

**PECO ENERGY COMPANY
STATEMENT NO. 9-R**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION
v.
PECO ENERGY COMPANY

DOCKET NO. R-2018-3000164

REBUTTAL TESTIMONY

WITNESS: ALAN B. COHN

SUBJECTS: DEFAULT SERVICE AND ALLOCATION
OF INDIRECT COSTS

DATED: JULY 24, 2018

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1 **REBUTTAL TESTIMONY**
2 **OF**
3 **ALAN B. COHN**

4 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

5 **1. Q. Please state your full name, professional position and business address.**

6 A. My name is Alan B. Cohn. I am employed by PECO Energy Company as Manager
7 of Regulatory Strategy. My business address is PECO Energy Company, 2301
8 Market Street, Philadelphia, Pennsylvania 19103.

9 **2. Q. Please describe your educational background.**

10 A. I received a Bachelor of Science Degree in Commerce and Engineering from Drexel
11 University in 1980. In 1985, I received a Master's Degree in Business
12 Administration from Drexel. In addition, I have completed the American Gas
13 Association ("AGA") Gas Rate Fundamentals Course at the University of Wisconsin
14 and the AGA Advanced Gas Rate Course at the University of Maryland.

15 **3. Q. Please describe your work experience with PECO.**

16 A. Upon graduation from college in 1980, I was hired by PECO as a Rate Analyst in the
17 Cost and Load Analysis Section of the Rate Division. In 1987, I was appointed
18 Supervisor of the Economic Analysis Section in PECO's Rates and Regulatory
19 Affairs Division. Since that time, I have held various management positions in
20 PECO's Rates and Regulatory Affairs Department and Strategic Planning Department
21 with responsibility for managing base rate case filings, cost of service studies and
22 financial and economic analyses.

1 **4. Q. Have you previously testified before this Commission or other regulatory**
2 **bodies?**

3 A. Yes. I have testified in regulatory proceedings before the Pennsylvania Public Utility
4 Commission (“Commission”), the Federal Energy Regulatory Commission and the
5 Maryland Public Service Commission. A listing of the cases in which I have
6 submitted testimony is attached hereto as Exhibit ABC-1.

7 **5. Q. Have you previously submitted testimony in this proceeding?**

8 A. No, I have not.

9 **6. Q. What is the purpose of your rebuttal testimony?**

10 A. The purpose of my rebuttal testimony is to respond to the testimony of NRG Energy
11 (“NRG”) witness Chris Peterson, who asserts that PECO has improperly allocated
12 over \$100 million in distribution service costs for residential customers. Mr. Peterson
13 believes that these costs should be re-allocated to PECO’s default service obligations
14 and recovered from residential customers who receive default service from PECO.

15 After providing a brief overview of PECO’s default service obligations, I explain how
16 Mr. Peterson’s testimony reflects a misunderstanding of PECO’s default service
17 program as well as utility cost accounting principles applied by this Commission and
18 does not support any reallocation of distribution service costs.

1 **II. PECO’S PROVISION OF DEFAULT SERVICE**

2 **7. Q. Mr. Cohn, what is PECO’s default service obligation?**

3 A. PECO is obligated to provide electric generation service to all distribution service
4 customers within its service territory who do not select an electric generation supplier
5 (“EGS”) or who return to default service after being served by an EGS which
6 becomes unable or unwilling to serve its customers. Every customer who receives
7 default service from PECO is a distribution service customer, and PECO provides
8 distribution service without regard to whether a customer also receives default
9 service.

10 As default service provider, PECO is required to file a plan with the Commission
11 which sets forth how PECO will meet its default service obligations, including a
12 strategy for procuring generation supply and a rate design to recover the costs of
13 providing default service. The Commission reviews PECO’s default service plans
14 and approves a plan if it is consistent with the Public Utility Code and the
15 Commission’s regulations. To date, the Commission has approved four PECO
16 default service plans, with the current plan in effect until May 31, 2021.

