather involved regulatory proceedings. The length of those proceedings gives transmission customers like EGSs more time to plan and forecast likely rate changes.

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79 *See, e.g., 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 (Opinion and Order entered at December 4, 2014) at 53-54. The Commission has also approved FirstEnergy's approach which requires the wholesale supplier to include the costs of NITS as part of their bids to provide default service. *Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company for Approval of their Default Service Programs*, Docket Nos. P-2013-2391369, P-2019-2391372, P-2013-2391375, P-2013-2391378 (Opinion and Order entered July 24, 2014) at 31-32.

More recently, FERC has allowed transmission owners to change the rates they charge more frequently and more suddenly through "formula" rates. The inputs to the formula rates include the capital investments a transmission owner *expects to make* next year, the operating expenses it expects to have to pay for, as well as a return on the existing investments in its system. These rates are then trued up annually, such that if a transmission owner spent more or spent less than it initially projected, the rate can swing up and down in line with the under- or over-recovery.

Q. HAS PECO SOUGHT AND RECEIVED FERC APPROVAL TO MOVE FROM 'STATED' TO 'FORMULA' TRANSMISSION RATES RECENTLY?

A. Yes. On May 1, 2017, PECO filed a request with the FERC to begin implementation of a wholesale transmission formula rate.[80] On June 27, 2017, PECO received FERC approval to begin the implementation of a formula rate, starting December 1, 2017.[81] The formula rate structure allows PECO to receive current recovery of its costs. PECO files its transmission formula rate update as part of an annual process to reconcile the prior year's rate to reflect any over- or under-recovery and to set the current year's rate based on projected costs. PECO filed its 2020 Formula Rate Annual Update on May 29, 2020.[82]

Q. WHAT OTHER FACTORS CAN INFLUENCE THE ANNUAL PROJECTED REVENUE REQUIREMENT?

A. In the division problem that is at the heart of formula ratemaking, the dividend is the annual revenue requirement of the transmission owner's projected cost of service—but

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80 PECO Energy Company PJM Interconnection, LLC, FERC Docket No. ER17-1519 dated May 1, 2017 available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=14578902

81 FERC Order Accepting and Suspending Filing, Subject to Refund, Establishing Hearing and Settlement Judge Procedures, FERC Docket No. ER17-1519 dated June 27, 2017 available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=14623778

82 PECO Energy Company Informational Filing of 2020 Formula Rate Annual Update, FERC Docket No. ER17-1519 dated May 29, 2020 available at: https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=15548295

the divisor is the PJM zone's total Network Service Peak Load (NSPL). Each LSE's NITS charge is based on their daily NSPL share of this annual revenue requirement. NSPLs are updated annually based on the prior year's peak load, which apart from any change in costs can nevertheless drive significant rate fluctuations as the divisor. When NSPL changes unexpectedly due to load increases—or as we have more recently seen, load decreases due to the COVID-19 pandemic[83]—that affects the ultimate quotient of this division problem, which is the rate charged to LSEs.

Q. DO YOU HAVE EXAMPLES OF ACTUAL IMPACTS TO LSES OF NITS RATES INCREASES?

A. Yes. Public Service Enterprise Group (PSEG) filed an annual formula rate update for rate year 2019.[84] PSEG's annual transmission revenue requirement effective January 1, 2019 was $1,194,757,707 (NITS Rate: $119,735.80/MW-Year). PSEG filed an updated annual revenue requirement on December 5, 2019. For the period beginning January 1, 2020, PSEG's new annual transmission revenue requirement was set at $1,526,297,808 (NITS Rate: $156,503.24/MW-Year), a 30.7% increase in the NITS Rate over the previous year.[85] Because of the effective date of the new NITS rates, LSEs had approximately a 25-day notice prior to the rate change. That is what I mean when I say

83 PJM Details COVID-19 Impacts on Electricity Demand, Apr. 15, 2020. https://insidelines.pjm.com/pjm-details-covid-19-impacts-to-electricity-demand/ (accessed June 15, 2020).

84 Public Service Electric and Gas Company Informational Filing of 2019 Formula Rate Annual Update (Revision) FERC Docket No. ER09-1257 dated January 18, 2019 and available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=15145006. The original filing for the 2019 Formula Rate Annual Update was dated October 15, 2018 and is available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=15073350. PSEG filed several revisions to the original filing.

85 Public Service Electric and Gas Company Informational Filing of 2020 Formula Rate Annual Update (Second Revision) FERC Docket No. ER09-1257 dated January 17, 2020 and available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=15073350. The original filing for the 2020 Formula Rate Annual Update was October 15, 2019 and is available at: https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=15073350. PSEG filed several revisions to the original filing.

that these rates change not just more frequently—on an annual basis—but also more suddenly, with a relatively short lead time. Below are similar increases for the FirstEnergy Companies: [86]

NITS Rates	Current NITS Rate	Current NITS Rate Effective Dates	Future NITS Rate	Future NITS Rate Effective Date
ATSI Zone	$55,074.34/MW/Year	Since January 1, 2019	$57,340.35/MW/Year	January 1, 2020
Allegheny Power Zone	$15,396.00/MW/Year	Since March 1, 2002	$15,396.00/MW/Year	March 1, 2002
MAIT Rates for ME & PN Zones	$28,796.22/MW/Year	Since January 1, 2019	$37,083.18/MW/Year	January 1, 2020

