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 MAY 31, 2025

DOCKET NO. P-2020-______________

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DIRECT TESTIMONY

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WITNESS: SCOTT G. FISHER

SUBJECT: DEFAULT SERVICE PROCUREMENT

DATED: MARCH 13, 2020
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DIRECT TESTIMONY

OF

SCOTT G. FISHER

I. INTRODUCTION AND PURPOSE OF TESTIMONY

1. Q. Please state your full name and business address.
   A. My name is Scott G. Fisher. My business address is 30 Monument Square, Suite 105, Concord, Massachusetts 01742.

2. Q. What is your current position?
   A. I am a Partner with The NorthBridge Group (“NorthBridge”), an economic and strategic consulting firm serving the electric and natural gas industries.

3. Q. On whose behalf are you submitting testimony?
   A. I am submitting direct testimony on behalf of PECO Energy Company (“PECO”).

4. Q. Please summarize your professional and academic background.
   A. Since joining NorthBridge in 1998, I have advised companies in the electric industry on decisions related to risk management, asset valuation and portfolio management, product pricing, contract negotiations, regulatory affairs, supply procurement, rate design, emerging technologies, public policy formulation and negotiations, and overall corporate strategy. I also have served as an expert witness on several of these topics, particularly with respect to default service supply procurement and ratemaking, in state public utility commission proceedings. Before joining NorthBridge, I was a consultant at Strategic Decisions Group, a management consulting firm serving a variety of industries. I received an A.B. from Dartmouth
College and a B.E. from the Thayer School of Engineering at Dartmouth College, with high honors. In addition, I received an M.S. in Engineering-Economic Systems from Stanford University and an M.B.A. from the Tuck School of Business at Dartmouth College, with high honors. I presently serve as a guest lecturer at the Tuck School of Business on energy industry matters.

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


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1 *See Petition of PECO Energy Company for Approval of Its Default Service Program and Rate Mitigation Plan, Docket No. P-2008-2062739 (Order entered June 2, 2009) (“DSP I Order”).
6. Q. **What is the purpose of your direct testimony?**

A. The purpose of my direct testimony is to evaluate PECO’s proposed default service plan (the “Default Service Plan” or “Plan” or “DSP V”) to procure supply for default service customers for the period beginning June 1, 2021 and ending May 31, 2025. My testimony is divided into two parts. First, I briefly review PECO’s first four default service plans, DSP I, DSP II, DSP III, and DSP IV, and identify several lessons learned. This discussion includes an analysis of the “residual compensation” incorporated in the prices of the residential full requirements contracts procured by PECO in accordance with these plans. Second, I evaluate PECO’s DSP V with respect to Act 129’s (the “Act’s”) requirement that the plan include a “prudent mix” of contracts designed to ensure the least cost to customers over time.  

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

A. First, with regard to the lessons learned from PECO’s earlier DSP plans (DSP I, DSP II, DSP III, DSP IV), I conclude the following:

- The participation by multiple suppliers in PECO’s open solicitations for fixed-price full requirements (“FPFR”) default service supply products, combined with my quantitative analysis of the results of these solicitations, indicate that the resulting contract prices obtained by PECO

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

6 66 Pa.C.S. § 2807(e)(3.4).
have been reasonable, considering the costs and risks that the suppliers
under these contracts assume to the benefit of customers.

- The mix of one-year and two-year FPFR products in PECO’s residential
default service supply portfolio, and the semi-annual overlapping of their
delivery periods, provide price stability benefits for residential customers.

- The basic default service model used by PECO has supported the
competitive retail electricity market. In fact, 102 alternative electric
generation suppliers (“EGSs” or “competitive retail suppliers”) currently
serve PECO customers, which is roughly triple the number since the DSP
I period began.7

Second, with regard to PECO’s proposed DSP V, I conclude the following:

- DSP V incorporates a prudent mix of contracts designed to ensure least
cost to customers over time, taking into account the benefits of price
stability, and includes prudent steps necessary to obtain least cost
generation supply contracts on a long-term, short-term and spot market
basis, as required by Section 2807(e)(3.4) and Section 2807(e)(3.7) of the
Act.8

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7 Source: PECO. Data is for the month ending February 25, 2020.
8 In PECO Energy Statement No. 1, PECO witness John J. McCawley provides the details regarding PECO’s proposal to solicit long-term contracts for a portion of the solar alternative energy credits (“AECs”) required for compliance with Pennsylvania’s Alternative Energy Portfolio Standards (“AEPS”) Act, and accordingly he addresses how this specific aspect of DSP V is consistent with the Act’s requirement that the plan include a
PECO’s Default Service Plan is designed to support the competitive retail electricity market in PECO’s service area while providing price stability benefits for small customers.