17 **8. Q. How does PECO meet its default service obligation?**

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

1 The principal procurement features of PECO's wholesale power contracts for
2 residential customers receiving default service (who are the focus of Mr. Peterson's
3 testimony) is the use of fixed-price, full requirements supply contracts. Under these
4 contracts, winning bidders in PECO's competitive procurements are responsible for
5 assuming, managing, and covering the financial costs and risks associated with
6 electricity supply for a percentage of residential customers, including all required
7 energy, capacity, and ancillary services, as well as alternative energy credits required
8 for compliance with Pennsylvania's Alternative Energy Portfolio Standards ("AEPS")
9 Act. The wholesale power supplier must satisfy this obligation, regardless of how
10 much market prices or generation costs may increase during the delivery period and
11 regardless of the default service load level (since the supplier is serving a percentage
12 of whatever the default service load is at any given time).

13 **9. Q. Does PECO earn a profit in providing default service?**

14 A. No, it does not. Under the Pennsylvania Public Utility Code, PECO is entitled to
15 recover all reasonable costs of providing default service under its approved
16 procurement plan. The Commission has not authorized PECO (or any other electric
17 distribution company ("EDC")) to earn a profit on the provision of default service.

18 **10. Q. How does PECO recover its default service costs?**

19 A. PECO recovers the costs of default service for each customer class through a class-
20 specific generation supply adjustment ("GSA") charge and a transmission service
21 charge ("TSC") set forth in its electric tariff. The price per kilowatt-hour charged

1 under each GSA and the TSC is the “Price to Compare,” or “PTC,” for the applicable
2 class and is updated at least quarterly as required by the Commission.

3 **11. Q. What types of costs are included in the PTC?**

4 A. In a Policy Statement regarding default service and retail electric markets (52 Pa.
5 Code § 69.1808), the Commission identified the types of costs that should be
6 recovered from default service customers. As the Policy Statement explains:

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

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

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

14 (3) Supply management costs, including supply bidding, contracting,
15 hedging, risk management costs, any scheduling and forecasting services
16 provided exclusively for default service by the EDC, and applicable
17 administrative and general expenses related to these activities.

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

22 (5) Applicable taxes, excluding Sales Tax.

23 (6) Costs for alternative energy portfolio standard compliance.
24

25 **12. Q. Does PECO’s PTC include each of these types of costs?**

26 A. Yes, it does. All of the costs of the wholesale power supply contracts I have
27 described, including the costs of energy, transmission, congestion, and AEPS
28 compliance are included in the PTC in accordance with 52 Pa. Code § 69.1808(a)(1),

1 (2), (5), and (6). To the extent that a supplier chooses to engage in hedging, risk
2 management, or similar activities as part of providing energy and other services under
3 its wholesale power contract, the costs of those supplier activities must be borne by
4 the supplier and included in its wholesale contract price, as well as any supplier
5 administrative costs. Supply procurement and administrative costs that are associated
6 with the wholesale power supply contracts, which include the costs of a default
7 service independent evaluator to oversee the procurement process and a charge for
8 working capital, are also included in the PTC as permitted by Section 69.1808(a)(3)
9 and (4). Regulatory costs and litigation costs associated with PECO's default service
10 plans are also recovered through the PTC.

11 **13. Q. Are information technology costs included in the PTC?**

12 A. Yes, when the information technology ("IT") costs relate specifically to the provision
13 of default service. For example, as part of PECO's second default service plan,
14 PECO sought – and the Commission approved – recovery of the capital costs for IT
15 upgrades necessary to implement the plan and those costs were included in the PTC.

16 **14. Q. Are any billing or collection costs included in the GSA?**

17 A. No, since all customers receiving default service are also PECO distribution
18 customers and already receive a PECO bill.¹

¹ I note that Mr. Peterson does not seek to allocate billing and collection costs to default service customers in light of the fact that many EGSs participate in PECO's purchase-of-receivables ("POR") program. *See* NRG St. No. 1, p. 23. Under this program, PECO purchases the amounts owed to EGSs by customers for electric generation service at full value and assumes responsibility for billing and collecting those amounts.

1 15. Q. What type of education costs are included in the PTC?

2 A. Costs associated with educating customers about retail market enhancements not paid
3 for by EGSs may be included in the PTC. The PTC does not include costs associated
4 with educating customers about the benefits of shopping for electricity, which are
5 recovered from all distribution service customers.

