

An abstract graphic on the left side of the slide, featuring a dark blue background with a complex network of white and light blue dots connected by thin lines, forming a shape reminiscent of a map of North America.

Default Service as a Risk- Management Framework

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CRA Charles River
Associates



Agenda

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Default Service in the Competitive Electricity Market

2

Components of a Default Service Program

3

Default Service Evolution

4

Default Service and Long-Term Capacity Hedging

5

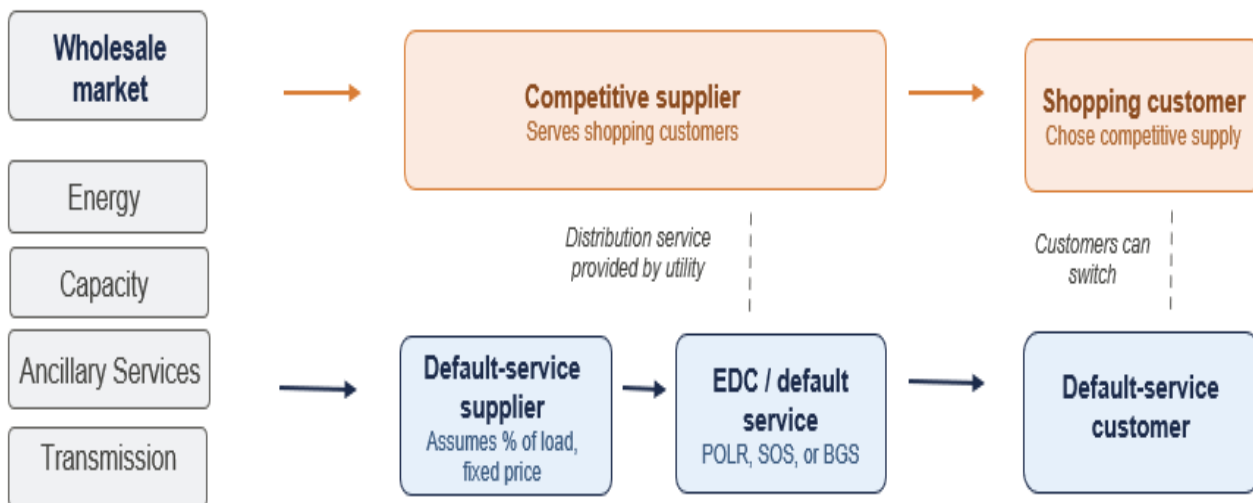
PJM's Three Paths Forward and Default Service



Default service transfers wholesale risk to suppliers and sets the retail price benchmark

How default service works

Wholesale costs are converted into a fixed price for non-shopping customers; competitive retail supply runs in parallel



Supply is generally full-requirements: the supplier assumes a share of actual default-service load and manages the underlying wholesale risk, providing the EDC a fixed price for the contract term. The EDC continues distribution service to both default-service and shopping customers.

Key Functions of Default Service Auctions

1

Risk Transfer

Hourly energy prices and scarcity spikes sit with the supplier for the contract term

2

Pricing Benchmark

The competitively procured default-service price gives customers an observable reference, e.g. Pennsylvania's Price to Compare, for evaluating competitive retail offers.



Five building blocks turn the obligation to serve into a defined procurement framework

1

Regulatory Plan and Framework



A commission-approved plan sets the customer classes, products, contract lengths, procurement schedule, auction or RFP design and cost recovery. Typically a 3- to 5-year Default Service Program.

2

Supplier Agreement



The supply agreement, a Supplier Master Agreement in Pennsylvania, a Master SSO Supply Agreement in Ohio, allocates PJM energy, capacity, ancillary, transmission and other charges, and sets settlement, credit and default remedies.

3

Product and Portfolio Design



Fixed-price full-requirements service for residential and small commercial load, with one- and two-year terms most common. Laddering across procurement dates and a mix of products smooth wholesale price movements; tranches are a percentage of actual load.