Each of these findings is discussed further below.

II. REVIEW OF EARLIER DSPS AND THE LESSONS LEARNED

8. Q. Please provide a brief overview of the mix of products procured under DSP I, DSP II, and DSP III.

A. Under PECO’s DSP I, a unique and tailored portfolio of supply products was procured for each of four different customer classes at different points in time. The portfolio consisted of a mix of 1-year and 2-year FPFR products and varying levels of spot-priced purchases by customer class. Twenty-five percent of the Residential class portfolio was served through a “block-and-spot” approach in which PECO made forward purchases of energy blocks (of 1-year, 2-year, 5-year, and seasonal delivery periods that were targeted to supply 20% of Residential default service load), and the spot market transactions were made to cover the mismatches between the fixed quantities of block energy supply purchased and the 25% portion of the actual hourly

“prudent mix” of contracts designed to ensure the least cost to customers over time.

Some of the initial delivery periods of the full requirements supply products procured in DSP I included an extra five months (from January 1, 2011 to May 31, 2011) to align the delivery periods of subsequent products with the commencement of the annual planning period of PJM Interconnection, L.L.C. (“PJM”), the regional transmission organization in which PECO participates.

Unlike full requirements products, deliveries under block products do not scale with changes in default service load, so the percentages of default service load served by the block products often deviated from the targeted percentage.
load requirement.

Under DSP II, PECO began to phase out the block-and-spot aspect of the supply portfolio for the Residential class and replace these products with FPFR products. For smaller customers, DSP II also included more frequent replacements of the supply products, as supply product delivery periods were timed to expire every six months rather than every year. Finally, DSP II involved generally shorter product delivery periods and shorter times between product procurement and the start of delivery.

PECO’s DSP III continued the basic procurement strategy that was established in DSP II, with a few changes. For the Medium Commercial class, PECO transitioned the supply portfolio from six-month FPFR products to hourly priced default service. The supply portfolio for the Residential class continued the procurement design established in DSP II consisting of 40% one-year FPFR products and 60% two-year FPFR products, with delivery periods that overlap on a semi-annual basis. During the DSP III period, approximately 96% of the supply portfolio transitioned to this product arrangement. By the end of the DSP III period, the remaining 4% of the overall default service supply portfolio for the Residential class consisted of a mix of 17-month FPFR products (approximately 3% of Residential default service load) and spot purchases (approximately 1% of Residential default service load) directly from the energy markets operated by PJM.

9. **Q.** Please provide a brief overview of the mix of products procured under DSP IV.

**A.** PECO’s DSP IV, the plan currently in effect, continues the basic procurement
strategy that was established in DSP III, which includes procurement of a prudent mix of products from competitive wholesale suppliers and has supported retail market competition.

- PECO consolidated the Medium Commercial class (peak demands 100 kW to 500 kW) and the Large Commercial and Industrial class (peak demands greater than 500 kW) into a Consolidated Large Commercial and Industrial class consisting of customers with peak demands that are equal to or greater than 100 kW. These customers continue to receive default service based on spot market prices. In PECO’s service area, the competitive retail market for the Consolidated Large Commercial and Industrial customers is very well developed, as 94% of the load has switched to service from competitive retail suppliers. As such, this customer class does not rely on having price stability in its default service rates, so the continuance of default service based on spot market prices is reasonable for it.

- For the Small Commercial class, PECO has transitioned from the previous supply portfolio composed entirely of one-year FPFR products to a supply portfolio consisting of 50% one-year FPFR products and 50% two-year FPFR products. The inclusion of the two-year products in the supply portfolio was designed to better ensure price stability for those small non-

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11 Source: PECO. Data is for the month ending February 25, 2020. The figure includes customers who will be switched to EGSs within 45 days. Percentage of load is based on kW.
residential customers who do not select service from a competitive retail supplier. PECO continues the practice of overlapping delivery periods on a semi-annual basis, and it also continues the practice of procuring each of the FPFR default service products approximately two months before delivery of the product begins. Specifically, the procurement approach has transitioned from the previous cycle in which 50% of the supply was replaced every six months to a cycle in which 37.5% of the supply is replaced every six months, thereby reducing the likelihood of significant rate changes due to adverse circumstances or market conditions at any given time.