6 16. Q. Are any costs recovered for generation owned by PECO?

7 A. No. PECO does not own any generation.

8 17. Q. Mr. Peterson notes (p. 13) that the Commission’s Policy Statement includes a
9 provision stating that “EDC rates should be scrutinized for any generation
10 related costs that remain embedded in distribution rates.” Has the Commission
11 scrutinized PECO’s rates?

12 A. Yes. When the Policy Statement was issued, most Pennsylvania EDCs were in
13 transition periods under the Electricity Generation Customer Choice and Competition
14 Act (the “Competition Act”) with rates established during the restructuring of
15 Pennsylvania’s electric industry. The full provision of the Policy Statement (52 Pa.
16 Code § 69.1808(b)) makes this clear:

17 (b) EDC rates should be scrutinized for any generation related costs that remain
18 embedded in distribution rates. This review should occur no later than the next
19 distribution rate case for each EDC filed after September 15, 2007. The
20 Commission may initiate a cost allocation case for an EDC on its own motion if
21 such a case is not initiated by December 31, 2007. Changes to rates resulting from
22 the examination would take effect after the expiration of Commission-approved
23 rate caps.

1 Consistent with the Policy Statement, the Commission has reviewed PECO's
2 distribution rates twice – once in 2010 and again in 2015 – and determined that those
3 distribution rates were just and reasonable. In addition, the Commission has
4 considered PECO's default service rate design (including the costs that would be
5 recovered in the PTC) four separate times in its approvals of PECO's default service
6 programs.

7 **18. Q. Were you involved in any of those proceedings?**

8 A. Yes. As set forth on Exhibit ABC-1, I testified regarding PECO's distribution rates
9 and cost allocation in both the 2010 and 2015 PECO rate cases as well as on default
10 service rate design in each of PECO's four default service program proceedings.

11 **19. Q. Do you believe PECO's allocation of default service costs to the PTC is**
12 **consistent with Commission requirements, including the most recent orders**
13 **approving PECO's distribution rates and default service plan?**

14 A. Yes, I do.

15 III. ALLOCATION OF INDIRECT COSTS

16 **20. Q. Mr. Cohn, please summarize Mr. Peterson's contentions regarding default**
17 **service and his proposals regarding indirect cost allocation.**

18 A. In his direct testimony, Mr. Peterson asserts (pp. 4-5) that there is more than \$100
19 million of "disproportionate" costs allocated by PECO to residential distribution
20 service customers which he believes should be allocated to those residential
21 customers receiving default service. Mr. Peterson's assertion rests primarily on his

1 claim that a “significant portion” of PECO’s expenses “reasonably support”
2 residential default service since PECO provides default service to approximately 66
3 percent of its residential customers and those costs would be incurred if default
4 service was provided through a division of PECO separate from its distribution
5 operations (pp. 17-18). The remainder of Mr. Peterson’s testimony (and the “utility
6 rate study” he attaches to his testimony) largely consist of his re-allocation of
7 distribution expenses in PECO’s fully projected future test year (“FPFTY”) to default
8 service customers using the ratio of residential default service revenues to total
9 distribution service revenues, the ratio of residential customers receiving default
10 service to all residential customers, and a ratio that is a hybrid of the revenue-based
11 and customer-based ratios. Based on his recommended re-allocations, he calculates a
12 PTC that he contends will assist customers in making “apples-to-apples” decisions in
13 shopping for electricity and avoid “overcharging” customers for distribution service.²
14 In addition, Mr. Peterson speculates (p. 6) that PECO may want a lower PTC to “gain
15 an unfair competitive advantage in the marketplace” through an ability to “attract and
16 retain residential default service customers.”

17 **21. Q. Let’s first address Mr. Peterson’s speculation that PECO has an interest in a**
18 **lower PTC as an “unfair competitive advantage” in attracting and retaining**
19 **default service customers. Is he correct?**

20 A. No. As I have explained, PECO makes no profit from providing default service to its
21 distribution customers or standing ready to serve those customers who return to

² NRG St. No. 1, p. 7 & Exhibit CP-3, p. N15.

