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September 7, 2018

VIA eFILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

Re: Pennsylvania Public Utility Commission v. PECO Energy Company
Docket No. R-2018-3000164

Dear Secretary Chiavetta:

Enclosed for filing is the **Initial Brief of PECO Energy Company** (the "Initial Brief") in the above-referenced matter.

As evidenced by the Certificate of Service, a copy of the Initial Brief has been served upon Deputy Chief Administrative Law Judge Christopher P. Pell and Administrative Law Judge F. Joseph Brady, and all parties of record.

Should you have any questions, please do not hesitate to contact me at 215-841-5974.

Very truly yours,



W. Craig Williams

Enclosures

cc: Per Certificate of Service (w/encls.)

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	DOCKET NO. R-2018-3000164
	:	
PECO ENERGY COMPANY	:	

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the **Initial Brief of PECO Energy Company** on the following persons in the manner specified in accordance with the requirements of 52 Pa. Code § 1.54:

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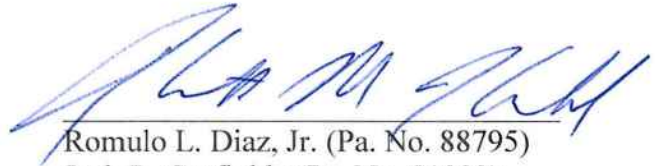
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION** :
:
: **Docket Nos. R-2018-3000164 et al.**
:
v. :
:
PECO ENERGY COMPANY :

**INITIAL BRIEF OF
PECO ENERGY COMPANY**

**Before Deputy Chief Administrative Law Judge Christopher P. Pell
And Administrative Law Judge F. Joseph Brady**

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I. INTRODUCTION AND PROCEDURAL HISTORY

On March 29, 2018, PECO Energy Company (“PECO” or “the Company”) filed with the Pennsylvania Public Utility Commission (“Commission”) Tariff Electric – Pa. P.U.C. No. 6 (“Tariff No. 6”). Tariff No. 6 reflects an increase in annual distribution revenue of approximately \$82 million, or 2.2% of PECO’s total Pennsylvania jurisdictional operating revenues. Accompanying Tariff No. 6, PECO filed the supporting data required by the Pennsylvania Public Utility Commission’s (“Commission’s”) regulations (52 Pa. Code § 53.52 *et seq.*) for a historic test year (“HTY”) ended December 31, 2017, a future test year (“FTY”) ending December 31, 2018 and a fully projected future test year (“FPFTY”) ending December 31, 2019. The Company’s supporting information included the prepared direct testimony of eight initial witnesses and the various exhibits sponsored by them.

By Order issued April 19, 2018, the Commission instituted a formal investigation to determine the lawfulness, justness and reasonableness of PECO’s existing and proposed rates, rules and regulations. Accordingly, Tariff No. 6 was suspended by operation of law until December 28, 2018.¹ This case was then assigned to Deputy Chief Administrative Law Judge Christopher P. Pell and Administrative Law Judge F. Joseph Brady (the “ALJs”) for purposes of conducting hearings and issuing a Recommended Decision.

A total of twenty parties appeared, intervened or filed complaints in the Company’s base rate proceeding, including the Commission’s Bureau of Investigation & Enforcement (“I&E”), the Office of Consumer Advocate (“OCA”), and the Office of Small Business Advocate

¹ Order, *Pa. P.U.C. v. PECO Energy Company*, Docket No. R-2018-3000164 (Order entered April 19, 2018). In accordance with the Commission’s April 19th Order and Section 53.71 of the Commission’s regulations, 52 Pa. Code § 53.71, PECO filed a tariff supplement suspending Tariff No. 6. *See* Supplement No. 1 to Tariff Electric – Pa. P.U.C. No. 6 Suspending Original Tariff No. 6 Until December 28, 2018, Docket No. R-2018-3000164 (filed April 27, 2018).

(“OSBA”). A complete list of parties is set forth in the Joint Petition for Partial Settlement filed on August 28, 2018 (“Joint Petition”).

A Prehearing Conference was held on May 8, 2018, at which a schedule was established for the submission of testimony and the conduct of hearings. Specifically, and consistent with Commission practice, a schedule was adopted whereby all case-in-chief, rebuttal and surrebuttal testimony would be submitted in writing in advance of hearings. Various parties submitted testimony in conformance with the procedural schedule to address a wide range of issues pertaining to revenue requirement, cost of service, revenue allocation and rate design, as well as other issues presented by the Company’s filing.

Negotiations were conducted by various parties to try to achieve a settlement of some or all of the issues in this case. As a result of those negotiations, the parties to the Joint Petition were able to agree to a settlement (the “Settlement”) that resolves all issues except for NRG Energy, Inc.’s (“NRG’s”) proposal to reallocate over \$100 million in distribution system costs to residential distribution customers receiving default service (the “Reserved Issue”). Consequently, except for PECO and NRG, the parties in this proceeding waived cross-examination of witnesses.

Evidentiary hearings took place on August 21, 2018, at which time PECO witness Alan B. Cohn was cross-examined by counsel for NRG and NRG witness Chris Peterson, who prepared NRG’s proposal, was cross-examined by counsel for PECO. In the course of the hearings, PECO moved to disqualify Mr. Peterson as an expert witness on the grounds that he was not qualified as an expert in utility accounting, utility ratemaking, utility operations, retail and wholesale energy markets, or default service.² The ALJs denied PECO’s motion, but stated

² Tr. 477-481.

that Mr. Peterson's level of expertise would be given appropriate weight in their decision in this proceeding.³ Following evidentiary hearings, the ALJs entered a Briefing Order for the Reserved Issue on August 24, 2018.

II. STATEMENT OF THE CASE

In light of the Joint Petition, the only contested issue remaining in this proceeding is NRG's proposal to allocate over \$100 million in distribution system costs in PECO's FPFTY only to those distribution service customers who receive default service instead of all distribution customers. Both PECO and the OCA submitted testimony in opposition to NRG's proposal,⁴ and no party other than NRG provided testimony in favor of NRG's proposal.