• The supply portfolio for the Residential class continues the basic procurement design established in DSP III, in which 96% of the supply consists of a mix of 40% one-year FPFR products and 60% two-year FPFR products, with delivery periods that overlap on a semi-annual basis. The remaining 4% of the overall default service supply portfolio for the Residential class consists of two tranches (each supplying 1.6% of the Residential class default service load) of two-year FPFR products, and the remaining sliver of the supply need is satisfied through spot purchases.\footnote{Including these two tranches of two-year FPFR products, the total default service supply portfolio for the Residential class consists of 38 tranches of two-year FPFR products (supplying approximately 61% of the load), 24 tranches of one-year FPFR products (supplying approximately 38% of the load), and a small portion of spot purchases.}

Each of the FPFR default service supply products for the Residential class
is procured approximately two months before delivery of the product begins.

The following chart provides a summary of the DSP IV portfolio for each customer class:

**DSP IV**

<table>
<thead>
<tr>
<th>Residential</th>
<th>Small Commercial</th>
<th>Consolidated Large Commercial and Industrial</th>
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<td>• 96% of the load is supplied by a mix of products in the following proportions: o 40% 1-year FPFR products with delivery periods that overlap on a semi-annual basis o 60% 2-year FPFR products with delivery periods that overlap on a semi-annual basis • The other 4% of the load is supplied by two-year FPFR products (approximately 3% of the supply) and spot purchases (approximately 1% of the supply) • All products are procured approximately two months before delivery of the product begins</td>
<td>Transitioned to: o 50% 1-year FPFR products o 50% 2-year FPFR products • Delivery periods overlap on a semi-annual basis • All products are procured approximately two months before delivery of the product begins</td>
<td>• 100% spot-priced full requirements products with 1-year delivery periods • All products are procured approximately two months before delivery of the product begins</td>
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10. **Q.** Mr. Fisher, you have testified that the majority of default service supply for the Residential, Small Commercial, and Medium Commercial classes was procured in the form of FPFR products in DSP I, DSP II, DSP III, and DSP IV. Please describe the characteristics of an FPFR product.

11. **A.** An FPFR default service supply product obligates the seller of the product to satisfy a specified percentage of all of the default service customers’ supply requirements in
every hour of the delivery period, regardless of the default service customers’ instantaneous changes in energy consumption, regardless of how frequently customers switch to or from default service, and regardless of how the seller’s cost to satisfy its supply obligation may change. The seller is paid a predetermined price per megawatt-hour for this service. The full requirements products that PECO has procured under DSP I, DSP II, DSP III, and DSP IV include the generation components required to supply PECO’s default service customers, including energy, capacity, and ancillary services, as well as AECs required for AEPS compliance. In PECO’s solicitations for FPFR products, qualified bidders compete with one another by submitting the prices at which they are willing to provide the full requirements default service supply, and the suppliers with the lowest prices are selected upon approval of the procurement by the Pennsylvania Public Utility Commission (the “Commission”).

11. Q. Have PECO’s solicitations for FPFR supply products attracted many qualified suppliers?

A. Yes. Between 9 and 13 suppliers participated in each of the FPFR product solicitations in DSP I, DSP II, DSP III, and DSP IV. Furthermore, the Commission has approved the bid results for approximately 99% of the FPFR default service supply product tranches that have been solicited to date. These facts indicate that

13 Source: PECO Energy Statement No. 1 (Direct Testimony of John J. McCawley). Participation in this context involves at least completing the steps required to be qualified to submit bids.

14 Source: http://www.pecoprocurement.com/index.cfm?s=background&p=previousResults. To date, 737 FPFR default service supply product tranches have been solicited by PECO. (The number increases to 757 if the 12-month 2011 “opt-in” fixed-price products for the Large Commercial and Industrial class are included.) The Commission has approved the bid results for all but seven of these tranches. On a related note, insufficient
many suppliers understand the products being solicited and are willing to compete to
provide those products. This is beneficial for customers and helps to ensure that the
winning prices are the lowest possible for the products being solicited. When bidders
are faced with a high likelihood that other bidders are also competing on the basis of
price for the same product, they have the incentive to submit their lowest possible
price in order to avoid being underpriced by another bidder.

12. Q. Do the bidders in FPFR product solicitations require compensation in the prices
that they offer to help them cover the associated costs and risks of their
obligation, to the benefit of customers?
A. Yes. As in any market, participants require compensation for the costs and risks that
they bear by providing a product.