4

Administration and Qualification



Solicitations are run by the utility or an independent auction manager. Bidders must qualify on PJM eligibility, financial standing, and creditworthiness, and post pre-bid security plus ongoing collateral once serving load.

5

Procurement Format



A descending-price clock auction gives continuous price discovery across rounds; a sealed-bid RFP is one-shot and puts more weight on a bidder's read of competitors. Neither is inherently preferable; it depends on the number of products and other factors.



Default service has already adapted to PJM market change through long-term PPAs and capacity proxy prices

Why the traditional construct is under pressure

- The construct was built around one- to three-year horizons with heavy reliance on the PJM capacity market for resource adequacy.
- PJM's Feb 2026 review finds restructured states hedge energy and ancillary costs but buy capacity at the wholesale price; PJM argues a one- to three-year structure cannot protect consumers from a sustained capacity shortage.
- Hedging does not eliminate a high underlying price, it changes the timing and variability of customers' exposure to it.

Two proven adaptations



District of Columbia: Pepco PPA pilot

- 2019 DCPSC pilot: renewables for 5% of SOS load
- 2025: 25-year PPA, 172,000 MWh/yr from 75 MW solar (energy and RECs, no capacity), deliveries from Dec 2027
- Order No. 22702 lifted the cap to a 25% of SOS target, 15-/20-/25-year terms with a 15% pricing-collar review



New Jersey: Capacity Proxy Price (CPP)

- Introduced when PJM auction delays began in 2019; now used in PA, OH and MD
- Bidders use a proxy capacity price, trued up to the actual PJM result
- Removes bid uncertainty, but customers still pay the actual capacity cost

Default service frameworks have evolved to reflect changing market conditions before. The construct does not need to be rebuilt to contract long term: components can be carved out while the residual clears through conventional solicitations.



PJM's 25% long-term capacity target can layer onto default service; structure, interaction and cost allocation are the open questions

1

What the long-term contract should procure?

- Capacity only, or bundled with energy and other attributes?
- Procured at once, or layered across dates?
- What share of load hedged long term?

2

How it should interact with default service supplier obligations?

- Remove the capacity obligation from the default-service product?
- Or retain it, with a pro rata capacity credit?

3

Which customers should bear the costs and benefits?

- Default-service customers alone?
- Or shared with shopping customers via a non-bypassable charge or credit?

The decisive question is not whether capacity is procured long term, but how that position folds into the supplier's full-requirements obligation and who bears the cost as customers migrate.



Each PJM path changes what default service must procure, none requires abandoning it

	Path A: Stabilized Markets	Path B: Differential Reliability	Path C: Energy Market Transition
Primary PJM change	Greater reliance on long-term capacity commitments	Different reliability levels for different loads	Greater reliance on energy and ancillary services, with long-term reliability commitments
Default service can remain?	Yes	Yes	Yes
What may change?	Part of the capacity obligation may move outside the traditional full-requirements product	Flexible or differentiated-reliability load may require a separate default-service product	Long-term reliability can be procured separately while energy remains largely within default service
Key state decision	Who procures long-term capacity and how it is allocated among LSEs	Define the reliability product, firm/flexible load, curtailment obligations and capacity treatment	Determine what the long-term reliability contract buys and what remains with default-service suppliers
Retail-choice issue	Long-term positions should follow load or be recovered through an appropriate non-bypassable mechanism	Avoid shifting the costs or risks of flexible load to conventional default-service customers	Allocate system-level reliability costs so they are not distorted by customer migration
Transition issue	Phase and ladder long-term capacity procurement	Coordinate implementation with development of PJM rules and state tariffs	Phase and ladder long-term reliability contracting
Default Service as a hedge	Continues to hedge energy and other included costs; capacity hedge may increasingly be separate	Continues for conventional customers; separate product can manage price risk for differentiated-reliability customers	Continues to hedge energy and other short-term wholesale costs if reliability is procured separately