Q. WHY ARE THESE COSTS DIFFICULT TO ESTIMATE?

A. In order to track NITS costs, one must know or estimate a number of factors related to transmission projects. PJM provides a Transmission Cost Information Center (TCIC) that has data related to each transmission owner's rates, but TCIC must be verified against the actual sources of new project information (i.e. PJM Schedule 12 Appendix/Appendix A filings, PJM Transmission Expansion Advisory Committee updates and Subregional Transmission Expansion Plan updates). None of these rates are final until they are approved by FERC and are subject to adjustments during those proceedings. These annual updates may or may not be timed in a way that allows an EGS to accurately estimate what NITS costs will be during the relevant contract period with its customers, and as evidenced by the PSEG example, can vary significantly from year to year.

[86] https://www.firstenergycorp.com/supplierservices/pa/me_pn/NITSRateInformation.html

Q. HAS THE ACTUAL COSTS OF NITS BEEN INCREASING OVER THE LAST SEVERAL YEARS?

A. Yes as displayed in the below table.[87]

NITS Rates ($/MW-Y)	Jan-20	Jan-19	Jan-18	% Increase Jan 2019 - Jan 2020	% Increase Jan 2018 - Jan 2019
MAIT	$37,083.18	$28,796.22	$26,069.39	28.8	10.5
PPL	$68,031	$58,865	$61,792	15.6	4.7
PSEG	$156,503.24	$119,735.80	$130,535.22	30.7	8.3

Q. DOES YOUR RECOMMENDATION CHANGE IF NITS RATES REMAIN STEADY OR DECREASE?

A. No. The core issue here is that NITS rates are unpredictable. While it poses a commercial difficulty for EGSs if NITS rates trend up and are unrecoverable, the fact that they are in the first instance unpredictable leads to a dynamic where EGSs will have to do something that PECO-as-DSP does not: forecast them. That likely will result in a risk premium added to EGS pricing, even if PECO rates end up being steady or going down. Moreover, when PECO rates go down, it means that EGS customers are likely paying more in transmission costs than the actual NITS rates, because of this process of estimation I have described. So it is the aspect of these NITS rates' unpredictable changes that are the issue, not just the direction of those changes.

Q. HOW DOES THE COALITION'S RECOMMENDATION SOLVE FOR THE UNPREDICTABILITY OF ACTUAL NITS COSTS?

A. NITS costs are driven by PECO's and other transmission owners' decisions on transmission spending. And with the change to formula ratemaking, they possess even

[87] Information from https://www.pjm.com/markets-and-operations/billing-settlements-and-credit.aspx under the heading "Network Integration Transmission Service Revenue Requirements & Rates."

more control over these charges than they once did. NITS as seen above has increased in its volatility, as well as in both the frequency and suddenness of the changes that occur. It is inappropriate to allow only PECO itself, for its default customers, to be immune from the risk of those price fluctuations—even while EGSs must absorb that risk in the prices they offer to retail customers. A better approach, one that establishes a level playing field and ensures that customers are paying only for the actual NITS costs, is to include the NITS costs associated with both default and shopping customers into PECO's existing NBT Charge, as Other PJM Charges already are.

Q. WHY SHOULD THE COMMISSION TAKE ACTION IN THIS PROCEEDING TO DIRECT PECO TO RECOVER THE COSTS OF NITS FROM ALL CUSTOMERS IN LIEU OF ITS CURRENT METHODOLOGY?

A. While the problem with cost recovery for NMB Charges has been difficult since the Commission first directed its Staff to informally investigate in 2014, the problem with NITS has become more difficult and continuing to do nothing about it makes no sense. There has been a persistently unlevel playing field between DSP and EGS, at least in the PECO service territory. The problem is getting worse, because PECO's decision to use formula rates has led to more frequent and sudden transmission rate changes. This places an even more significant burden on EGSs to estimate the price effect of PECO's managerial decision-making—even while PECO itself as a default supplier can collect the price changes from customers (and is of course paid them as a transmission owner) from its default customers after the fact. This situation is unreasonable and must be corrected.

VII. RECOVERY OF DEFAULT SERVICE COSTS

Q. WHAT IS THE COALITION'S POSITION ON THE RECOVERY OF DEFAULT SERVICE COSTS?

A. Although PECO bears substantial costs in providing default service, PECO has a regulated distribution business that absorbs many of those costs, effectively cross-subsidizing its default service offering. It is critical that the price to compare ("PTC") that is established through this default service proceeding actually reflect the costs that PECO is incurring to provide default service.

Q. WHY IS THIS AN APPROPRIATE PROCEEDING TO PURSUE THESE ISSUES?

A. PECO uses this proceeding to propose existing and likely future allocations associated with its DSP.[88] An important aspect of this proceeding is to design PECO's PTC to recover all of the costs associated with providing default service.[89] As such, the formula that is developed here will establish whether the design of the PTC properly recovers such costs.