13. Q. Have you performed a quantitative analysis of the results of PECO’s DSP I, DSP
II, DSP III, and DSP IV solicitations for FPFR default service supply products,
in order to better understand the compensation that is required by suppliers?
A. Yes. I have performed an analysis of the residential supply product pricing.

14. Q. What was the basic approach that you adopted in your analysis?
A. For each of the FPFR product solicitations that PECO completed, I calculated the
values of the individual cost components that can be quantified in a fairly simple way,
bids were received for some of the spot-priced full requirements products solicited in 2010 for the Large
Commercial and Industrial class. (See Fall 2010 Solicitation Approval Secretarial Letter (9/22/2010)). Spot-
priced full requirements products are quite different from FPFR products, as spot-priced full requirements
products do not offer the opportunity to potential suppliers to manage all of the costs and risks of full
requirements supply at a fixed price on behalf of customers.
I and deducted them from the winning bid prices. Then, by examining whether the difference (i.e., the “residual compensation” required by suppliers to cover the other costs and risks that I did not individually quantify) represents a relatively small or large portion of the winning bid prices, I determine whether this “residual compensation” is reasonable, considering the costs and risks assumed by FPFR product suppliers to the benefit of customers.

15. Q. Please identify the cost components of full requirements service that you individually quantified.

A. For each solicitation, I used market price information and load data available at the time of the solicitation to quantify cost components related to energy (including the effect of load shape), capacity, ancillary services, and various credits.¹⁵

16. Q. How did you quantify each of these cost components?

A. For energy, I relied on forward block energy prices as reported by the New York Mercantile Exchange (“NYMEX”).¹⁶ I then added a load shaping adjustment to account for the fact that market prices are generally higher during hours in which

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¹⁵ For all solicitations except the March 2015 solicitation, I only used market price information and load data available at the time of the solicitation to quantify costs. At the time of the March 2015 solicitation, PJM had filed its Capacity Performance Proposal with the Federal Energy Regulatory Commission, and it was widely recognized that approval of this proposal would increase the costs of capacity for June 2016 and beyond. As such, for the March 2015 solicitation, the price used for capacity for deliveries starting in June 2016 and the corresponding Zonal UCAP Obligation are based on the actual results of the Capacity Performance Transition Incremental Auction, which incorporate the Capacity Performance Resources in PJM’s Capacity Performance Proposal.

¹⁶ For any solicitation in which sufficient PECO Zone forward prices were not available, NYMEX forward block energy prices for PJM Western Hub were used and a basis adjustment was applied. The basis adjustment was calculated based on historical market price data available as of the time of the respective solicitation. NYMEX prices were provided by ABB Velocity Suite.
customer loads are higher.\textsuperscript{17} The load shaping was performed using actual PECO hourly loads and prices.

For capacity, I applied PJM-published capacity prices to megawatt quantities of required capacity, and I divided the products by the commensurate megawatt-hour loads in order to express capacity costs in terms of dollars per megawatt-hour. The capacity quantities were calculated based on the reported peak load contribution values for the appropriate classes of customers, and the corresponding megawatt-hour load values were calculated from publicly available load values as of the times of the solicitations.

The other cost components that I individually quantified include ancillary services costs,\textsuperscript{18} AECs,\textsuperscript{19} Auction Revenue Rights ("ARR") credits,\textsuperscript{20} and marginal loss credits.\textsuperscript{21} These values tend to be much smaller than the cost of energy and capacity and, therefore, they have a much smaller effect on the results of my analysis.\textsuperscript{22}

For each solicitation, I quantified these cost components and then deducted the

\textsuperscript{17} The calculation of this load shaping adjustment involved applying actual historical percentage differences between load-weighted hourly energy prices and straight-average hourly energy prices.

\textsuperscript{18} The ancillary services costs that I used were based on PECO’s historical ancillary services costs.

\textsuperscript{19} The costs of AECs were calculated using AEC prices as of the time of the solicitation and the volume requirements of the winning suppliers.

\textsuperscript{20} ARR credits were calculated by dividing zonal ARR credit allocations published by PJM by zonal loads calculated from PJM zonal load forecasts.

\textsuperscript{21} Marginal loss credits were calculated using actual credit data provided by PJM.

