

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

Docket No. R-2010-2161575

v.

**PECO ENERGY COMPANY
ELECTRIC DIVISION**

:
:

**OFFICE OF SMALL BUSINESS ADVOCATE
STATEMENT IN SUPPORT OF THE
JOINT PETITION FOR PARTIAL SETTLEMENT**

I. Introduction

The Office of Small Business Advocate ("OSBA") is an agency of the Commonwealth of Pennsylvania authorized by the Small Business Advocate Act (Act 181 of 1988, 73 P.S. §§ 399.41 – 399.50) to represent the interests of small business consumers as a party in proceedings before the Pennsylvania Public Utility Commission ("Commission").

II. Filing Background

On March 31, 2010, PECO Energy Company ("PECO" or the "Company") filed Supplement No. 2 to Tariff Electric Pa. P.U.C. No. 4 ("Supplement No. 2"). The proposed tariff, if approved by the Commission, would increase the total electric distribution revenues of PECO by approximately \$288.364 million per year. This is an increase of 31.5% over the current level of distribution revenues. The proposed tariff, if approved, would also increase the electric transmission revenues of PECO by approximately \$26.7 million per year. This is an increase of 15.1% over the current level of transmission revenues. Moreover, the Company's proposed rate

increase would produce an 8.95% overall rate of return on its original cost rate base, including an 11.75% return on common equity.

On April 20,2010, the OSBA filed a Complaint and a Public **Statement**. On May 20, 2010, the Commission entered an Order at this docket which suspended the proposed rate increase for investigation. As such, the filing was suspended by operation of law through December 30,2010. The Commission also identified areas of concern in Appendix A of its **May 20,2010, Order**. The Commission ordered the parties to address those areas of concern during the instant proceeding.

A pre-hearing conference, at which a procedural schedule was established, was held on June 9,2010. The OSBA, as well as other intervening parties to the proceeding, filed direct testimony on July 7,2010. Public Input Hearings took place on June 28,2010. Rebuttal testimony was filed by the OSBA and other intervening parties on August 3,2010. On August 12,2010, surrebuttal testimony was filed by the OSBA and several other parties.

After negotiations, the parties have reached a settlement of all but one of the issues in this case. The OSBA actively participated in the negotiations that led to the Joint Petition for **Partial Settlement** ("Partial Settlement") and is a signatory to the Partial Settlement. The OSBA submits this statement in support of the Partial Settlement.

III. Summary of the OSBA's Principal Concerns

In its Complaint, Prehearing Memorandum, and testimony, the OSBA identified several issues of concern, including the following:

1. Whether the Company's proposed cost-of-service methodology is appropriate;
2. Whether the Company's proposed assignment of its claimed **transmission-related**

revenue requirement to rate classes is lawful, just, and reasonable;

3. Whether the Company's proposed distribution revenue allocation properly moves all classes closer to their respective cost of service indications;

4. Whether the Company's proposed rate design for its Rate GS comports with traditional rate design principles;

5. Whether PECO's security deposit requirements for small business customers are just and reasonable; and

6. Whether the Company's efforts to adjust revenues to reflect expected declines in sales due to conservation programs is **permissible**.

IV. **Partial Settlement**

The Partial Settlement sets forth a comprehensive list of issues which were resolved through the negotiation process. This statement outlines the OSBA's specific reasons for joining the Partial Settlement. The following provisions were of particular significance to the OSBA in concluding that the Partial Settlement is in the best interests of small business customers:

A. **Distribution Revenue Requirement**

1. **Summary**

In its initial filing, PECO proposed a distribution revenue increase of **\$288.364 million** per year.¹ In the Company's rebuttal testimony, PECO lowered its distribution revenue requirement by approximately **\$22.4 million**.² In the Partial Settlement, PECO has agreed to

¹ PECO Statement No. 3 at 44.

² PECO Statement 3-R at 2.

reduce the revenue requirement to \$198.3 million per year.³ At a time when all types of utility service are becoming more expensive, the significant reduction in the distribution revenue increase provided by the Partial Settlement will benefit PECO's small business customers.