Q. IS PECO RECOVERING ALL COSTS OF DEFAULT SERVICE THROUGH THE PTC?

A. No. As I will explain, PECO is today recovering no overhead costs that it incurs as a company to provide distribution service as an EDC and default service as a DSP through the PTC for default service. In addition, as I describe in my testimony related to PECO's TOU proposal (Section IV), PECO likely is underestimating the direct costs required to roll out TOU and is not appropriately amortizing its proposed capital expenditures over the life of the DSP plan period.

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88 *See* Exhibit JAB-6.

89 *See* 2807(e) of the Competition Act, 66 Pa.C.S. § 2807 (e)(3.9).

Q. WHAT ARE OVERHEAD COSTS?

A. Overhead costs are typically known as costs incurred by a business that cannot be directly assigned or attributed to a particular function of the business. They are sometimes called indirect, common or shared costs. Everyday examples of overhead costs include office rent, office furniture, information technology, human resources, computer equipment, office supplies, and administrative and general ("A&G") expenses. Typically, when such costs cannot be directly assigned or attributed to a particular function of the business, they are allocated among the business' various functions.

Q. IS PECO INCURRING OVERHEAD COSTS TO OFFER DEFAULT SERVICE?

A. Clearly it is. In this filing alone, PECO proposes to make upgrades to its IT system and customer call center in order to allow the company to answer questions about its proposed TOU product. Yet it includes only the estimated *incremental cost* of those system upgrades, rather than allocating embedded costs associated with these systems to its DSP.[90] This is the equivalent of a renter moving into an apartment building, but only being expected to pay to have the locks changed.

Even more strikingly, PECO is presenting the testimony of three of its employees in this proceeding. Yet none of the costs of their salaries, benefits, workspace, and work equipment are allocated to default service. In discovery, the Coalition asked for the "amount of time each [employee] will spend on an annual basis" during the DSP period on administering the DSP. PECO responded that "PECO does not track the time spent by any of its employees, including the witnesses in this proceeding, on issues related to

[90] Exhibit JAB-6.

default service."[91] As well, the Coalition asked how much time its customer service representatives would be expected to spend on the company's new TOU offering. PECO is proposing to use its "Company Care Center" to enroll customers in its new TOU offering.[92] But "PECO is not proposing to allocate any time associated with call center staffing to the cost of administering the DSP."[93] As with the capital costs of the IT system and customer call center, the PTC PECO has proposed is designed to take a free ride on the considerable overhead expenses associated with employees who do work related to PECO's role as a DSP, but whose costs are allocated entirely to distribution base rates.

These are only the most obvious examples. The reality is that PECO has other, substantial overhead costs, such as for its holding company's executives. And, similarly, none of their costs are allocated to default service, even though in my experience such executives spend a good deal of time talking about the evolving utility business model, of which default service is (unfortunately) a substantial part.

Q. DOES PECO CONCEDE THAT ITS PTC FOR DEFAULT SERVICE REFLECTS NO OVERHEAD COSTS?

A. Yes. PECO has indicated in response to ESC discovery that its current PTC includes no "indirect costs."[94] Rather, PECO proposes to continue recovering all indirect costs that it incurs to operate both its distribution and default service businesses through distribution rates.

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91 Exhibit TK-15 (PECO Response to ESC-IV-3).

92 PECO Statement No. 2 at 22.

93 Exhibit TK-16 (PECO Response to ESC-IV-12).

94 Exhibit TK-17 (PECO Response to ESC-I-14).

Q. HOW DO YOU RECOMMEND RECTIFYING THIS PROBLEM?

A. As I will describe in further detail below, I recommend rectifying this problem by the Commission requiring PECO to allocate a portion of its overhead costs to default service and recover them through the PTC.

A. Direction Provided by Commission's Regulations Regarding Recovery of Costs through PTC

Q. WHAT DIRECTION DO THE COMMISSION'S REGULATIONS PROVIDE ABOUT THE COSTS TO BE RECOVERED THROUGH THE PTC?

A. The Commission regulations require the PTC for default service to "be designed to recover *all* default service costs, including generation, transmission and other default service cost elements, incurred in serving the average member of a customer class."[95] The Commission's policy statement, which was adopted in tandem with these regulations, provides greater detail, identifying the specific cost elements that EDCs should recover through the PTC for default service.[96]

Q. WHAT SPECIFIC COST ELEMENTS DOES THE COMMISSION IDENTIFY IN ITS POLICY STATEMENT AS NEEDING TO BE RECOVERED THROUGH THE PTC?

A. The Commission's policy statement provides that:[97]

(a) The PTC should be designed to recover all generation, transmission and other related costs of default service. These cost elements include:

(1) Wholesale energy, capacity, ancillary, applicable RTO or ISO administrative and transmission costs.

(2) Congestion costs will ultimately be recovered from ratepayers. Congestion costs should be reflected in the fixed price bids submitted by wholesale energy suppliers.

(3) Supply management costs, including supply bidding, contracting, hedging, risk management costs, any scheduling and forecasting services provided exclusively for

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95 52 Pa. Code § 54.187(e).

96 52 Pa. Code § 69.1808(a) (emphasis added).

97 52 Pa. Code § 69.1808(a).

default service by the EDC, and applicable administrative and general expenses related to these activities.

(4) Administrative costs, including billing, collection, education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service.

(5) Applicable taxes, excluding Sales Tax.

(6) Costs for alternative energy portfolio standard compliance.