\textsuperscript{22} The values of both the ARR credits and the marginal loss credits were netted from the values of the other cost components that I calculated (i.e., these credit values effectively act as cost components with negative values), because a positive value for these credits equates to a positive dollar value allocated to the winning bidders in the solicitations.
resulting values from the winning bid price to determine how much was left over—the “residual compensation” for all other cost and risk items that were not individually quantified. The following illustrative chart graphically portrays this approach:

**Illustrative Full Requirements Product Price Analysis**

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

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

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

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

- **Customer migration** – the financial costs and risks associated with the uncertainty regarding customer switching and its effect on the default service volumes to be supplied.

- **Usage and price uncertainty** – various costs and risks due to unexpected events that affect usage and price levels.\(^{23}\)

- **Unexpected congestion** – various costs and risks associated with the possibility that differences in prices between a given trading hub and the delivery location will be higher than expected values.

- **Adverse selection** – the costs and risks associated with the likelihood that high cost-to-serve customers (e.g., with less attractive load shapes) will disproportionally remain on default service due to competitive retail suppliers’ lack of interest in marketing to such customers.

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\(^{23}\) These include extreme weather patterns, changes in customer usage patterns, plant outages or transmission line outages (which also affect congestion costs), fuel price shocks, and unexpected economic growth levels. Furthermore, the general positive correlation between loads and prices (e.g., a heat wave drives up both prices and loads) compounds the potential costs associated with this uncertainty.
• Adverse developments in energy markets during the time a bid is held open – even for a few days, while the bids are evaluated and considered for approval by the applicable regulatory body.

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

• Administrative and legal costs

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

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

19. Q. What residual compensation values did you calculate when you deducted the values of the individually quantified cost components from the winning bid prices?

A. As the following exhibit shows, the residual compensation values for solicitations during DSP I, DSP II, and DSP III generally range between about $2 per megawatt-hour and about $5 per megawatt-hour (about 4% to 8% of the winning supply bid price).
Furthermore, as the following exhibit shows, the residual compensation values in PECO’s DSP IV solicitations have been between about $2.50 per megawatt-hour and about $3.50 per megawatt-hour (about 5% to 6% of the winning supply bid price).
20. Q. Do you believe that the residual compensation values that you calculated are reasonable, considering the costs and risks assumed by the winning bidders in these solicitations to the benefit of customers?

A. Yes. As I explained earlier, the participation by multiple suppliers in these open solicitations helped to ensure that the winning prices were the lowest possible for the products being solicited. Furthermore, these residual compensation values represent only a small portion of the winning bid prices, especially considering the other costs and risks that I described above, which FPFR suppliers intend to cover through the residual compensation to the benefit of customers.
Q. Do the mix of one-year and two-year FPFR products in PECO’s residential default service supply portfolio, and the semi-annual overlapping of their delivery periods, provide price stability benefits for residential customers?

A. Yes, having a majority of two-year FPFR products supplemented almost entirely by one-year FPFR products, all with semiannually overlapping delivery periods, provides price stability benefits for residential customers. PECO’s portfolio of overlapping one-year and two-year products limits the percentage of supply that must be solicited or replaced at any given time or in any given short period, thereby reducing the likelihood of significant rate changes due to adverse circumstances or market conditions at any given time. For example, the January 2014 solicitation was held at a time in which unprecedented short-term factors caused potential default service bidders to divert their attention and resources to urgent matters other than PECO’s solicitation. This resulted in higher residual compensation values and some unsubscribed tranches. However, PECO’s residential product mix and overlapping delivery periods provided price stability benefits for residential customers.

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24 During the weeks leading up to PECO’s January 2014 solicitation, the regional energy market was in the throes of a prolonged, record-breaking, cold spell. All conventional forms of generation were challenged. As a result, hourly wholesale energy market prices were very volatile during January 2014. It is likely that potential default service bidders needed to divert resources to urgent portfolio management issues precipitated by the extreme market conditions at the time of PECO’s January 2014 default service supply solicitation, resulting in low bidder participation. In addition, in light of the urgencies caused by the weather-related turbulence in the markets, both PJM and the neighboring New York Independent System Operator, Inc. (“NYISO”), submitted filings shortly before bids in PECO’s default service supply solicitation were due, intervenors were required to file their comments on these filings within one week after the filings were made, and numerous parties dedicated resources to developing and submitting comments in these proceedings in the short periods allotted. Furthermore, bids were due in multiple other default service supply solicitations on the same day or within one day of PECO’s January 2014 solicitation’s bid due date. Given the issues related to the market-related events that I have described, potential bidders may have had abnormally limited resources available to fully compete in multiple default service supply solicitations at that time, and some may have chosen to focus on solicitations other than PECO’s. (PECO Energy Statement No. 3 (Direct Testimony of Scott G. Fisher) in Docket No. P-2014-2409362. Petition of PECO Energy Co. for Approval of Its Default Serv. Program for the Period from June 1, 2015 through May 31, 2017, pp. 18-21.)
delivery periods restricted the amount of supply that needed to be solicited in that
solicitation to only 27.2% of the overall residential default service supply
requirement, thereby limiting the effect on customer rates of the adverse conditions.