The Joint Petition reflects the agreement of a wide variety of stakeholders, including residential, commercial and industrial customers; organizations representing the interests of low-income customers; and developers of electric vehicles ("EVs") and EV charging networks.⁵ Consistent with the Commission's policies in favor of settlements and for the reasons set forth in this Brief, the Commission should adopt the Joint Petition and reject NRG's proposal.

III. SUMMARY OF THE ARGUMENT

NRG's proposal to allocate over \$100 million in distribution system costs to distribution service customers who receive default service and thereby raise the price of default service by fifteen percent is inconsistent with basic principles of utility cost allocation. Mr. Peterson lacks relevant utility experience, which is reflected in his use of default service revenues and the number of distribution customers receiving default service to reallocate distribution system costs. Mr. Peterson admitted that he knew of no other utility in the United States that allocates indirect

³ See Tr. 482.

⁴ See PECO St. 9-R and OCA St. 3R.

⁵ See generally Joint Petition and PECO's Statement in Support of the Joint Petition for Partial Settlement (filed August 28, 2018).

expenses as he has proposed, and that he did not ask about different default service functions performed by PECO employees in developing his proposal. Mr. Peterson also conducted no analysis as to the effect of his cost allocations on PECO's ability to recover its distribution system costs if the number of customers shopping for generation service increases, and he could only guess as to the level of shopping that would have an impact on the reasonableness of his proposed allocations. NRG's proposal should be rejected.⁶

IV. ARGUMENT

A. Overview Of NRG Proposal

In his testimony on behalf of NRG, Mr. Peterson asserted that PECO has allocated more than \$100 million of costs to all residential distribution service customers that should be allocated only to residential distribution service customers receiving default service.⁷ According to Mr. Peterson, PECO could not provide default service to residential customers "without incurring administrative costs of the type and magnitude" he identified.⁸ Mr. Peterson therefore proposed to reallocate these costs to default service and increase the price that residential customers pay for default service by fifteen percent.⁹

Mr. Peterson's direct testimony largely consists of his discussion of a "utility rate study" attached to his testimony (the "Peterson Study").¹⁰ In the Peterson Study, Mr. Peterson selects various distribution expenses in PECO's FPFTY for reallocation to distribution customers receiving default service, including PECO's common physical plant and employee salaries and

⁶ In accordance with the Briefing Order entered on August 28, 2018, Proposed Findings of Fact, Conclusions of Law, and Ordering Paragraphs are included in Appendix A.

⁷ NRG St. 1, p. 6.

⁸ NRG St. 1-SR, p. 8.

⁹ NRG St. 1, pp. 33-34.

¹⁰ NRG St. 1, Exhibit CP-3.

pension expense for all PECO employees. He then calculates the ratio of PECO's projected FPFTY default service revenues to its total distribution revenues (43%) and the ratio of the number of customers Mr. Peterson believes will be receiving default service in 2019 to the total number of projected PECO distribution customers (66%). Using these ratios, he models three different cost allocations in which he assigns 43% of the selected FPFTY distribution costs to distribution customers receiving default service ("Methodology A"), 66% ("Methodology B"), and a hybrid mix of both ratios ("Methodology C") in which he uses either 43% or 66%, depending upon the selected cost he is allocating.¹¹

After considering the results of his calculations, Mr. Peterson concluded that Methodology C was preferable and that the resulting fifteen percent increase in the price of default service from the \$101 million in costs he reallocates to customers receiving default service will assist PECO customers in making "apples-to-apples" decisions in shopping for electricity.¹²

In the course of his testimony, Mr. Peterson conceded that he did not know of any utility in the United States that allocated indirect expenses to default service as he proposed.¹³ He also did not determine whether the costs he proposed to allocate were actually associated with any default service function performed by PECO employees, nor did he calculate the costs that PECO would not incur if it did not provide default service.¹⁴ Although his analysis was based in part upon his view that PECO would "necessarily incur" these costs if it operated a separate division to provide residential default service, he could not identify any utility in the United

¹¹ NRG St. 1, pp. 25-30.

¹² NRG St. 1, p. 34.

¹³ PECO St. 9-R, p. 11 & Exhibit ABC-2; Tr. 472-73.

¹⁴ Tr. 472 & 497 (stating that such analysis would be outside the scope of his work or what he was requested to do by NRG).

States that actually operates a separate default service division.¹⁵ In addition, he acknowledged that he had not studied what would happen if the price of default service were increased by fifteen percent.¹⁶

B. PECO's Provision Of Default Service And Applicable Law

1. PECO's Default Service Obligations

As a Pennsylvania electric distribution company ("EDC"), PECO serves as the default service provider to retail electric customers within its service territory in accordance with its obligations under Section 2807(e) of the Pennsylvania Public Utility Code.¹⁷ As default service provider, PECO provides electric generation service to those customers who do not select an electric generation supplier ("EGS") or who return to default service after being served by an EGS that becomes unable or unwilling to serve them.¹⁸ Every customer who receives default service from PECO is a distribution service customer, and PECO provides electric distribution service without regard to whether a customer also receives default service.¹⁹

As default service provider, PECO is required to file a plan with the Commission that sets forth how PECO will meet its default service obligations, including a strategy for procuring generation supply and a rate design to recover the costs of providing default service.²⁰ Pursuant to the Commission's default service regulations,²¹ PECO's default service plan must include, *inter alia*: (1) a default service procurement plan that sets forth PECO's strategy for procuring generation supply and complying with Pennsylvania's Alternative Energy Portfolio Standards

¹⁵ PECO St. 9-R, p. 11 & Exhibit ABC-2.

¹⁶ Tr. 499 & 503.

¹⁷ 66 Pa.C.S. § 2807(e).

¹⁸ 66 Pa.C.S. § 2807(e)(3.1).

¹⁹ PECO St. 9-R, p. 3.

²⁰ 66 Pa.C.S. § 2807(e)(3.6).