2. Return on Equity

In analyzing the Company's filed request for a \$288.364 million distribution rate increase, OSBA witness Brian Kalcic opposed PECO's proposed return on equity ("ROE") of 11.75%. Specifically, Mr. Kalcic testified, as follows, that the Company's awarded ROE should be significantly lower:

Counsel advises that the PPL Electric base rate case at Docket No. R-00049255 represents the most recent litigated proceeding. I am further advised that the Commission awarded PPL Electric an ROE of 10.70% in that proceeding, via its Opinion and Order entered December 22, 2004.⁴

* * *

In general, interest rates and capital costs have declined since late 2004. For example, in December 2004, the prime lending rate (charged by banks to their most credit-worthy customers) was 5.00%. Today, the prime lending rate stands at 3.25%. [footnote omitted] Logically, this suggests that the baseline 10.70% ROE awarded to PPL Electric in Docket No. R-00049255 should act as the cap or ceiling on the ROE awarded to the Company in this proceeding.

* * *

In support of its pension expense claim in this case, the

³ Partial Settlement at 5.

⁴ In his rebuttal testimony, Mr. Kalcic noted that the Commission awarded Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec") an ROE of 10.1% in their consolidated base rate proceeding at Docket Nos. R-00061366 and R-00061367 (Order entered January 11, 2007). Although the ROE in the consolidated Met-Ed and Penelec proceeding was lower and more recent than the ROE awarded in PPL's 2004 proceeding, Mr. Kalcic testified that the OSBA's recommended ROE cap remained at 10.7%. See OSBA Statement No. 2 at 13.

Company relies upon an actuarial study conducted by Towers Watson. [footnote omitted] In that study, Towers Watson utilizes a number of assumptions to arrive at its opinion regarding PECO's required pension contributions.

As shown in Attachment OTS-RE-62B of PECO's response to OTS-RE-62, the assumed rate of return on pension assets is only 8.50% for 2010, with projected returns assumed to decline to 8.00% by 2013. If these are the types of return that the Company can reasonably expect to achieve on its pension assets in today's economic environment, the Commission should be skeptical of the Company's claim that those same economic conditions necessitate that the Company be awarded an ROE of 11.75%.⁵

As Mr. Kalcic testified, "a reduction in PECO's requested ROE **from** 11.75% to **10.70%** would reduce the Company's requested increase by \$30 million, **i.e.**, from \$288.4 million to **\$258.4 million.**"⁶

3. Act 129-Related Sales Decline

As part of its original request for a \$288.364 million distribution rate increase, PECO included several claims intended to compensate the Company for the decline in sales predicted to occur because of energy efficiency and **conservation** programs under Act 129. Mr. Kalcic proposed a disallowance of a portion of PECO's Act 129 Revenue Adjustment. In support of his recommended disallowance, Mr. Kalcic testified as follows:

According to Exhibit RLO-I, Schedule **D-5E**, the cumulative impact of Act 129 on 2011 distribution revenues is \$35.2 million. However, PECO will have already accounted for \$19.5 million of those losses in this proceeding, by reflecting the impact of Act 129 programs on pro **forma** test period revenues. Therefore, the

⁵ OSBA Statement **No. 1** at **14-15**.

⁶ OSBA Statement **No. 1** at **15**.

incremental impact of Act 129 on 2011 distribution revenues is \$35.2 million minus \$19.5 million, or \$15.7 million.

Going out another year, PECO estimates the cumulative impact of Act 129 on 2012 distribution revenues to be \$47.4 million. Similar to PECO's 2011 calculation, the incremental impact of Act 129 on 2012 distribution revenues would be \$47.4 million minus \$19.5 million, or \$27.9 million.

PECO's proposed \$31.5 million revenue adjustment is separate and distinct **from** (i.e., in addition to) the \$19.5 million of claimed distribution revenue losses that are reflected in the test period.

PECO is proposing to include the additional \$31.5 million adjustment because the (\$19.5 million) test period adjustment would not permit PECO to recover: a) the Act 129 losses PECO is incurring today, i.e., in 2010, before the Company's new rates go into effect; or b) the incremental Act 129 losses that PECO expects to incur in 2011 and 2012.

Counsel advises that Act 129 permits an EDC to recover known and measurable test period revenue losses, on a going-forward or prospective basis only. In other words, Act 129 permits PECO to adjust its test period billing determinants downward **by** \$19.5 million for ratemaking purposes – nothing more.⁷

4. Total Adjustments

As explained above, PECO lowered its proposed distribution rate increase by approximately \$22.4 million during the rebuttal stage of this proceeding. If the Commission were to agree with Mr. Kalcic's proposed 10.7% cap on PECO's ROE, the revenue **requirement** would decline by another \$30 million. Furthermore, if the Commission were to adopt Mr.