1 default service after shopping with an EGS. The Company is required to be able to
2 provide default service to **all** of its distribution customers under Pennsylvania law and
3 the Orders of this Commission, regardless of whether the customer shops or does not
4 shop for electricity. Default service is not an area in which PECO seeks to “compete”
5 with EGSs or any other entity.

6 **22. Q. Do you believe Mr. Peterson otherwise portrays PECO’s provision of default**
7 **service correctly?**

8 A. No, I do not. Mr. Peterson refers to PECO’s distribution service and default service
9 as two “operating divisions” (p. 29) and “business lines” (Ex. CP-3, p. N13), which is
10 fundamentally wrong. PECO is an electric distribution company in the business of
11 distributing electricity to its customers. Default service is not a separate “operating
12 division,” but a service to distribution customers in the form of electric generation
13 provided by wholesale suppliers under Commission-approved contracts with PECO
14 to meet the electricity needs of those customers who have not chosen an EGS or
15 whose EGS decides to cease providing service to such customers. PECO customers
16 are not distribution customers **or** default service customers; they are distribution
17 customers who may or may not receive default service, which PECO provides at its
18 cost and without profit in accordance with the requirements of the Commission.

1 **23. Q. Do you agree with Mr. Peterson’s contention that the provision of default service**
2 **should be treated as a separate operating division of PECO for purposes of cost**
3 **allocation?**

4 A. No. In fact, Mr. Peterson cannot identify a single U.S. electric utility that provides
5 residential default service through a separate default service division, nor can he
6 identify any electric utility that allocates indirect expenses associated with residential
7 default service using any of the approaches he has recommended in this proceeding.³

8 **24. Q. Does Mr. Peterson cite any decisions of this Commission that he believes support**
9 **treatment of the provision of default service as a separate division of PECO?**

10 A. Yes. Mr. Peterson relies upon a decision of the Commission during PECO’s 1997
11 restructuring proceedings in which the Commission rejected a proposal by PECO to
12 “unbundle” its generation, distribution and transmission rates.⁴ As Mr. Peterson
13 notes, the Commission at the time agreed with testimony of a witness for the Office
14 of Consumer Advocate (“OCA”) that the unbundling of generation, transmission and
15 distribution rates in restructuring “should produce results that should look like what
16 functional costs would be if PECO were to separate itself into functionally separate
17 divisions.”⁵

³ See Response to PECO-NRG-II-12 and PECO-NRG-II-14, attached as Exhibit ABC-2.

⁴ 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*, R-00971265 (Order entered Dec. 29, 1997) (“1997 Restructuring Order”).

⁵ *Id.*, pp. 57-58.

1 25. Q. Do you believe that this 1997 decision supports Mr. Peterson’s views of default
2 service as a separate (or separable) business line and is “as valid today as [it was]
3 over twenty years ago,” as he contends (p. 10)?

4 A. No, I do not. What Mr. Peterson ignores in his discussion of the 1997 Restructuring
5 Order is that at the time, PECO was a very different company – one that included
6 generation operations with twice the employees of its distribution operations.⁶ The
7 1997 Restructuring Order reflects Commission concern regarding the allocation of
8 administrative expense between two different business groups with significant
9 administrative requirements. Notably, the allocator adopted by the Commission to
10 address the administrative expense of PECO’s generation and distribution operations
11 was neither revenues nor customers, nor some hybrid of the two, as Mr. Peterson
12 proposes in this proceeding; instead, the Commission allocated administrative
13 expense based upon the number of employees working in generation and distribution
14 operations.⁷

15 Twenty years later, PECO does not have a generation business and is no longer at the
16 beginning of the restructuring era. And PECO’s rates and those of other EDCs have
17 been subject to scrutiny in both default service proceedings and in distribution rate
18 proceedings where the Commission has “strived to address” the need to ensure that
19 the PTC reflects all costs of default service.⁸

⁶ *Id.*, p. 60.

⁷ *Id.*, pp. 60-61.

⁸ See Final Order, *Investigation of Pennsylvania’s Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (Order entered Feb. 15, 2013), p. 21.

1 26. Q. Turning to Mr. Peterson’s actual allocation methods, can you please explain his
2 approach?