²¹ 52 Pa. Code § 54.181 *et seq.*

Act, 73 P.S. § 1643.1 *et seq.* (“AEPS” or “AEPS Act”); (2) an implementation plan identifying the schedule and other details of PECO’s proposed competitive procurements for default supply, with forms of supplier documents and agreements and an associated contingency plan; and (3) a rate design plan to recover all reasonable costs of default service.²²

The Commission reviews PECO’s default service plans and approves a plan if it is consistent with the Public Utility Code and the Commission’s regulations. To date, the Commission has approved four PECO default service plans, with the current plan in effect until May 31, 2021.²³

2. Procurement of Default Service and the Price-to-Compare

In accordance with the default service plans approved by the Commission, PECO conducts competitive procurements and enters into wholesale power contracts and associated services for three different default service customer classes: Residential, Small Commercial (up to 100 kW annual peak demand and lighting customers), and Medium/Large Commercial (greater than 100 kW annual peak demand).²⁴

The principal procurement feature of PECO’s wholesale power contracts for residential customers receiving default service is the use of fixed-price, full requirements supply contracts. Under these contracts, winning bidders in PECO’s competitive procurements are responsible for assuming, managing, and covering the financial costs and risks associated with electricity supply for a percentage of residential customers, including all required energy, capacity, and ancillary services, as well as alternative energy credits required for compliance with the AEPS Act. Each

²² 52 Pa. Code § 54.185.

²³ PECO St. 9-R, p. 3; *see generally* Opinion and Order, *Petition of PECO Energy Company for Approval of its Default Service Program for the Period from June 1, 2017 through May 31, 2021*, P-2016-2534980 (Order entered December 8, 2016).

²⁴ PECO St. 9-R, p. 3.

wholesale power supplier must satisfy this obligation, regardless of how much market prices or generation costs may increase during the delivery period and regardless of the default service load level (since the supplier is serving a percentage of whatever the default service load is at any given time).²⁵

PECO recovers the default service costs for each customer class through a class-specific generation supply adjustment (“GSA”) charge and a transmission service charge (“TSC”) set forth in its electric tariff.²⁶ The price per kilowatt-hour charged under each GSA and the TSC is the Price-to-Compare (“PTC”) for the applicable customer class and is updated at least quarterly as required by the Commission.²⁷ PECO recovers all of the costs of the wholesale power contracts in the PTC as well as default service administrative costs (including the cost of an independent evaluator to oversee the procurement process), working capital, information technology costs, and regulatory and litigation costs associated with PECO’s default service plan.²⁸ In accordance with the Commission’s regulations, PECO is prohibited from recovering costs of default service in distribution rates, and its PTC is audited annually by the Commission.²⁹ PECO is not permitted to make a profit from the provision of default service.³⁰

As Mr. Cohn explained, virtually all (more than 90%) of the amounts recovered through the residential PTC are paid directly to wholesale suppliers by PECO’s Energy Acquisition team, or “EA.”³¹ EA is responsible for the PECO service territory load’s interaction with wholesale electric markets, electric and gas choice coordination responsibilities, payments and associated

²⁵ PECO St. 9-R, p. 4.

²⁶ See PECO St. 9-R, p. 4, and PECO Exhibit MK-2, Original Page No. 34.

²⁷ See PECO St. 9-R, pp. 4-5; 52 Pa. Code § 54.187(h).

²⁸ See 52 Pa. Code. § 54.187(e); 52 Pa. Code § 69.1808; PECO St. 9-R, pp. 5-6.

²⁹ See 52 Pa. Code § 54.187(e) & (f); 66 Pa.C.S. § 1307(d).

³⁰ PECO St. 9-R, p. 4.

³¹ PECO St. 9-R, p. 15; Tr. 439-41.

accounting for PECO natural gas supply, transportation, and storage contracts, and wholesale default supply purchase agreements. In the electric sector, EA manages all of the accounting and administrative functions associated with the continuous delivery of electric energy from the wholesale energy market operated by PJM Interconnection, Inc. (“PJM”) to PECO’s electric distribution system customers, whether they shop with an EGS or receive default service.³²

Nineteen employees work in the EA team, and the largest group supports electric and gas customer choice. It is EA’s responsibility to match each distribution customer’s wholesale load responsibility to their retail provider (whether that is one of over 100 electric generation suppliers or nine wholesale default suppliers) and provide that information daily to PJM for proper PJM billing.³³

Despite the large amount of revenue paid to default service suppliers, EA’s arrangements for payments to suppliers are straightforward. Monthly invoices of default service suppliers are automatically generated, reviewed by one EA employee, and approved for payment in accordance with PECO’s established payment procedures.³⁴ Because the work performed by the EA team supports both shopping and non-shopping customers (who can always choose to shop at any time), PECO includes the costs of the EA team in distribution rates. EA costs are not separately allocated to customers receiving default service, and EGSs are not charged for services provided on behalf of EGSs.³⁵

³² Tr. 439-41.

³³ *Id.*

³⁴ Tr. 440. The cost of the information technology necessary to generate wholesale supplier invoices was included in the PTC and recovered from default service customers. Tr. 440.

³⁵ Tr. 440-41.

C. NRG Proposal To Reallocate Costs

1. Qualifications of Mr. Peterson

At evidentiary hearings, the ALJs accepted Mr. Peterson as an expert in this proceeding, but they explained that his level of expertise would play a factor in their decision and be given due weight based upon that level.³⁶ Mr. Peterson's testimony both before and after the ALJs' ruling clearly established that his alleged expert testimony regarding cost allocation of utility expenses in this rate proceeding, as well as various opinions he offered regarding default service, prior Commission decisions, PECO filings in other Commission proceedings, and advertising by PECO, should be given no weight at all.

The Commission "abide[s] by the Pennsylvania Supreme Court's standard that a person qualifies as an expert witness if, through education, occupation or practical experience, the witness has a reasonable pretension to specialized knowledge on the matter at issue."³⁷ In this proceeding, Mr. Peterson's lack of the required specialized knowledge was plainly demonstrated.