B. Cost Elements Included in PECO's PTC

Q. WHICH COST ELEMENTS DOES PECO'S PTC INCLUDE?

A. PECO's PTC includes the cost elements that the policy statement identifies in (a)(1)-(3) and (5)-(6). PECO also includes certain costs associated with (a)(3)-(4). These elements include the direct costs that PECO incurs to pay for electricity in the wholesale market, the costs that PECO incurs to manage supply for the 1.5 million customers on default service, and the taxes and costs for alternative energy portfolio standard compliance.

Q. WHAT ABOUT THE ADMINISTRATIVE COSTS IDENTIFIED IN (A)(4) OF THE POLICY STATEMENT?

A. PECO's PTC includes some of the administrative costs identified in (a)(3) and (4) of the policy statement but also omits certain of these costs and understates the remaining costs. The administrative costs identified by the policy statement include "billing, collection, education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service," as well as "administrative and general expenses" rated to the supply management activities described in (a)(3).[98]

[98] 52 Pa. Code § 69.1808(a)(4).

Q. WHICH ADMINISTRATIVE COSTS DOES PECO'S PTC OMIT?

A. Of the cost elements identified by the policy statement for recovery through the default service price, PECO's current PTC contains *no* administrative costs for billing, collection, education, regulatory, tariff filings or information system.[99] They also include A&G expense associated with either the supply management, customer relationship, or regulatory affairs aspects of administering the DSP.

Q. ARE YOU USING THE TERMS 'ADMINISTRATIVE COSTS' AND 'A&G' DISTINCTLY?

A. Yes. The policy statement defines a set of costs as "administrative costs" in (a)(4) that lists cost categories that relate to the customer service and regulatory affairs aspects of providing default service. A&G is separately identified in both (a)(3) and (a)(4). A&G costs traditionally include rent, utilities, insurance, and certain managerial salaries that need to be allocated to a business' component parts for accounting and, as here, ratemaking purposes.

Q. IS IT PLAUSIBLE THAT PECO SIMPLY DOES NOT BEAR CERTAIN COSTS IN RELATION TO PROVIDING DEFAULT SERVICE?

A. No. The Commission sensibly enumerated the cost categories that should be allocated to default service in its policy statement. If PECO does not actually incur any of those costs, it should explain in detail its theory of how it does not. To use but one example, by allocating zero costs for A&G expense associated with executive compensation, PECO is essentially asking the Commission to believe that its corporate executives do not spend a moment's time concerned about the company's role as a DSP, including highly visible

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99 Exhibit TK-18 (PECO Response to ESC-I-1).

issues like whether and how the company will enter into solar purchase agreements. That is not plausible.

Q. WHICH ADMINISTRATIVE AND A&G COSTS *DOES* PECO INCLUDE IN THE PTC?

A. PECO's PTC for March 1 to May 31 of this year included $46,492 for "litigation," $465,492 for "working capital," and $137,372 of A&G costs for an independent evaluator and external consultant. No other costs were allocated to the PTC.[100]

Q. WHAT IS THE RATE IMPACT OF THIS?

A. As a result of PECO excluding all overhead costs from the computation of its PTC, the total administrative costs to be reflected in the PTC that commences this DSP will amount to 0.005 cents/kWh for each procurement effective June 1, 2021 through August 31, 2021.[101] This tiny amount stands in stark contrast to the 0.19 cents per kWh included in the PTC to reflect working capital costs.[102]

C. Why Omission of Overhead Costs is a Problem

Q. WHY IS PECO'S FAILURE TO ALLOCATE ANY OVERHEAD COSTS TO DEFAULT SERVICE A PROBLEM?

A. Not only is PECO overlooking the express terms of the Commission's policy statement and regulations, but also by failing to allocate any overhead costs to the PTC for default service, PECO is allocating all of these costs to the regulated or monopoly distribution side of its business. This means that all overhead costs, such as human resources costs, incurred by PECO to run its two businesses—of providing distribution service and default service—are recovered by PECO wholly through distribution rates. As a result,

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[100] Exhibit TK-17.

[101] PECO Response to ESC-I-13.

[102] PECO Statement No. 2 at 4-5.

PECO is using its distribution revenues to subsidize the default service side of its business, which is in direct competition with the members of the Coalition.

Q. IS THIS HARMFUL TO THE COMPETITIVE RETAIL MARKET?

A. Yes. By using monopoly revenues to subsidize the side of its business that is directly competing with members of the Coalition, PECO is charging a price for default service that is artificially low. Naturally, EGSs have difficulty competing with an artificially low price for default service, which in turn means that they are unable to deliver the full array of the benefits of a truly competitive market to consumers – including access to a wide array of innovative products and services.

Q. ARE THERE OTHER INDICATIONS IN PENNSYLVANIA POLICY THAT SUGGEST WHAT ALLOCATION IS APPROPRIATE IN DEFAULT SERVICE RATEMAKING?