22. **Q.** Has the basic default service model used by PECO supported the competitive
retail electricity market?

**A.** Yes. In fact, since the DSP I period began, competitive retail market activity in
PECO’s service area has grown considerably. As the following chart shows, there
has been substantial growth in the number of EGSs competing in PECO’s service
area since the DSP I period began.\(^{25}\)

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\(^{25}\) Data provided by PECO.
The number of EGSs licensed and certified to serve customers in PECO’s service area has increased substantially since the start of DSP I, with 158 EGSs currently licensed and certified to serve customers. Similarly, the number of EGSs serving PECO customers has roughly tripled since the DSP I period began, as has the number of EGSs serving PECO residential customers. Currently, 102 EGSs serve PECO customers, and 95 of these EGSs currently serve PECO residential customers.

Furthermore, 60% of PECO’s total customer load is currently being served by an EGS, with switching percentages equal to 30% for the Residential class, 56% for the Small Commercial class, and 94% for the Consolidated Large Commercial and Industrial class. In contrast, as of October 1, 2010, only a few months before supply deliveries under DSP I began, only 1.7% of PECO’s total customer load was being served by an EGS.

Clearly, PECO’s transition from long-term, capped default service rates to default service rates based on competitive market pricing for PECO’s prudent mix of default service supply products has supported a competitive retail market in PECO’s service area.

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26 Source: PECO. Data is for the month ending February 25, 2020.
27 Source: PECO. Data is for the month ending February 25, 2020.
28 Source: PECO. Data is for the month ending February 25, 2020. The figure includes customers who will be switched to EGSs within 45 days. Percentages of load are based on kW.
29 Figure is “Percentage of Customers Load (MW) Served By An Alternative Supplier As Of 10/1/2010” as found in “Pennsylvania Electric Shopping Statistics – October 1, 2010” published by the PA Office of Consumer Advocate.
30 The successful phase-out of the block-and-spot aspect of the supply portfolio and the greater reliance on FPFR products also has supported retail market development. Specifically, this has decreased the likelihood of material reconciliations between supply costs and retail revenues that can distort default service rates and
III. EVALUATION OF PECO’S PROPOSED DSP V

23. Q. Please summarize PECO’s proposed plan for DSP V.

A. PECO’s proposed DSP V will continue the basic procurement strategy that was established in DSP IV, which includes procurement of a prudent mix of products from competitive wholesale suppliers and has supported retail market competition.

The following chart provides a summary of the DSP V portfolio for each customer class:

<table>
<thead>
<tr>
<th>Residential</th>
<th>Small Commercial</th>
<th>Consolidated Large Commercial and Industrial</th>
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| • 96% of the load is supplied by a mix of products in the following proportions:  
  o 40% 1-year FPFR products with delivery periods that overlap on a semi-annual basis  
  o 60% 2-year FPFR products with delivery periods that overlap on a semi-annual basis  
• The other 4% of the load is supplied by two tranches of 2-year FPFR products (approximately 3% of the supply) and spot purchases (approximately 1% of the supply)  
• All products are procured approximately two months before delivery of the product begins |
| Supplied by a mix of:  
  o 50% 1-year FPFR products  
  o 50% 2-year FPFR products  
• Delivery periods overlap on a semi-annual basis  
• All products are procured approximately two months before delivery of the product begins |
| • 100% spot-priced FR products with 1-year delivery periods  
• All products are procured approximately two months before delivery of the product begins |

reduce the transparency of future default service rates, which is important for customers to make informed supply decisions.
Mr. Fisher, the Act requires a default service plan to produce a prudent mix of contracts, and include prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis. What guidance has the Commission provided in interpreting that standard?

On October 4, 2011, the Commission entered its Second Default Service Rulemaking Order, in which it provided guidance regarding interpretation of the terms “least cost” and “prudent mix” as follows:

[T]he [“least cost’] standard must give the DSP sufficient latitude to select contracts that constitute a “prudent mix” which includes a sufficient variety of products that adequately take into consideration price volatility, changes in generation supply, customer usage characteristics and the need to assure safe and reliable service.

