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March 1, 2010

VIA FEDERAL EXPRESS

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: **Petition of PECO Energy Company for Approval of its Smart Meter
Technology Procurement and Installation Plan, Docket No. M-2009-2123944**

Dear Secretary McNulty:

Enclosed please find the original and nine copies of the Reply Of PECO Energy Company To The Exception Of The Office Of Consumer Advocate. As evidenced by the enclosed Certificate of Service, copies of the enclosed Reply have been served upon all parties of record. Also enclosed is a disk containing the Reply in searchable PDF format.

An additional copy of this letter and the Reply are enclosed, which we request be date-stamped and returned to us in the envelope provided.

Sincerely,



Thomas P. Gadsden

Enclosures

c: Per Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PETITION OF PECO ENERGY
COMPANY FOR APPROVAL OF ITS
SMART METER TECHNOLOGY
PROCUREMENT AND INSTALLATION
PLAN

DOCKET NO. M-2009-2123944

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

REPLY OF PECO ENERGY COMPANY TO
THE EXCEPTION OF THE OFFICE OF CONSUMER ADVOCATE

To The Recommended Decision of Administrative Law Judge
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March 1, 2010

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I. INTRODUCTION AND OVERVIEW

A. The Initial Decision

On January 19, 2010, Administrative Law Judge Marlane R. Chestnut (the “ALJ”) issued her decision (“Initial Decision” or “I.D.”) in the above-captioned matter recommending that the Pennsylvania Public Utility Commission (the “Commission”):

- **Approve** the Joint Petition For Partial Settlement, which resolved all issues pertaining to the Smart Meter Technology Procurement and Installation Plan (“Smart Meter Plan”) of PECO Energy Company (“PECO” or the “Company”) except for two issues that were reserved for briefing and decision; and
- **Adopt** the Company’s positions on the two reserved issues.

As the basis for her recommendations on the reserved issues, the ALJ made specific, detailed findings of fact (I.D., pp. 11-18) and conclusions of law (I.D., pp. 30-32). She also provided a thorough, well-reasoned analysis of the issues (I.D., pp. 24-30), explaining why the Office of Consumer Advocate’s (“OCA’s”) position is without merit and should be rejected. As developed in the Initial Decision and as discussed in detail in the Company’s Initial and Reply Briefs filed on December 2 and December 9, 2010, respectively, the ALJ’s findings, conclusions and recommendations are fully supported by substantial record evidence, by prior decisions of this Commission and by the applicable provisions of the Public Utility Code.

B. The Issues Reserved For Briefing

The two issues reserved for briefing involve: (1) the appropriate method for allocating Smart Meter Plan “common” costs, as described in more detail below, among customer classes; and (2) whether Smart Meter Plan costs should be recovered from the commercial and industrial

classes through a customer-based or an energy-based charge. Only the first issue was the subject of Exceptions filed in this proceeding, and, therefore, PECO's Reply is limited to this issue.

C. Positions Regarding Allocation of Common Costs

All parties agreed that the costs to procure and install smart meters can be identified by customer class and, therefore, will be directly assigned to each customer class. The balance of PECO's smart meter program costs will be incurred to gather, store and manage the data that smart meters generate, to provide the information technology infrastructure to interconnect the smart meter system with PECO's customer accounting and billing system, and to administer and manage the Smart Meter Plan. Those "common" costs, which are incurred to provide systems and functions used in common by all customer classes, cannot be directly assigned and, therefore, must be allocated among customer classes.

In its Smart Meter Plan, the Company proposed to allocate "common" costs among classes based on each class' number of customers because such costs are customer-related, i.e., they vary based on the number of customer accounts. PECO's proposed allocation method was supported by the Office of Small Business Advocate ("OSBA") and the Philadelphia Area Industrial Energy Users Group ("PAIEUG"), and was not opposed by any party except the OCA. The OCA proposed an allocation based on the "average of the percentage shares of each class' energy at [the] meter and each class' contribution to PECO's annual single coincident peak" to serve as a proxy for the "benefits" it assumes each class will realize from the deployment of smart meters and the implementation of dynamic pricing. *See* OCA St. 3, p. 8.