A. Yes. As I describe in our proposal to transition PECO out of its role as DSP, the Commission may designate an "alternative supplier" to perform in the role of default service provider in lieu of the electric distribution company ("EDC").[103] A third party providing default service would not have regulated distribution revenues that it could rely upon to subsidize default service. It would necessarily have to recover a portion of its overhead costs from customers who are not purchasing generation from EGSs. The law providing that default service can be provided by an entity other than the EDCs underscores the separate and distinct nature of the two functions that PECO as a EDC/DSP combination company performs: 1) purchasing electricity for customers on its distribution system who do not purchase their supply from the competitive market, and 2) delivering electricity to all customers on its distribution system.

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[103] 66 Pa.C.S. § 2807(e)(3.1).

D. PECO's Proposal Runs Contrary to Industry Guidance

Q. DOES PECO'S PROPOSAL TO ALLOCATE ZERO OVERHEAD COSTS TO THE PTC FOR DEFAULT SERVICE RUN COUNTER TO INDUSTRY GUIDANCE?

A. Yes. PECO's proposal to allocate zero indirect costs to the PTC for default service is inconsistent with the NARUC Cost Allocation Manual ("NARUC CAM") and NARUC Guidelines.

Q. PLEASE EXPLAIN.

A. NARUC has published the NARUC CAM, which is an almost 200-page tome on cost allocation in utility ratemaking. The NARUC CAM states that "few analysts seriously question the standard that service should be provided at cost" and that this principle applies when setting rates "for individual services, classes of customers, and segments of the utility's business."[104] At that time, NARUC was envisioning an allocation of costs of monopoly services offered by a utility operating both monopoly and competitive markets. It is particularly compelling that NARUC recognized that costs should be allocated to each business segment, even if it is not operating as a separate business unit.

Q. PLEASE CONTINUE.

A. In addition, the NARUC Guidelines, which address cost allocation in the context of affiliate transactions, include a set of principles that are directly relevant to pricing default service. Specifically, according to the NARUC Guidelines, these cost allocation principles should be applied "whenever products or services are provided between a regulated utility and its non-regulated affiliate or division."[105] The NARUC Guidelines

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[104] http://pubs.naruc.org/pub/53A3986F-2354-D714-51BD-23412BCFEDFD

[105] http://pubs.naruc.org/pub/539BF2CD-2354-D714-51C4-0D70A5A95C65

also provide that "[t]he general method for charging indirect costs should be on a fully allocated basis."[106] This principle runs counter to the concept advanced by PECO where all overhead costs are simply allocated to the monopoly distribution service without any consideration given to whether that cost category would likewise be incurred to provide default service.

Q. DO YOU HAVE ANY OTHER INDUSTRY REFERENCES THAT SUPPORT YOUR VIEWS?

A. Yes. Earlier I referenced two articles authored by Frank Lacey, which have been published in Public Utilities Fortnightly and the Electricity Journal. In Mr. Lacey's Electricity Journal article, he refers to a practice engaged in by incumbent electric utilities serving as default service providers of allocating few to no indirect costs to default service rates. He explains that the resulting rate for utility-provided default service is a below-market price, which allows the utilities to maintain dominant market positions in the retail market.[107] To rectify this anti-competitive result, Mr. Lacey describes a "simple thought experiment to see if appropriate costs are being allocated to the default service business is to imagine what would happen if default service was severed from the utility's distribution business." In this proceeding, PECO is in effect suggesting to the Commission that it cost in the last full quarter less than $200,000 in administrative costs, other than working capital, to serve about 1 million customers default service, while incurring no administrative costs for billing, collection, education, regulatory, tariff filings or information system. As Mr. Lacey explains, "nearly every default service program would be bankrupt in a matter of days, if not hours, if it was removed from the

[106] *Id.*, Section B.4.

[107] Exhibit TK-2 at 4.

distribution business."[108] As Mr. Lacey concluded in the article published in Public Utilities Fortnightly, "[a]ppropriately allocating costs currently paid by distribution customers to default service is a critical next step in creating more competitively neutral energy markets in the United States." While he opined that this "one step will not create the perfect markets…it will remove a significant anti-competitive pricing advantage held by monopoly utilities."[109]

E. <u>Summary of Recommendations</u>

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO ADDRESS THE PROBLEM WITH DEFAULT SERVICE PRICING THAT YOU HAVE IDENTIFIED.

A. To address the problem with default service pricing that I have identified, I recommend that the Commission require PECO to modify its proposed rate design for default service to recover a reasonable or appropriate portion of its overhead costs through the PTC. Because PECO has said that it does not track its employees time, or track whether or not they work on DSP, it will be necessary to use an allocating methodology that takes each of the corporate cost centers that PECO has that relates to the Commission's policy statement and allocate some portion of them to the DSP PTC. This exercise would facilitate the recovery of all costs associated with default service through the default service rate, as required by the Commission's regulations. The Coalition envisions the following steps needing to occur:

1. PECO's modified rate design for the PTC for default service would need to include each and every administrative cost element specified in subsection 4 of

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[108] Exhibit TK-2 at 5.

[109] Exhibit TK-3 at 44.