Mr. Peterson has no relevant utility experience. Aside from his work for NRG relating to PECO's distribution rates in preparation of the Peterson Study, Mr. Peterson's entire experience with respect to electric, gas and water utility companies was limited to accounting work involving legal fees at the Macomb County Public Works Department in Macomb County, Michigan, which builds water, sewer, and drainage systems.³⁸ In order to perform his work for NRG, he testified that he engaged a third-party energy consultant, whose relevant experience and role in the Peterson Study was not established.³⁹ After explaining that he also relied on four

³⁶ Tr. 482.

³⁷ Order, *Manes v. PECO Energy Co.*, Docket No. C-20015803 (Order entered June 14, 2002) (citing *Ruzzi v. Butler Petroleum Co.*, 588 A.2d 1 (Pa. 1991)), p. 3.

³⁸ Tr. 473-74.

³⁹ NRG St. 1-SR, pp. 1-2

other employees at the accounting firm with which he is associated who had some utility experience, Mr. Peterson admitted that the experience of those employees was limited to only three other engagements, none of which involved investor-owned utilities or default service, and that he had not worked on any of those engagements himself.⁴⁰ Mr. Peterson's specific lack of expert ratemaking knowledge and experience was further demonstrated by his incorrect assertion that PECO earns a return on distribution charges,⁴¹ as well as by his acknowledgment on cross-examination that he was unaware of the standard practice of utilities in allocating indirect costs.⁴²

Mr. Peterson had no personal knowledge of several PECO programs to support his opinions about those programs. Mr. Peterson admitted that he had relied upon counsel to explain many aspects of Pennsylvania's utility and default service regulatory framework, including what the PTC is intended to recover, the Commission's statements on unbundling of commodity and distribution costs, and a 1997 order restructuring PECO's generation and distribution operations.⁴³ When asked about his reference to PECO's Standard Offer Program to support his own statement that "default service is broader than the procurement of energy," Mr. Peterson was unable to explain anything at all about the Standard Offer Program.⁴⁴ Similarly, despite testifying that the PTC should include costs associated with other PECO proposals before the Commission relating to microgrids and prepaid electric service because those proposals "would have a direct impact on the competitive market and the provision of default service to customers," Mr. Peterson did not know any details of those proposals he cited, and he admitted

⁴⁰ Tr. 517 and PECO Cross-Examination Exhibit No. 2.

⁴¹ NRG St. 1-SR, p. 33. As Mr. Cohn explained during cross-examination, PECO earns a return on its investment on rate base in distribution service, not on indirect costs of distribution service. Tr. 445-46.

⁴² Tr. 473 & 517-18.

⁴³ Tr. 475.

⁴⁴ NRG St. 1-SR, p. 7; Tr. 487-88.

under cross examination that he had not looked at any of those cited proceedings and instead relied on counsel for that testimony.⁴⁵

Mr. Peterson has no experience to support his opinions regarding advertising or branding. Mr. Peterson repeatedly alleged that PECO used default service or its Commission-mandated energy efficiency programs to “unfairly promote its brand name”⁴⁶ and made additional assertions that PECO was “incentivized” to “build its long-term relationship with customers” and was “portraying itself as the dominant provider of generation service (through default service)”⁴⁷ On cross-examination, Mr. Peterson acknowledged that he was not an expert in consumer advertising or branding, but that he believed he had seen an unspecified reference by PECO to itself as “your energy company.” He did not provide any evidence to support his belief, nor did he provide any instance where PECO claimed to be “the dominant provider of generation service.”⁴⁸

In short, Mr. Peterson lacked both the personal knowledge and specialized knowledge sufficient to support his proposal regarding PECO’s distribution rates and his opinions on other aspects of PECO’s operations and programs. Accordingly, the ALJs should give his testimony no weight in this proceeding.

⁴⁵ NRG St. 1-SR, pp. 9-10; Tr. 491-94.

⁴⁶ See NRG St. 1, p. 37; NRG St. 1-SR, p. 36.

⁴⁷ NRG St. 1-SR, p. 18.

⁴⁸ See Tr. 496-97.

2. NRG's Alternative Cost Allocation

a. Mr. Peterson's Proposal Is Inconsistent With Principles Of Utility Cost Allocation

In this proceeding, PECO witness Jiang Ding described the uncontested principles PECO applied in developing its cost of service study and selecting allocation factors for distribution system costs:

The central element in performing a COS study is the determination of allocation factors based on causal relationships between, on the one hand, customer demands, load profiles and usage characteristics, and, on the other hand, the costs incurred by the Company to meet customers' service requirements imposed by those demands, load profiles and usage characteristics. The primary goals in selecting allocation factors are:

1. The appropriate recognition of cost causality;
2. The stability of study methods and their consistent application over time, so that trends in the direction of class revenues relative to cost of service can properly be discerned from case to case; and
3. Completeness, such that the COS study captures all of the costs that each class imposes on the distribution system.⁴⁹

As Mr. Cohn explained,⁵⁰ Mr. Peterson's proposal to reallocate over \$100 million of distribution system costs based on default service revenues and the number of customers receiving default service under Methodology C entirely fails to meet these bedrock principles for two major reasons.

First, Mr. Peterson's allocation reflected no assessment of the actual costs of PECO's provision of default service – an unsurprising result in light of Mr. Peterson's admission at

⁴⁹ See PECO St. 6, pp. 6-7.