3 A. Certainly. Mr. Peterson proposes to allocate costs associated with PECO’s
4 distribution operations that he believes either “reasonably support” or “necessarily
5 support” PECO’s provision of default service and would be incurred if default service
6 was operated as a separate PECO division (pp. 17-18). After identifying various
7 categories of costs, he reallocates the costs based on residential customer revenue,
8 number of residential customers, and a “hybrid” allocation of both residential
9 customer revenue and number of residential customers (which he refers to as
10 “Allocation Methods” A, B, and C, respectively) (p. 24).

11 27. Q. What costs does Mr. Peterson believe should be re-allocated to customers
12 receiving default service?

13 A. Mr. Peterson proposes to re-allocate the following costs to distribution customers:

- 14 • Customer Service Expenses, including:
 - 15 o Customer Assistance
 - 16 o Information Advertisement
 - 17 o Miscellaneous Customer Service
- 18 • Sales Expenses, including:
 - 19 o Demonstrating & Selling
- 20 • A&G Expenses, including:
 - 21 o Administrative Salaries
 - 22 o Office Supplies & Expense

- o Outside Services Employed
- o Property Insurance
- o Injuries & Damages
- o Employees Pensions & Benefits
- o Regulatory Commission
- o Duplicate Charges — Credit
- o Miscellaneous General
- o Maintenance of General Plant
- Depreciation & Amortization Expense relating to:
 - o Intangible Plant
 - o General Plant
 - o Common Plant

28. Q. Do you believe these are appropriate costs for reallocation to default service customers?

A. No, I do not. PECO witness Jiang Ding explains in her direct testimony how each of the above costs was properly functionalized and assigned to distribution customers.⁹ As I have explained, all PECO customers – whether they receive electric generation supply from EGSs or from PECO – are distribution customers, and responsibility for distribution business costs should not vary based upon receipt of default service. In effect, Mr. Peterson is assuming that a separate default service division is appropriate and that it would have many of the same costs PECO has as a distribution company without determining the costs PECO actually incurs in providing default

⁹ See PECO Statement No. 6, pp. 14-25.

1 service. By choosing to then allocate the hypothetical costs of a separate default
2 service division based on default service revenue and number of default service
3 customers, he creates an artificially high PTC.

4 **29. Q. Why do you believe default service revenue is an improper factor for cost**
5 **allocation?**

6 A. Let me provide an example to illustrate. Under Mr. Peterson’s analysis, PECO’s
7 FPFTY residential default service revenues total \$636 million. Of that amount,
8 93.4% (\$594.2 million) is paid to wholesale suppliers for residential default service
9 supply and to the PJM Interconnection, L.L.C. (“PJM”) for default-service related
10 transmission expense and another almost 6% to the state for gross receipts tax.¹⁰ By
11 using a ratio of residential default service revenues to total residential sales (\$1.5
12 billion), Mr. Peterson concludes that \$61 million of \$136 million in administrative
13 expenses currently allocated to residential distribution service customers should be re-
14 allocated to residential default service customers.¹¹

15 In discussing his re-allocation of administrative employee salary expense based on
16 default service revenues, Mr. Peterson asserts (p. 29) that this re-allocation is proper
17 because “administrative employees are clearly needed to maintain the levels of
18 revenue achieved by both default service and distribution service operating

¹⁰ Mr. Peterson’s analysis does not properly reflect the fact that some of PECO’s transmission expense is collected from customers on a non-bypassable basis. See Opinion and Order, *Petition of PECO Energy Company for Approval of its Default Service Program for the period from June 1, 2015 through May 31, 2017*, Docket No. P-2014-2409362 (Order entered Dec. 4, 2014). In light of the lack of merit to Mr. Peterson’s proposals, I have not recalculated his analysis to reflect this error.

¹¹ See NRG Exhibit CP-7, p. 2.

1 divisions,” and therefore “percentage of revenues is an appropriate way to allocate
2 these costs.” But this assertion underscores Mr. Peterson’s apparent
3 misunderstanding of default service: PECO is not seeking to “maintain” the levels of
4 default service “achieved,” has no “default service” operating division, and passes
5 virtually all of the revenue received from default service customers to wholesale
6 suppliers under contract with PECO who deliver their energy directly to PJM. In
7 comparison, thousands of PECO employees and contractors are employed in
8 providing distribution service using significant capital assets. Under Mr. Peterson’s
9 revenue allocation approach, however, there would be a 45% re-allocation of the
10 associated administrative and general expense of those employees and operations to
11 default service customers.