Section 1808 of the Commission's policy statement, and the A&G costs associated with subsection 3 of the same section. The policy statement identifies these administrative costs as including: "billing, collection, education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service."[110]

2. PECO would need to use its 2018 cost of service study and scale it back to reflect the Commission-approved amount of the increase so as to quantify the total administrative costs in each of the above categories.
3. PECO would need to use reasonable or appropriate allocators to propose the allocation of a certain percent of each of these costs to the DSP. A variety of methodologies exist for this purpose, including some used by PECO and its parent and affiliates. The Coalition believes that PECO should initially propose the allocator(s) to be used in a compliance filing.
4. Upon the filing by PECO of a modified rate design, the Commission should afford all interested parties an opportunity to comment and/or present evidence showing the deficiencies of PECO's proposal.
5. As part of its ultimate approval of a new PTC that includes an appropriate allocation of the costs I have identified, the Commission should require PECO to record a regulatory liability associated with the incremental revenues it will collect through the PTC, in recognition that these should be refunded to distribution customers when PECO next files a base rate application in order to prevent double-recovery.

[110] 52 Pa. Code § 69.1808(a)(4).

6. The Coalition believes that the Commission should require PECO to make such a filing in compliance with the Commission's order in this proceeding, and that the issue be addressed expeditiously to be implemented by June 2021. However, the change also could be implemented at some point during the program period since it will not otherwise disrupt the DSP.

VIII. PECO'S EXISTING AND PROPOSED RETAIL MARKET ENHANCEMENT PROGRAMS

A. STANDARD OFFER PROGRAM

Q. PLEASE BRIEFLY DESCRIBE PECO'S PROPOSAL WITH RESPECT TO THE STANDARD OFFER PROGRAM.

A. As explained in the Direct Testimony of Ms. Reilly, PECO proposes to continue the Standard Offer Program ("SOP") that was first implemented as part of PECO's second default service program.[111] She states that since June 1, 2017, the SOP has resulted in more than 26,000 residential customer and 500 small commercial customer referrals to EGSs that have voluntarily chosen to offer customers a twelve-month contract priced 7 percent below PECO's default service rate at the time of the offer.[112]

Q. DO YOU HAVE ANY COMMENTS ABOUT PECO'S SOP PROPOSAL?

A. Yes. Initially, I note that with the exception of modifications to PECO's call handling process and revisions to SOP training materials and scripts during the DSP IV proceeding, PECO has implemented the same SOP since 2013. No substantive modifications have been made since the DSP II proceeding. With the passage of time, it seems prudent to consider whether measures should be taken to "mature" the SOP. This

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[111] PECO Statement No. 3 at 16-17; *Petition of PECO Energy Company for Approval of its Default Service Program II,* Docket No. P-2012-2283641 (Order entered October 12, 2012) ("DSP II proceeding").

[112] PECO Statement No. 3 at 16.

is particularly important data point. According to PECO's data, the number of SOP referrals was the highest in 2015 and 2016, with total referrals of 74,056 and 70,763, respectively. The past three years of 2017 through 2019, the total program referrals have precipitously declined to 22,331, 10,088 and 8,750.[113]

Q. DOES THE COALITION HAVE SPECIFIC RECOMMENDATIONS FOR MODIFICATIONS?

A. Yes. The Coalition recommends that: (i) all new customers (who have not already made an affirmative choice of an EGS) be automatically enrolled in the SOP; (ii) PECO be required to allow SOP signups from its website; (iii) the script should be modified; and (iv) PECO should be required to revisit the situations in which the SOP is mentioned, particularly to default service customers who contact the call center, and to otherwise engage in periodic communications, such as quarterly when changes to the PTC occur, promoting SOP to all customers on default service.

Q. PLEASE EXPLAIN THE COALITION'S RECOMMENDATION FOR ALL NEW CUSTOMERS (OTHER THAN THOSE WHO HAVE ALREADY MADE AN AFFIRMATIVE CHOICE OF AN EGS) TO BE AUTOMATICALLY ENROLLED IN THE SOP.

A. Currently, even though default service is intended to ensure that consumers continue to receive electricity even if they do not choose an EGS or in the event their EGS stops providing service, it has the connotation of being a provider of "first" resort service rather than a provider of "last" resort service. My earlier testimony discussed the predominant role that PECO has of providing default service to more than two-thirds of the residential customers on its system. Since the SOP has been designed to give customers a 7 percent discount off PECO's PTC for default service, while also introducing customers to

[113] Exhibit TK-19 (PECO Response to ESC-II-8 and 8(a)).

participation in the retail market,[114] no reason exists to initially place a customer on PECO's default service. Rather, new customers (who have not already made an affirmative choice of an EGS) should automatically receive the benefit of this market enhancement program that was initially very successful in the referral of customers to EGSs participating in the SOP. Importantly, automatically placing these new customers on the SOP eliminates the notion of PECO's default service as the "first" service in which consumers enroll.

Q. PLEASE PROVIDE FURTHER DETAIL ABOUT THE ABILITY OF CUSTOMERS TO SIGN UP FOR SOP ON PECO'S WEBSITE?

A. Certainly. During a time when consumers are increasingly dependent on electronic enrollments or registrations for many products and services, they should be permitted to sign up for the SOP on PECO's website. Coalition member, Shipley, reports that 28% of its SOP enrollments through PPL Electric Utilities Corp. occur through the website. Since PECO customers can initiate service online, enrolling in the SOP could easily be incorporated in that process. An added benefit of website enrollments is that since no third party verification is required, the SOP fee should be waived or reduced.