⁵⁰ See PECO St. 9-R, pp. 14-17.

hearing that he prepared his report before discovery in this proceeding.⁵¹ As noted *supra*, Mr. Peterson never sought to determine whether the costs he proposed to allocate were actually caused by any default service function; in fact, he testified that asking about different default service functions performed by PECO employees would be “outside of the scope of what I was requested to do.”⁵²

For example, even after PECO explained that virtually all of the default service revenue received from customers was paid directly to wholesale suppliers in accordance with their power supply contracts,⁵³ Mr. Peterson continued to insist on allocating nearly half of PECO’s \$52 million in FPFTY employee salaries and pension expense to customers receiving default service using his 43% default service revenue ratio, because he believed that portion of administrative salaries and other administrative expenses somehow “must be incurred to support PECO’s default service operations.”⁵⁴ He did not explain why so many employees or expenses are required. Later, Mr. Peterson appeared to conclude that actual labor costs do not matter at all – in his view, it is “immaterial whether any direct salary and wage cost is for default service.”⁵⁵

Similarly, Mr. Peterson asserted that call center costs – which PECO assigned to all distribution customers based on a weighted average of residential, small commercial, and industrial customers⁵⁶ – should instead be divided, with 66% allocated to customers receiving

⁵¹ Tr. 485.

⁵² Tr. 472.

⁵³ PECO St. 9-R, p. 16.

⁵⁴ NRG St. 1-SR, pp. 27-28 and Tr. 468-71.

⁵⁵ NRG St. 1-SR, pp. 43-44 (emphasis added).

⁵⁶ See PECO St. 6, pp. 23-24.

default service. He did not provide any basis to conclude that call center costs are driven by the number of customers receiving default service.⁵⁷

Second, Mr. Peterson's choice of default service-based ratios for the allocation of such costs as PECO's physical buildings and employee salaries do not correspond with cost causality. Mr. Cohn described how Mr. Peterson's allocations would lead to PECO losing money as more customers shop, since PECO would continue to incur the costs that Mr. Peterson proposed to allocate to default service customers.⁵⁸ These losses would increase as PECO continues to promote retail competition in accordance with Commission requirements and more customers shop for electricity.⁵⁹ Mr. Peterson acknowledged that he had not determined what might happen under his proposal at different levels of shopping by distribution customers, and he could only offer a "guess" as to the effect of a five-percent change in customer shopping.⁶⁰

Notably, Mr. Peterson's assertion that his proposed reallocation is necessary because PECO witness Ding did not "take the additional step" of allocating costs between distribution service and default service is only a restatement of his assumption that there are costs allocated to distribution operations that are caused by the provision of default service. Mr. Peterson admits that he does not know of any United States utility that allocates indirect expenses to default service as he has proposed,⁶¹ and nothing in his testimony demonstrates that his proposed allocators better reflect the actual causation of PECO's costs of service described by Ms. Ding.

⁵⁷ Tr. 441-42 & 498. Similarly, Mr. Peterson proposed to allocate administrative costs "incurred to communicate with default service customers including, but not limited to, expenses related to printing and postage" even though he acknowledged he had no idea whether PECO sends any special mailings to distribution customers that receive default service. *See* NRG St. 1-SR, p. 8 & Tr. 491.

⁵⁸ PECO St. 9-R, pp. 17-18; Tr. 442.

⁵⁹ *See* PECO St. 1, pp. 24-25 (describing PECO initiatives to enhance retail competition).

⁶⁰ Tr. 502-03.

⁶¹ *See* PECO St. 9-R, p. 11 & Exhibit ABC-2.

b. Mr. Peterson’s “Separate Operating Division” Argument Does Not Justify His Reallocation of Distribution System Costs

In the absence of any actual causation analysis, Mr. Peterson contends that his allocation of between 43% and 66% of various distribution system costs to customers receiving default service is still appropriate because PECO would “necessarily incur these types of expenses” if it “were to operate a separate functional division that provides default service.”⁶² Having assumed that PECO would incur \$100 million in various costs **if** it were to operate a separate division providing default service, Mr. Peterson argues that PECO’s distribution operations and its provision of default service **should** be treated as “separate operating divisions” to support his proposal. The Commission should reject his argument.

As a factual and legal matter, default service is not an “operating division” or “business line” of PECO. PECO is an EDC in the business of distributing electricity to its customers, and default service is for all distribution customers who have not chosen an EGS or whose EGS ceases to provide generation service to such customers.⁶³ PECO is required to provide this service for all of its distribution customers under Pennsylvania law and the Orders of this Commission, and it must do so without profit and in accordance with the Commission’s requirements.⁶⁴ The provision of actual generation service for delivery to customers is contracted to wholesale suppliers and administered by PECO’s EA team as Mr. Cohn described.⁶⁵

In support of his contention that the provision of default service must nevertheless be treated as a separate division of PECO, Mr. Peterson relies heavily on a 1997 decision of the

⁶² NRG St. 1-SR, p. 3.

⁶³ PECO St. 9-R, p. 10.

⁶⁴ *See id.* & Section IV.B *supra*.

⁶⁵ *See* Section IV.B *supra*.

Commission regarding PECO’s restructuring following the enactment of the Electricity Generation Customer Choice and Competition Act (the “Competition Act”)⁶⁶ in which the Commission agreed with the OCA that PECO’s administrative expenses should be allocated as if PECO were to separate its generation and distribution business into “functionally separate divisions.”⁶⁷ But this reliance is entirely misplaced: as both Mr. Cohn and OCA witness Clarence Johnson explained, the 1997 decision involved a very different company, with two distinct business groups.⁶⁸ At the time, the generation business had thousands of employees (twice the number of distribution operations employees) and significant income on a standalone basis.⁶⁹ Moreover, the Commission approved allocation of administrative expenses between generation and distribution based upon a labor allocator in 1997, and that decision provides no support for allocation of administrative expenses based on default service revenues or the number of customers served as Mr. Peterson advocates.⁷⁰

Similarly, Mr. Peterson’s implicit suggestion that the Commission has neglected its policy of ensuring that default service costs are not included in distribution rates in the absence of a consideration of his proposal is unfounded.⁷¹ In approving PECO’s distribution rates, the Commission has a fundamental obligation to consider whether PECO’s rates are just, reasonable, and in accordance with law.⁷² This obligation applies even in the context of a settlement; as the Commission explained in approving the settlement of PECO’s 2015 distribution rate proceeding,

⁶⁶ 66 Pa.C.S. § 2801 *et seq.*

⁶⁷ Opinion and Order, *Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement*, Docket No. R-00971265 (Order entered December 29, 1997), p. 58.