II. ARGUMENT

A. The ALJ Properly Rejected The OCA's Cost Allocation Proposal (OCA Exception No. 1).

1. The Cost Allocation Proposal Adopted By The ALJ Reflects "Reasonable Cost of Service Practices."

The Commission addressed the allocation of smart metering costs to customer classes in its Implementation Order (p. 32) and directed that common costs be allocated according to "reasonable cost of service practices." The Commission specifically addressed cost allocation as follows:

The Commission will require that all measures associated with an EDC's smart metering plan shall be financed by the customer class that receives the benefit of such measures. In order to ensure that proper allocation takes place, it will be necessary for the utilities to determine the total costs related to their smart metering plans, as discussed in [Section] E.1. [of this order]. Once these costs have been determined, we will require the EDC to allocate those costs to the classes whom [sic.] derive benefit from such costs. *Any costs that can be clearly shown to benefit solely one specific class should be assigned wholly to that class. Those costs that provide benefit across multiple classes should be allocated among appropriate classes using reasonable cost of service practices.* (Emphasis added.)

Smart Meter Procurement and Installation, Docket No. M-2009-2092655 (June 24, 2009) ("Implementation Order").

PECO's proposed allocation method comports with "reasonable cost of service practices" because it is the same method that utilities, with the Commission's approval, have employed for many years to allocate metering and customer accounting costs among customer classes. As explained in PECO's Initial Brief (pp. 6-8), the Commission¹ and other well-accepted

¹ *Pa. P.U.C. v. Pennsylvania Power Co.*, 85 P.U.R.4th 323, 392-93 (1987).

authorities² on utility rate regulation have recognized that customer-related costs are those which vary in accordance with the number of customers and that costs so classified are properly allocated to the various customer classes based on the number of customers in each class.

The ALJ concluded – and no party disputes – that smart meter costs, including “common” costs, vary with the number of customers. I.D., p. 27. As PECO’s witness, Alan B. Cohn, explained:

From a cost of service perspective, smart meter common costs are driven by the number of meter locations and, therefore, are properly allocated on the basis of the number of customers. Specifically, the size of the network needed to read meters and the size of the systems used to store meter data are a function of the number of meter locations that have to be connected and, therefore, vary in proportion to the number of customers. A customer’s demand and energy use do not affect (or affect only marginally) the cost of the build-out in common infrastructure.

PECO St. 5-R, p. 7. Accordingly, applying “reasonable cost of service practices,” smart meter-related common costs should be allocated in proportion to the number of customers in each class. See I.D., p. 29 (“[T]he Company’s proposal . . . accurately assigns those costs to each customer group based on reasonable cost of service and causation principles which have long been determined by the Commission as the fundamental basis for utility ratemaking and which is explicitly required by the Implementation Order.”).

2. The OCA’s Proposal Is Inconsistent With “Reasonable Cost of Service Practices.”

The OCA claims that the ALJ erred in adopting PECO’s proposal because traditional cost of service principles, Act 129 and the Implementation Order support the allocation of common costs on the basis of energy and demand. In particular, the OCA contends: (1) that the

² Charles F. Phillips, Jr., *The Regulation of Public Utilities* (1985); James H. Cawley & Norman James Kennard, *Rate Case Handbook – A Guide To Utility Ratemaking Before The Pennsylvania Public Utility Commission* (1983).

Implementation Order “clearly evidenced [the Commission’s] intention to assign costs to the classes which derive the benefit[s]”; (2) that a “benefits” based allocation is consistent with the principle that costs should be allocated “in proportion to the extent to which classes have caused those costs to be incurred;” and (3) that it is “simply inappropriate” to allocate the same dollar level of expense to an individual residential customer as a large industrial or commercial customer. *See generally* OCA Exceptions, pp. 5-13. None of these reasons is valid.

Contrary to OCA’s contention, the Commission’s Implementation Order does not prescribe a “benefits” based allocation for costs not capable of direct assignment. While the Commission issued the general directive that “all measures associated with an EDC’s smart metering plan shall be financed by the customer class that receives the benefit of such measures,” it more specifically instructed that costs which can be identified with a particular class of customers be “assigned wholly to that class” and that costs not so assigned be “allocated among appropriate classes using reasonable cost of service practices.” Implementation Order, p. 32. In short, the Commission prescribed a cost-based allocation, not a benefit-based allocation.

Contrary to OCA’s contention, its proposed allocation method is not supported by the “traditional cost of service principle” that costs should be allocated based on the factors that caused such costs to be incurred. OCA distorts this principle by asserting that the “cause” of the smart meter costs is the intended benefit that smart meters will enable. This “benefits” based analysis ignores the actual cost-causative factors in this case, i.e., the need to electronically interconnect customer accounts and to store and manage customer data, which vary by the number of customers. As the ALJ explained, “[s]imply put, it is the need for the meter itself . . . that ‘causes’ those specific costs to be incurred.” I.D., p. 28. When costs vary by number of

customers, it is well-established that those costs should be allocated based on the number of customers.