12 A further problem with Mr. Peterson’s approach is that default service revenue
13 amounts are affected by the price of power. Using default service revenues as a cost
14 allocator would result in an allocation of costs dependent on the price of default
15 service supply without any established causation between the price of default service
16 power and the costs Mr. Peterson seeks to allocate.

17 In short, default service revenue is clearly a poor cost allocator for administrative
18 expenses generally, and Mr. Peterson’s analysis is inconsistent with principles of cost
19 allocation discussed by Ms. Ding.¹² Ms. Ding allocated most administrative general
20 costs and outside services by labor since these costs generally support the operations
21 of a utility performed by employees, and labor is a rational allocator for salaries, the

¹² See PECO Statement No. 6, pp. 6-7 (discussing goals in selecting cost allocation factors, including “appropriate recognition of cost causality”).

1 buildings where utility employees work, the tools they use, support services (such as
2 human resources), and costs which are included in common and general plant.¹³

3 **30. Q. Do you have similar concerns with allocations based on the number of default
4 service customers?**

5 A. Yes. Under Mr. Peterson's allocation method, if all customers became default service
6 customers, large amounts of PECO distribution system costs (including depreciation
7 and amortization expense for general, common and intangible plant) would need to be
8 recovered from those customers. Alternatively, if all of PECO's customers decide to
9 shop (which they are free to do), PECO would not recover any distribution business
10 expenses under Mr. Peterson's allocation method that are allocated to default service
11 even though all the costs would still remain with PECO.

12 **31. Q. Mr. Peterson suggests (p. 6) that PECO "may be motivated" to include common
13 or shared costs that should be allocated to default service customers to avoid
14 fluctuations in cost recovery. How do you respond?**

15 A. Mr. Peterson is wrong. PECO manages many varying mechanisms for cost recovery
16 as part of its business, including the fluctuating amounts paid by default service
17 customers and amounts it must pay to default service suppliers. But under principles
18 of utility cost allocation, the result I have described clearly indicates that the
19 distribution business costs Mr. Peterson proposes to allocate to default service

¹³ See *id.*, pp. 24-25. As noted earlier, the Commission used labor in allocating administrative and general expense in the 1997 Restructuring Order. See 1997 Restructuring Order, pp. 60-61. Despite Mr. Peterson's reliance on that order for his concept of a separate division for default service, he does not explain why he uses a different allocator than the Commission chose for this expense.

1 customers are not a function of the number of distribution customers that receive
2 default service or the amount such customers pay for default service.¹⁴

3 **32. Q. Does Mr. Peterson address the real possibility that, if his reallocations were**
4 **adopted, PECO would not recover its actual distribution system costs?**

5 A. No. Mr. Peterson claims that “[t]he recasting of expenses presented in this study
6 should produce a no net effect on PECO’s operations as a whole,”¹⁵ but he does not
7 explain why. In fact, he appears to believe that “[a]s costs are shifted from
8 distribution service to default service, the level of expenses attributable to the
9 distribution service customer base decreases.”¹⁶ That is clearly not the case. All of
10 the expense, whether allocated to default service or not, remains with PECO.

11 **33. Q. Does Mr. Peterson’s combination of allocation by default service revenues and**
12 **number of customers in his Allocation C method address your concerns?**

13 A. No. In Allocation C, Mr. Peterson simply reallocates some expenses based on default
14 service revenue, while other expenses are allocated based on number of default
15 service customers. That approach does not change the fact that both are improper
16 allocators for costs that PECO will continue to incur regardless of the level of
17 shopping by distribution system customers.

¹⁴ This is true for customer assistance expense as well the other costs I have described. For example, PECO’s customer assistance expense includes significant funding for low-income usage reduction programs that are available to both shopping and non-shopping customers. See PECO Exhibit JD-7, p. 10.

¹⁵ *Id.*, p. N16.

¹⁶ *Id.*, pp. N12-13.