Q. PLEASE DISCUSS THE RECOMMENDATION TO MODIFY THE SCRIPT THAT PECO IS USING FOR THE SOP.

A. PECO is proposing to continue using the current SOP script. Under this script, moving customers are advised, as follows:

> "Your new account number is [12345-67899]. In Pennsylvania, you can choose the supplier that provides your electricity without impacting the quality of service provided by PECO. PECO is sponsoring a program called the *PECO Smart Energy Choice Program* which may be able to offer you a potential savings

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[114] *Investigation of Pennsylvania's Retail Electricity Market: Intermediate Work Plan*, Docket No. I-2011-2237952 (Order entered 16, 2011), at pp. 9-21.

> opportunity by enrolling with an electric generation supplier. Would you like to hear more?"
>
> New customers are advised as follows:
>
> "In Pennsylvania, you can choose the supplier that provides your electricity without impacting the quality of service provided by PECO. *PECO is sponsoring a program called the PECO Smart Energy Choice Program* which may be able to offer you a potential savings opportunity by enrolling with an electric generation supplier. Would you like to hear more?"
>
> If the customer answers yes, then PECO continues:
>
> PECO is responsible for delivering your electricity. The actual generation of the electricity you receive can be provided by PECO or a participating supplier of your choice. The *PECO Program* offers a fixed price of [SOP rate] cents/kWh for one year provided by an Electric Generation Supplier. The fixed Program price provides a 7% discount off of today's Price to Compare which is [PTC Rate] cents/kWh. PECO's Price to Compare changes quarterly in March, June, September and December. The *PECO Smart Energy Choice Program* price will not change during the 12 monthly bills, but the Price to Compare could be higher or lower than the *PECO Program* price during this period. Would you like to enroll in the *PECO Smart Energy Choice Program*?"[115]

Q. WHAT ARE THE COALITION'S OBSERVATIONS REGARDING THESE SCRIPTS?

A. Assuming the customer enrolls in the program, she will have heard no fewer than six times that it is the "PECO Smart Energy Choice Program," a "PECO Program," or that "PECO is sponsoring a program"—as indicated in the italicization above. Of course, the whole point of this program is to introduce customers to the competitive retail market in Pennsylvania—at a savings to them. It is inappropriate for PECO to slap its brand so aggressively on the program, which both frustrates one of its purposes and demonstrates the points I have earlier made about the deeply frustrating and conflicted role that PECO occupies as the DSP in this part of the state. Also, the underlined text references a "potential savings opportunity." That is not cogent. The word "opportunity" itself convenes possibility, not a sure thing. In any case, it is absolutely true that savings will be

[115] Exhibit TK-8 (emphasis added).

realized in the first PTC period, because the whole premise of the program is a 7% discount off of it. The useful clarification of the details that the PTC is subject to change then ensues if the customer expresses interest. Changing the language "which may be able to offer you a potential savings opportunity" to "which will offer you savings opportunity" would increase the attractiveness of the program to customers, causing them to want to hear more.

Movers:

"Your new account number is [12345-67899]. Also, PECO is implementing a Supplier Savings Program, which allows you to lower your electricity generation costs by 7%. Would you like to hear more?"

Non-movers:

"While I have you on the phone, PECO is implementing a Supplier Savings Program, which allows you to lower your electricity generation costs by 7%. Would you like to hear more?"

If customer answers yes:

Here's how it works. The program gives you a chance to lock in a fixed rate that is 7% lower than PECO's current price to compare. That means, instead of paying PECO's rate of [PTC Rate] cents/kWh today, you'll pay the Supplier's [SOP rate] cents/kWh. This fixed rate is provided by an approved electricity generation supplier, is good for 12 months, and can be cancelled any time without penalty. You can pick a supplier of your choice, or we will be happy to provide one for you. You'll still experience the same quality service from PECO. PECO's price to compare can change quarterly, so the price to compare could be higher or lower than this rate during the 12-month period. Can we go ahead and set you up with your discounted rate today?

Q. PLEASE FURTHER DISCUSS THE COALITION'S RECOMMENDATION TO EXPAND CONSUMER COMMUNICATIONS ABOUT THE SOP.

A. Given the significant drop in referrals over the past several years, the Coalition believes that it is necessary to revisit the situations in which consumers are told about the SOP. While the Coalition understands that the PECO would not discuss the SOP with customers who are calling in regarding outages or other emergencies, it may be possible to expand the list of scenarios in which PECO would inform default service customers about the availability of SOP. For instance, PECO does not have this discussion with non-moving customers who call in with billing disputes.[116] Those calls would seem to be ideal opportunities to discuss supplier savings through the SOP. In addition, PECO should be directed to engage in periodic communications, such as quarterly when changes to the PTC occur, promoting SOP to all customers on default service. Through these additional efforts, the Coalition expects that default service customers will become more aware of the availability of the SOP, have greater opportunities to realize the benefits of this program and gain a familiarity with interacting with EGSs in the competitive retail market.