⁶⁸ PECO St. 9-R, p. 12 & OCA St. 3R, p. 7.

⁶⁹ Tr. 443.

⁷⁰ *See id.*

⁷¹ *See* NRG St. 1-SR, pp. 12-13.

⁷² 66 Pa.C.S. § 1308(c).

“[d]espite the policy favoring settlements, the Commission does not simply rubber stamp settlements without further inquiry. In order to accept a settlement such as those proposed here, the Commission must determine that the proposed terms and conditions are in the public interest.”⁷³

Despite Mr. Peterson’s repeated refrain that businesses typically allocate costs across business lines using his “widely accepted” allocators of revenue and number of customers,⁷⁴ Mr. Peterson acknowledged that he did not know of any utility in the United States that provides default service through a separate division or allocates indirect expenses as if it operates a separate default service division as he proposed.⁷⁵ While Mr. Peterson suggests that Pennsylvania should be the first state to require his allocation methodology to continue its role as a national leader for retail electric choice,⁷⁶ he provides no evidence that such an action would, in fact, be consistent with responsible leadership. In fact, it is not. Allocating costs to default service that artificially inflate the PTC is fundamentally inconsistent with principles that properly should guide the development of a competitive retail electricity market. The Commission should reject Mr. Peterson’s suggestion that responsible “leadership” would require the Commission to put a “thumb on the scale” to drive the PTC above the level that is justified by sound and well-accepted cost-allocation principles that have been approved by this Commission in numerous base-rate and default-service proceedings.

⁷³ Opinion and Order, *Pennsylvania Public Utility Commission v. PECO Energy Company*, Docket No. R-2015-2468981 (Order entered December 17, 2015), p. 8.

⁷⁴ See, e.g., NRG St. No. 1-SR, pp. 5 & 34.

⁷⁵ PECO St. 9-R, p. 11.

⁷⁶ NRG St. 1-SR, p. 20.

D. Effects Of NRG's Proposal

In his written testimony, Mr. Peterson asserted that his proposal would have no “net effect” on PECO’s operations because he believed that PECO would recover all of the costs it currently incurs.⁷⁷ At hearing, however, Mr. Peterson acknowledged that he had done no “sensitivity analysis” regarding the effects of his proposal to increase the PTC and could only “guess” as to what level of customer shopping would make his proposed cost allocation unreasonable.⁷⁸

As Mr. Cohn explained, if all customers decide to shop (which they are free to do), PECO would not recover any of its distribution expenses allocated to default service by Mr. Peterson, even though all those distribution costs would remain.⁷⁹ And while Mr. Peterson suggested that such a result would be “dramatic,” he provided no evidence as to what customers are likely to do if the price of default service is increased by 15%. Mr. Peterson’s failure to consider the effects of shopping on his cost allocation is a significant omission and further undermines his proposal – and expertise.

E. Additional Issues

In attempting to support his proposed cost allocation, Mr. Peterson argues that PECO is “motivated” to include indirect expenses in distribution costs because “PECO earns a rate of return on distribution charges.”⁸⁰ In addition, in response to Mr. Cohn’s explanation that PECO does not compete to provide generation service and makes no profit from default service, Mr. Peterson suggests that PECO should be “indifferent” to his proposal but instead remains motivated to provide default service to make other programs that earn a return on investment

⁷⁷ NRG St. 1-SR, pp. 33-34.

⁷⁸ Tr. 503.

⁷⁹ PECO St. 9-R, p. 17.

⁸⁰ NRG St. 1-SR, p. 18.

more “palatable.”⁸¹ Mr. Peterson also asserts that PECO should be including other expenses in the PTC, including regulatory, litigation, and education expenses, on the grounds that PECO’s other programs have an impact on default service and PECO’s energy efficiency and conservation (“EE&C”) programs provide an opportunity to educate customers about default service.⁸²

The Commission should reject all of these arguments. As noted *supra*, PECO does not earn a return on distribution charges.⁸³ And while PECO does not earn a profit on default service, it cannot be indifferent to a proposal that will misallocate distribution system costs and result in losses to PECO as customers shop.⁸⁴ Mr. Peterson also offered no evidence to support his contentions regarding PECO’s other proposals and programs, conceding that he was unfamiliar with the regulatory proposals on which he based his opinion and could not identify any instance where PECO portrayed itself as “the dominant provider of generation service (through default service)” as he claimed.⁸⁵

F. Summary

PECO’s Main Brief is summarized in Section III.

⁸¹ *Id.*

⁸² NRG St. 1-SR, pp. 11-12.

⁸³ See Section IV.C.1 & n.40 *supra*.

⁸⁴ PECO St. 9-R, p. 17 & Tr. 442.

⁸⁵ See NRG St. 1-SR, p. 18, Tr. 493-94 & Tr. 496-97.

VI. CONCLUSION

For the reasons set forth above, the Commission should reject NRG's proposal to reallocate distribution system costs as presented by Mr. Peterson and adopt the Joint Petition.



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Dated: September 7, 2018

Counsel for PECO Energy Company

APPENDIX A

PROPOSED FINDINGS OF FACT

1. On March 29, 2018, PECO Energy Company (“PECO” or “the Company”) filed with the Pennsylvania Public Utility Commission (“Commission”) Tariff Electric – Pa. P.U.C. No. 6 (“Tariff No. 6”). Tariff No. 6 reflects an increase in annual distribution revenue of approximately \$82 million, or 2.2% of PECO’s total Pennsylvania jurisdictional operating revenues. Accompanying Tariff No. 6, PECO filed the supporting data required by the Commission’s regulations (52 Pa. Code § 53.52 *et seq.*) for a historic test year (“HTY”) ended December 31, 2017, a future test year (“FTY”) ending December 31, 2018 and a fully projected future test year (“FPFTY”) ending December 31, 2019. The Company’s supporting information included the prepared direct testimony of eight initial witnesses and the various exhibits sponsored by them.