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

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

We agree with the majority of parties that the “prudent mix” of contracts be interpreted in a flexible fashion which allows the DSPs to design their

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31 66 Pa.C.S. § 2807(e)(3.4), and 66 Pa.C.S. § 2807(e)(3.7).
33 Id., p. 40.
34 Id., p. 41.
own combination of products that meets the various obligations to achieve “least cost to customers over time,” ensure price stability, and maintain adequate and reliable service.35

We do reject the positions of those parties that “prudent mix” be defined to always require a specific mix or percentage of types of contract components in each default service plan or a minimum of two types of products.36

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

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

1. The procurement process is designed to ensure the least cost to customers by requiring qualified bidders in the supply product solicitations to compete and be selected based on the lowest price. Furthermore, when FPFR products are solicited, default service customers are provided the benefits of competition on all aspects of the full requirements supply obligation, including the portfolio management function.37 It is reasonable to assume that bidders in the FPFR product solicitations will consider the costs and risks associated with all forms of supply available to them to satisfy their fixed-price full

35 Id., p. 60.
36 Id.
37 FPFR product suppliers have the responsibility for continuously satisfying the uncertain and constantly changing supply requirements at the agreed-upon price, and therefore must manage the associated costs and risks through their supply portfolio decisions.
requirements obligation, and will reflect in their bid prices the benefits of any
opportunity that they believe is the least cost supply opportunity.

2. PECO’s Plan predominantly relies on FPFR default service supply products,
which are well-tested in the marketplace. These products have been
successfully procured by PECO in DSP I, DSP II, DSP III, and DSP IV, and
are frequently procured by utilities in Pennsylvania and in other
jurisdictions.\[38\]

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

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

The [full requirements] process insulates default supply customers
from the volatility associated with wholesale market conditions

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\[38\] Examples of specific jurisdictions in which full requirements supply products are procured include
Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, Ohio, Pennsylvania,
and Washington D.C.
with the supplier bearing the risks of factors such as customer
migration, weather, load variation and economic activity.\textsuperscript{39}

We do express a preference for continued reliance by DSPs on the
[full requirements] approach to the extent this method best suits the
DSP's particular procurement needs.\textsuperscript{40}

The seller of an FPFR product is responsible for assuming, managing, and
covering the financial costs and risks associated with electricity supply, while
customers are protected against adverse market and/or generation cost
outcomes. Sellers of FPFR products must satisfy their obligation, regardless
of how much market prices or generation costs may increase during the
delivery period and regardless of the default service load level. Yet if market
prices decrease after these types of supply contracts are signed, customers
may elect service from a lower cost competitive retail supplier.

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

\textsuperscript{39} Second Default Service Rulemaking Order, p. 54.
\textsuperscript{40} Id., p. 56.
6. PECO’s Plan is also prudent because it includes tailored supply portfolios for different customer classes that take into account the benefits of price stability, the different shopping propensity of each customer class, and the desire to support the competitive retail market in PECO’s service area.

26. Q. **Has the Commission supported the use of a tailored supply portfolio for each customer class?**

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

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

27. Q. **Does PECO’s proposed DSP V include a reasonable degree of flexibility to accommodate the possibility of future changes in the default service supply approach?**

A. Yes. PECO’s proposed DSP V incorporates this flexibility in several ways. First, the default service supply product portfolio for the Consolidated Large Commercial and Industrial class does not include any supply products with delivery periods that extend beyond May 31, 2025, the end of the DSP V period. As a result, the Commission can easily adopt a similar plan or a very different plan for the period starting June 1, 2025, without the need to face situations involving pre-existing

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41 Second Default Service Rulemaking Order, p. 69.
default service supply products for this customer class with deliveries that extend beyond the DSP V period.

Second, the first solicitation for Residential and Small Commercial supply products with delivery periods that extend beyond May 31, 2025 (the end of the DSP V period) does not occur until September 2023. As a result, there is a significant amount of time before commitments to new supply products extending beyond the DSP V period are made, should changes need to be made due to legislative or regulatory mandates. In the meantime, these solicitations remain scheduled because they allow for the option for a fairly seamless continuation of the laddered procurement cycle as PECO transitions from DSP V to DSP VI,\(^{42}\) and they avoid subjecting Residential and Small Commercial customers to a “hard stop” with regard to their supply products at the end of the DSP V period. This is consistent with the approach approved by the Commission in DSP II, DSP III and DSP IV, and it helps to avoid the need to replace a large portion of default service supply in a short period at the end of the DSP V period. Customers could be exposed to magnified risks and rate instability if a default service plan were to require that a large portion of the customers’ default service supply must be procured in a short period.