OCA cites *ICC v. FERC*, 576 F.3d 470 (7th Cir. 2009) as affirming its contention that allocating costs to customer classes in proportion to the assumed “benefits” each class might receive from those expenditures is “an accepted cost of service principle.” PECO’s Reply Brief describes in detail why, read in its entirety, *ICC v. FERC* does not support the OCA’s position in this case. PECO Reply Brief, pp. 2-4. Rather, as explained, the case simply applies the accepted principle that a customer should not bear the cost of facilities that are not used to serve it.

The OCA’s reliance on *Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa. Commw. Ct. 2006) is similarly misplaced. While the Commonwealth Court cited the “benefits” of the Sustainable Energy Fund (“SEF”) to distribution customers generally to support the continued collection of SEF funding from those customers, cost allocation between classes of customers was not analyzed by the court, let alone justified through the kind of “benefits”-based allocation of costs that the OCA advocates in this proceeding. *See* 904 A.2d at 1025-1027.

The OCA further suggests that the “historic ‘number of customers’ methodology” is inapplicable in this case because smart meters do more than “simply . . . count kWh for billing purposes” and, in fact, enable customers to reduce costs through energy efficiency and demand reduction. OCA Exceptions, pp. 5-6, 10. As discussed in PECO’s Initial Brief, this Commission and other regulatory agencies have long recognized that conventional meters, and the usage-based pricing that conventional meters enable, produce substantial system-wide and customer-specific “benefits” by creating incentives for conservation, promoting wise and efficient use of utility service and reducing overall costs. PECO Initial Brief, pp. 10-11. Despite the Commission’s recognition that conventional meter costs – not just smart meter costs – are

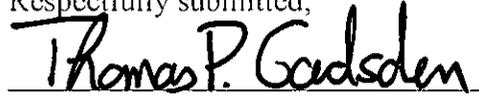
incurred in order to promote the efficient use of utility service, it has consistently approved the allocation of such costs on a customer basis. *Id.* The enhanced potential for energy efficiency and cost savings enabled by smart meters is simply not a valid basis for the Commission to deviate from its longstanding cost allocation methods.

Finally, the fact that a customer-based allocation assigns the same dollar level of expense to each customer, regardless of class, and imposes a larger proportion of “common” costs on the residential class than a demand or energy-based allocation, does not justify the OCA’s proposed method. The OCA would have its desired outcome, a reduction in the costs assigned to the residential class, dictate the propriety of the allocation method to be employed. That is obviously an invalid argument and should be rejected. As the Implementation Order provides, “reasonable cost of service practices” should be employed in order to achieve a reasonable result. The Company’s proposed customer-based allocation does that and, therefore, should be approved.

III. CONCLUSION

For the foregoing reasons, the Commission should reject the Exception filed by the Office of Consumer Advocate and adopt the Initial Decision without modification.

Respectfully submitted,



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Dated: March 1, 2010

**BEFORE THE
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PETITION OF PECO ENERGY :
COMPANY FOR APPROVAL OF ITS :
SMART METER TECHNOLOGY : **DOCKET NO. M-2009-2123944**
PROCUREMENT AND INSTALLATION :
PLAN :

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the Reply Of PECO Energy Company To The Exception Of The Office Of Consumer Advocate on the following persons in the manner specified in accordance with the requirements of 52 Pa. Code § 1.54:

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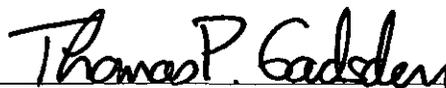
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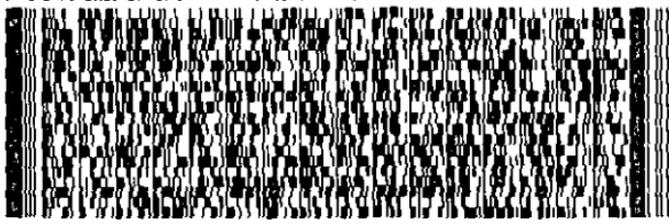
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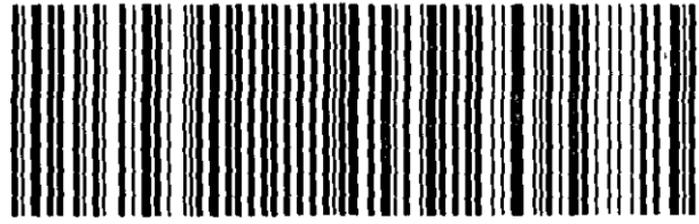
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