1 **34. Q. Does Mr. Peterson identify any direct cost among the cost categories he proposes**
2 **to allocate that he believes is clearly associated with default service and not now**
3 **included in the PTC?**

4 A. Yes, but he misunderstands the nature of the cost he identifies. In proposing to
5 allocate sales expenses to residential default service customers, he asserts that PECO
6 is “engaging in messaging that is intended to retain customers on default service” and
7 cites (p. 22) to a page on PECO’s website that encourages customers to “take the first
8 step in finding how PECO can help save you money and energy.”¹⁷ The program
9 Mr. Peterson highlights, however is part of PECO’s separately-funded Energy
10 Efficiency and Conservation Program which is available to all distribution customers
11 (both shopping and non-shopping) to help them save by reducing their energy usage.
12 It has nothing to do with default service, which PECO does not market and therefore
13 incurs no related sales expense.

14 **35. Q. In his testimony, Mr. Peterson also asserts that “full absorption costing”**
15 **provides additional support for his proposed cost allocations. Do you agree?**

16 A. No. Full absorption costing is a cost accounting methodology for allocating fixed and
17 variable costs to a company’s products. PECO’s “product” is the transmission and
18 distribution of electric energy for its electric operations and the distribution of gas for

¹⁷ See NRG St. No. 1, p. 22 n. 31. Mr. Peterson was subsequently unable to identify any other messaging that he believes demonstrates PECO’s “intention to retain customers on default service.” See Interrogatory PECO-NRG-II-16 (attached as Exhibit ABC-3). Mr. Peterson also contends that PECO “may be able to unfairly promote its brand name, and thereby its residential default service, under the guise of marketing its EE&C program” and that “the public may be better served through EE&C program advertising that does not contain references to specific public utilities,” but he provides no support for his claim. See *id.*, p. 37 & NRG St. No. 1, Exhibit CP-3, p. N14.

1 its gas operations, and PECO has applied full absorption costing in its cost of service
2 study to fully allocate its costs (both fixed and variable) to its electric distribution
3 customers across the distribution rate classes. As most costs are fixed, those costs are
4 allocated in the cost of service study to customer classes based on established cost
5 causation principles.

6 Although Mr. Peterson notes that full absorption costing can use a variety of
7 allocators (p. 18), he does not explain why full absorption costing provides any
8 further support for the allocators he has chosen in his analysis.

9 **36. Q. In his testimony, Mr. Peterson offers “additional rationale” for increasing the**
10 **PTC, including his belief that customers are unable to accurately compare**
11 **PECO’s PTC to EGS prices on the website administered by the Commission**
12 **(www.papowerswitch.org) due to “improper price signals” that preclude**
13 **“apples-to-apples” comparison (p. 33). Do you believe his “additional rationale”**
14 **have merit?**

15 A. No. Mr. Peterson’s “additional rationale” has two components: an assertion that
16 PECO’s PTC is inaccurate because PECO’s distribution rates include default service
17 costs, and a claim that PECO’s PTC may move in a direction opposite to wholesale
18 energy market prices due to the mix of default service contracts which PECO uses to
19 procure default service supply. I have previously explained that PECO already
20 includes in the PTC all of the costs that properly belong there, that Mr. Peterson’s
21 proposed reallocation of distribution expenses would create an artificially high PTC

1 and is flawed for various reasons, and, therefore his analysis provides no basis for a
2 claim that PECO's PTC is inaccurate.

3 With respect to PECO's wholesale contracts, in PECO's most recent default service
4 proceeding, the Commission determined that PECO's "prudent mix" of contracts
5 complies with statutorily-imposed criteria, is appropriate to furnish default service,
6 and is in the public interest. As a result, I do not agree with Mr. Peterson's claims
7 that the PTC includes any improper costs or that PECO's PTC precludes an "apples-
8 to-apples" comparison of EGS offers and default service.

9 **37. Q. In light of your concerns regarding Mr. Peterson's proposed reallocation of**
10 **distribution costs, do you believe the Commission should adopt Mr. Peterson's**
11 **recommendations in this proceeding?**

12 A. No, I do not.

13 IV. CONCLUSION

14 **38. Q. Does this complete your rebuttal testimony?**

15 A. Yes, it does.