Finally, PECO’s proposed DSP V provides flexibility because it relies on full requirements supply products. Full requirements products provide just enough supply

\(^{42}\) In its Second Default Service Rulemaking Order, the Commission recognized the importance of “laddering” contracts in procuring default service supply. Specifically, the Commission stated, “We agree with those parties that utilizing such practices as laddering contracts, with varying procurement periods and contract durations over multiple procurements provide definite benefits in terms of minimizing the impacts of market volatility and decreasing customer risk.” (Second Default Service Rulemaking Order, pp. 62-63.)
to satisfy the actual load obligations, thereby mitigating the risk of being saddled with commitments to purchase supply that is not needed. This is especially valuable given ongoing uncertainty about future customer migration.

28. Q. Is PECO’s Plan designed to support the competitive retail electricity market?

A. Yes. As in previous PECO default service plans, EGSs will compete against market-based default service rates, as the default service rates will be based on the prices for supply products obtained through competitive solicitations in which multiple bidders compete to sell the products solely on the basis of price. In addition, the use of FPFR supply products for the Residential and Small Commercial classes will allow those classes’ default service rates to closely match the market-based supply costs, reducing the likelihood of significant over- and under-collections from retail customers and enhancing rate transparency for retail supply decisions. Furthermore, the FPFR supply products and their procurement timing under PECO’s proposed DSP V will result in a relatively stable and transparent residential price-to-compare benchmark against which residential customers can compare competing retail offers. Finally, as discussed by PECO witnesses John J. McCawley (PECO Energy Statement No. 1)

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Over- and under-collections are related to the degree to which actual costs during a given period may vary from the retail rates that were set for that period. If there is significant uncertainty about the all-in dollar-per-megawatt-hour default service supply cost for an upcoming rate period when the default service retail supply rate for that period is set, then the likelihood of significant over- and under-collections is increased. This is the case when a block-and-spot supply component is included in the portfolio, because under the block-and-spot approach the electric distribution company must forecast future default service loads and spot prices, and actual outcomes may deviate significantly from the forecasted values. In contrast, FPFR products generally entail very little uncertainty about the default service supply costs on a dollars-per-megawatt-hour basis for any given upcoming rate period at the time that the default service retail rate for that period is set, effectively reducing the potential for significant over- or under-collections. It should be noted that over- and under-collections also can occur due to billing cycle lag.
and Carol Reilly (PECO Energy Statement No. 3), PECO will continue its existing
Standard Offer Program through May 31, 2025.

29. **Q.** Do you believe that FPFR suppliers’ bid prices will be noticeably higher due to
PECO’s proposal to include the supply for PECO’s Time-of-Use (“TOU”)
default service customers in the FPFR products?\(^{44}\)

**A.** No. Both the standard default service and the TOU default service will be supplied
via the same FPFR products, so customer switching between standard default service
and TOU default service will not cause load uncertainty issues that the suppliers
otherwise may be expected to price into their bids.\(^{45}\) Furthermore, since suppliers
will be paid the same price for a megawatt-hour of supply whether that supply is for a
standard default service customer or a TOU default service customer, suppliers will
not bear any revenue risk associated with whether a given megawatt-hour of supply is
needed by a standard default service customer or a TOU default service customer. In
addition, to the extent that customers elect TOU default service and shift their usage
to lower-priced periods or reduce their usage during higher-priced periods, the
underlying market-based cost to supply the customers could be reduced, resulting in
lower FPFR supplier bid prices over time. Finally, experience with opt-in time-of-use
programs indicates that the number of customers who elect PECO’s TOU default

\(^{44}\) In PECO Energy Statement No. 2, PECO witness Joseph A. Bisti describes PECO’s TOU default service
proposal in detail.

\(^{45}\) In contrast, if the supply for the TOU default service customers were solicited separately, the suppliers of the
standard default service FPFR supply products would bear additional risks related to customer switching to and
from the TOU default service option. PECO’s proposal eliminates these risks and is relatively easy to
administer.
service is likely to be relatively small relative to the overall default service customer base. If TOU default service is expected to represent a small percentage of a given FPFR product’s supply, then any effects of the TOU default service offering on the FPFR product supplier’s bid price should be small.

IV. CONCLUSION

30. Q. Does this conclude your direct testimony?

A. Yes, it does.