2. On August 28, 2018, a Joint Petition for Partial Settlement (the “Joint Petition”) was filed on behalf of PECO, the Commission’s Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, the Philadelphia Area Industrial Energy Users Group, the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania, the Tenant Union Representative Network and Action Alliance of Senior Citizens of Greater Philadelphia, the Community Action Association of Pennsylvania, Tesla, Inc., ChargePoint, Inc., and Wal-Mart Stores East, LP and Sam’s East, Inc.

3. The settlement set forth in the Joint Petition resolves all issues in this proceeding except for a proposal by NRG Energy, Inc. (“NRG”), to reallocate over \$100 million in distribution system costs to residential distribution customers receiving default service.

A. PECO's Provision Of Default Service

4. PECO provides default electric generation service to retail electric customers within its service territory who do not select an electric generation supplier ("EGS") or who return to default service after being served by an EGS that becomes unable or unwilling to serve them. PECO St. 9-R, p. 3.

5. Every customer who receives default service from PECO is a distribution service customer, and PECO provides electric distribution service without regard to whether a customer also receives default service. PECO St. 9-R, p. 3.

6. PECO files plans with the Commission that set forth how PECO will meet its default service obligations. The Commission reviews PECO's default service plans and approves a plan if it is consistent with the Pennsylvania Public Utility Code and the Commission's regulations. To date, the Commission has approved four PECO default service plans, with the current plan in effect until May 31, 2021. PECO St.- 9-R, p. 3.

7. The Commission has also reviewed PECO's distribution rates twice – once in 2010 and again in 2015 – and determined that those distribution rates were just and reasonable. PECO St. 9-R, p. 8.

8. In accordance with the default service plans approved by the Commission, PECO conducts competitive procurements and enters into wholesale power contracts and associated services for three different default service customer classes: Residential, Small Commercial (up to 100 kW annual peak demand and lighting customers), and Medium/Large Commercial (greater than 100 kW annual peak demand). PECO St 9-R, p. 3.

9. The principal procurement feature of PECO's wholesale power contracts for residential customers receiving default service is the use of fixed-price, full requirements supply contracts. Under these contracts, winning bidders in PECO's competitive procurements are responsible for assuming, managing, and covering the financial costs and risks associated with electricity supply for a percentage of residential customers, including all required energy, capacity, and ancillary services, as well as alternative energy credits required for compliance with Pennsylvania's Alternative Energy Portfolio Standards Act, 73 P.S. § 1643.1 *et seq.* ("AEPS" or "AEPS Act"). Each wholesale power supplier must satisfy this obligation, regardless of how much market prices or generation costs may increase during the delivery period and regardless of the default service load level (since the supplier is serving a percentage of whatever the default service load is at any given time). PECO St. 9-R, p. 4.

10. PECO recovers the default service costs for each customer class through a class-specific generation supply adjustment charge and a transmission service charge set forth in its electric tariff. The price per kilowatt-hour charged under each Generation Supply Adjustment ("GSA") and the transmission service charge ("TSC") is the Price-to-Compare ("PTC") for the applicable customer class and is updated at least quarterly as required by the Commission. PECO St. 9-R, pp. 4-5.

11. PECO recovers all of the costs of the wholesale power contracts in the PTC as well as default service administrative costs (including the cost of an independent evaluator to oversee the procurement process), working capital, information technology costs, education costs, and regulatory and litigation costs associated with PECO's default service plan. PECO St. 9-R, pp. 5-7.

12. PECO's Energy Acquisition team, or "EA," is responsible for the PECO service territory load's interaction with wholesale electric markets, electric and gas choice coordination responsibilities, payments and associated accounting for PECO natural gas supply, transportation, and storage contracts, and wholesale default supply purchase agreements. In the electric sector, EA manages all of the accounting and administrative functions associated with the continuous delivery of electric energy from the wholesale energy market operated by PJM Interconnection, Inc. ("PJM") to PECO's electric distribution system customers, whether they shop with an EGS or receive default service. Tr. 439-41.

13. Nineteen employees work in the EA team, and the largest group supports electric and gas customer choice. It is EA's responsibility to match each distribution customer's wholesale load responsibility to their retail provider (whether that is one of over 100 electric generation suppliers or nine wholesale default suppliers) and provide that information daily to PJM for proper PJM billing. Tr. 439-40.

14. Virtually all (more than 90%) of the amounts recovered through the residential PTC are paid directly to wholesale suppliers. PECO St. 9-R, p. 15.

15. Monthly invoices of default service suppliers are automatically generated, reviewed by one EA employee, and approved for payment in accordance with PECO's established payment procedures. Tr. 440.

16. PECO includes the costs of the EA team in distribution rates. EA costs are not separately allocated to customers receiving default service, and EGSs are not charged for services provided on behalf of EGSs by the EA team. Tr. 440-41.

17. PECO is not permitted to make a profit from the provision of default service. PECO St. 9-R, p. 4.

B. NRG's Proposal To Reallocate Distribution System Costs

18. NRG witness Chris Peterson asserted that PECO has allocated more than \$100 million of costs in PECO's FPFTY to all residential distribution service customers that should be allocated only to residential distribution service customers receiving default service. NRG St. 1, p. 6.

19. Mr. Peterson believed that PECO could not project over \$637 million in annual default service revenues without incurring the administrative costs of the type and magnitude he identified. NRG St. 1-SR, p. 8.

20. Mr. Peterson's proposed reallocation would increase the price that residential customers pay for default service by fifteen percent. NRG St. 1, p. 6.

21. The costs Mr. Peterson proposed to reallocate included administrative and general expenses (such as sales, employee pensions and benefits, and office supplies), customer service expenses (including customer assistance), sales expenses, and depreciation and amortization expense of PECO's common plant, intangible plant, and general plant. NRG St. 1, p. 17.