B. SHOPPING BY CUSTOMER ASSISTANCE PROGRAM ("CAP") CUSTOMERS

Q. WHAT IS THE CURRENT STATUS OF SHOPPING BY CUSTOMER ASSISTANCE PROGRAM ("CAP") CUSTOMERS IN PECO'S SERVICE TERRITORY?

A. Currently, PECO CAP customers are not able to shop for electric generation supply.[117]

Q. DOES PECO PROPOSE TO CHANGE THAT AS PART OF THIS PROCEEDING?

A. Yes. In this proceeding, Ms. Carol Reilly testifying for PECO notes that in the Proposed Policy Statement Order, the Commission outlined uniform CAP shopping policies and requirements for EDCs.[118] Ms. Reilly further points to the Commission's Secretarial

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116 PECO Response to OCA-I-2.

117 PECO Statement No. 3 at 4.

118 *Electric Distribution Company Default Service Plans – Customer Assistance Program Shopping*, Docket No.M-2018-3006578 (Proposed Policy Statement Order entered February 28, 2019) ("Proposed Policy Statement Order"); PECO Statement No. 3 at 4-5.

Letter dated January 23, 2020, acknowledging that its proposed CAP shopping policy statement was unlikely to be final in time for some upcoming DSP proceedings and therefore directing all EDC to use the prior guidance to develop CAP proposals as part of those filings.[119]

Q. DID PECO DEVELOP A CAP SHOPPING PLAN THAT IS CONSISTENT WITH THE COMMISSION'S PRIOR GUIDANCE?

A. Yes. Under PECO's proposed plan, EGSs would be required to charge CAP customers a rate for generation service that is at or below the PECO residential PTC at all times during the contract. Also, EGSs serving CAP customers may not enter into contracts that impose early cancellation and termination fees or other fees unrelated to generation service.[120]

Q. PLEASE DESCRIBE OTHER KEY FEATURES OF PECO'S CAP SHOPPING PROPOSAL.

A. EGSs wishing to serve CAP customers would be required to submit a notice of intent to participate and use PECO's "bill-ready EDC consolidated billing option for CAP customers. In addition, EGSs offering a rate do CAP customers would be required to post that rate on the Commission's PAPowerSwitch.com shopping website.[121] PECO also proposes to implement the program only after receipt of notices of intent to participate from at least five EGSs.[122]

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[119] PECO Statement No. 3 at 5.

[120] PECO Statement No. 3 at 5-6.

[121] PECO Statement No. 3 at 6-7.

[122] PECO Statement No. 3 at 14.

Q. WHAT ARE THE COALITION'S CONCERNS REGARDING PECO'S PROPOSAL?

A. The Coalition has identified three primary concerns with PECO's proposal. While the Coalition commends PECO for developing a proposal to permit shopping by CAP customers, it does not believe it is appropriate to: (i) require the EGS price to be at or below PECO's PTC the entire time; (ii) require EGSs to post their CAP shopping rate on the PAPowerSwitch.com shopping website; and (iii) commit to implementing the CAP shopping plan only upon confirmation that five EGSs intend to participate.

Q. PLEASE EXPLAIN YOUR CONCERNS WITH THE REQUIREMENT THAT THE EGS PRICE BE AT OR BELOW PECO'S PTC THE ENTIRE TIME.

A. The Coalition recognizes that this restriction is consistent with the Commission's proposed Policy Statement Order. However, as that is only a proposal at this time, PECO is not obligated to comply with all provisions of that order. Moreover, that approach wholly overlooks the fact that PECO's PTC is artificially low in that it does not reflect any overhead costs associated with providing default service.

Q. WHAT DOES THE COALITION RECOMMEND INSTEAD?

A. While it may be may be beneficial in some ways to require the initial offers to match the current PTC, it is not realistic to impose that requirement for the entire year. Particularly since PTCs are reconcilable and do not at any given time reflect the market, EGSs should be permitted on their own to adjust their prices during the program year to reflect the market conditions they are facing. Since customers may leave the EGS CAP Shopping program without penalty at any time, they will not be harmed.

Q. WHAT IS WRONG WITH PECO'S PROPOSAL TO REQUIRE EGSS TO POST THEIR CAP RATE ON PAPOWERSWITCH.COM?

A. Currently, the Commission does not require EGSs to post any rates, let alone all of its rates, on PAPowerSwitch.Com. If the Commission departs from this long-standing precedent to instead require EGSs to post their CAP rate on the shopping website, the result will be confusing to customers. Seeing a rate that has been developed only for a specific subgroup of PECO's customers would give others the impression that this rate is also available to them. Experience shows that confused customers often leads to the filing of more complaints with the Commission, which should be avoided in order to ensure satisfied consumers participating in the retail market. A better way of promoting transparency of the CAP rate would be to create a separate portal on PAPowerSwitch.com, which only customers on the CAP may access. In this way, the affected consumers could see the rate that is being offered but other consumers would only be able to access rates that may be available to them.

Q. WHAT IS THE COALITION'S OBJECTION TO PECO'S REQUIREMENT FOR FIVE EGS INDICATING AN INTENT TO SERVE CAP CUSTOMERS?

A. As a threshold matter, PECO has offered no reason for the number of five EGSs. It has also not explained why one, two, three or four EGSs could not serve as many CAP customers as five EGSs. The number of EGSs who are willing to participate should have no bearing on PECO's commitment to implement the program. Therefore, this condition should be eliminated.

Q. DOES THAT COMPLETE YOUR DIRECT TESTIMONY?

A. Yes; however, I reserve the right to supplement this testimony as may be appropriate.