22. In calculating the costs to be reallocated to residential customers receiving default service, Mr. Peterson applied a ratio of 43% derived from projected default service revenues and PECO's total projected electric distribution revenues. He also used a ratio of 66% based on a projected number of distribution customers receiving default service and the total number of projected distribution customers. He applied the 43% ratio or the 66% ratio to PECO's FPFTY

distribution costs based upon his view as to whether the cost was more related to default service revenues or the number of distribution customers receiving default service. NRG St. 1, pp. 25-30; Tr. 468-71.

23. A determination of the costs of service requires an appropriate recognition of cost causality. PECO St. 6, p. 6.

24. Mr. Peterson prepared his proposal before discovery in this proceeding. Tr. 485.

25. Mr. Peterson did not determine whether the costs he proposed to allocate were actually associated with any default service function performed by PECO employees. Such a determination was outside the scope of the work he was requested to do by NRG. Tr. 472.

26. Mr. Peterson is unaware of the standard practice of utilities in allocating indirect costs. Tr. 473.

27. The distribution service costs Mr. Peterson proposes to allocate to default service customers are not a function of the number of distribution customers that receive default service or the amount such customers pay for default service. PECO St. 9-R, pp. 15-18.

28. Mr. Peterson did not know of any utility in the United States that allocated indirect expenses as he proposed. PECO St. 9-R, p. 11 & Exhibit ABC-2.

29. Despite proposing that PECO's provision of default service should be viewed as a separate "operating division," Mr. Peterson could not identify any utility in the United States that operates a separate default service division. PECO St. 9-R, p. 11 & Exhibit ABC-2.

30. Mr. Peterson did not identify the costs that PECO would not incur if it did not provide default service. Tr. 497.

31. Mr. Peterson did not provide any basis to conclude that call center costs are driven by the number of customers receiving default service. Tr. 441-42 & 498.

32. Mr. Peterson's entire experience with respect to electric, gas and water utility companies was limited to accounting work involving legal fees at the Macomb County Public Works Department in Macomb County, Michigan, which builds water, sewer, and drainage systems. Tr. 473-74.

33. Mr. Peterson relied on the experience of other employees at the accounting firm with which he is associated, but the experience of those employees was limited to only three other engagements (none of which involved investor-owned utilities or default service), and Mr. Peterson did not work on any of those engagements himself. Tr. 516-17; PECO Cross-Examination Exhibit No. 2.

34. Mr. Peterson believes that PECO earns a return on distribution charges, which is not correct. NRG St. 1-SR, p. 33; Tr. 445-46.

35. Mr. Peterson had no personal knowledge of several existing and proposed PECO programs on which he offered opinions, including PECO's Standard Offer Program, PECO's proposed microgrid program, and PECO's prepaid electric service proposal, and he did not review related proceedings cited in his testimony. Tr. 487-88 & 491-94.

36. Mr. Peterson is not an expert in consumer advertising or branding. Tr. 497.

37. Mr. Peterson acknowledged that he had not determined what might happen under his proposal at different levels of shopping by distribution customers, and he could only offer a “guess” as to the effect of a five-percent change in customer shopping. Tr. 502-03.

38. Under Mr. Peterson’s allocations, PECO would lose money as more customers shop since PECO would continue to incur the costs that Mr. Peterson proposed to allocate to default service customers. PECO St. 9-R, pp. 17-18 & Tr. 442.

39. When the Commission issued its 1997 order on the restructuring of PECO after enactment of the Electricity Generation Customer Choice and Competition Act (the “Competition Act”), PECO’s operations included an energy generation business with thousands of employees (twice the number of employees of its distribution operations), substantial income on a standalone basis, and significant administrative requirements. PECO St. 9-R, p. 12; OCA St. 3R, p. 7; Tr. 443.

PROPOSED CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter and parties to this proceeding.

2. The settlement rates, terms and conditions contained in the Joint Petition for Partial Settlement at Docket No. R-2018-3000164 filed by PECO Energy Company, the Commission’s Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, the Philadelphia Area Industrial Energy Users Group, the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania, the Tenant Union Representative Network and Action Alliance of Senior Citizens of Greater Philadelphia, the Community Action Association of Pennsylvania, Tesla, Inc., ChargePoint, Inc., and Wal-

Mart Stores East, LP and Sam's East, Inc. are just, reasonable and in the public interest without modification, including modifications proposed by NRG Energy, Inc.

PROPOSED ORDERING PARAGRAPHS

3. That the Joint Petition for Partial Settlement filed at Docket No. R-2018-3000164 on August 28, 2018, by PECO Energy Company, the Commission's Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, the Philadelphia Area Industrial Energy Users Group, the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania, the Tenant Union Representative Network and Action Alliance of Senior Citizens of Greater Philadelphia, the Community Action Association of Pennsylvania, Tesla, Inc., ChargePoint, Inc., and Wal-Mart Stores East, LP and Sam's East, Inc. is approved without modification.

4. That PECO Energy Company shall be permitted to file a tariff supplement incorporating the terms of the Joint Petition and changes to rates, rules and regulations as set forth in Appendix A of the Joint Petition, to become effective upon at least one (1) days' notice after the date of entry of this Opinion and Order, for service rendered on and after January 1, 2019, which tariff supplement increases PECO Energy Company's rates so as to produce an annual increase in electric operating revenues of \$85.5 million, which is reduced to \$14.9 million following the application of 2019 tax savings related to Tax Cuts and Jobs Act. The revenue requirement is further adjusted to account for the roll-in of Distribution System Improvement Charge revenue for a net revenue increase of \$24.9 million as shown in the proof of revenues provided in Appendix B of the Joint Petition.

5. That the Formal Complaint filed by the Office of Consumer Advocate at Docket No. C-2018-3001112 be deemed satisfied and marked closed.

6. That the Formal Complaint of the Office of Small Business Advocate at Docket No. C-2018-3001043 be deemed satisfied and marked closed.

7. That the Formal Complaint of the Philadelphia Area Industrial Energy Users Group at Docket No. C-2018-3001471 be deemed satisfied and marked closed.

8. That upon Commission approval of the tariff supplement filed by PECO Energy Company in compliance with the Commission's Order, the investigation at Docket No. R-2018-3000164, be marked closed.

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