⁷ OSBA Statement No. 1 at 12-13.

Kalcic's proposed disallowance related to the anticipated sales decline because of energy efficiency and conservation programs, PECO's revenue requirement would drop by an additional \$31.5 million. The net effect of PECO's concession in rebuttal testimony and the OSBA's adjustments would be a distribution revenue requirement of approximately \$205 million.

The Partial Settlement provides a distribution revenue requirement of \$198.3 million, which is below the cap supported by Mr. Kalcic's testimony.

B. Distribution Revenue Allocation

in its filing, PECO proposed a revenue allocation that purportedly moved all major rate classes closer to cost of service as measured by the Company's cost of service study ("COSS").⁸ However, as noted by Mr. Kalcic in his direct testimony, PECO's proposed revenue allocation was problematic, in part because it was based on a COSS which bundled transmission and distribution revenues.⁹ Based on advice of counsel, Mr. Kalcic pointed out that "[r]ates for distribution and transmission service are to be set on an unbundled basis, i.e., determined separately on the basis of the cost of providing each service."¹⁰

After disaggregating the distribution and transmission components of PECO's proposed revenue allocation at the full revenue requirement, Mr. Kalcic determined that PECO's proposal failed to move all classes closer to their distribution cost of service. In that regard, he pointed

⁸ PECO Statement No. 9 at 5-6. In his direct testimony, OSBA witness Mr. Kalcic indicated that he was unable to replicate the Company's calculation of the proposed class rates of return. See OSBA Statement No. 1 at 6. However, based on subsequent modifications by PECO, Mr. Kalcic submitted a revised Schedule BK-3 with his rebuttal testimony. That revised schedule sets forth the class rates of return under PECO's COSS and revenue allocation at the full revenue requirement. See OSBA Statement No. 2 at 1-2 and Schedule BK-3 (Revised 8/3/10).

⁹ OSBA Statement No. 1 at 6.

¹⁰ OSBA Statement No. 1 at 6. See also *Lloyd v Pennsylvania Public Utility Commission*, 904 A.2d 1010, 1020-1021.

out that PECO proposed to move some classes from above cost of service at present rates to materially below cost of service at proposed rates.” He also pointed out that PECO proposed a rate increase for Rate GS that would be 1.75 times the system average.”

In an effort to move all classes closer to cost and to minimize rate shock, Mr. Kalcic proposed an alternative allocation of the distribution rate increase at the Company's full revenue requirement. Mr. Kalcic's alternative is set forth in Schedule BK-6, attached to his direct testimony. Mr. Kalcic began by assigning each class the increase (or decrease) needed to reach cost of service under the Company's COSS. He then adjusted those results to prevent any class; from receiving an increase that is greater than 1.5 times the system average and to prevent any class from receiving a rate decrease. As a result of these adjustments, some classes would receive slightly larger increases than needed for those classes to reach cost at the full revenue requirement.¹³

Mr. Kalcic also proposed a disproportionate scaleback of his full revenue requirement allocation in the event that the Commission were to award PECO some amount less than the requested \$288.4 million. Specifically, Mr. Kalcic proposed first dollar relief (“FDR”) to mitigate the subsidies provided by the classes which would be overpaying their cost of service under his proposed allocation at the Company's full revenue request.¹⁴ Under Mr. Kalcic’s

¹¹ OSBA Statement No. 1 at 6.

¹² OSBA Statement No. 1 at 8.

¹³ OSBA Statement No. 1 at 8-9.

¹⁴ OSBA Statement No. 1 at 10. See also Schedule BK-7.

scaleback proposal, Rates R, OP, and HT would receive FDR in order to mitigate the subsidies they would provide to other classes at the full revenue **requirement**.¹⁵

To illustrate how his FDR proposal would work, Mr. Kalcic presented Schedule BK-8, which reflects the **OSBA's** recommended revenue increases if PECO were to receive a hypothetical increase of \$273.3 **million**.¹⁶

In contrast to the recommendations of PECO (\$87.44.0 million increase for Rate GS) **and** Mr. Kalcic (\$75.144 million increase for Rate GS), OCA Witness Clarence Johnson recommended an increase of \$95.121 million for Rate GS at the Company's proposed full revenue **requirement**.¹⁷ In rebutting OCA witness Mr. Johnson, Mr. Kalcic noted that the **OCA's** proposed increase for Rate GS would be 1.9 times the requested system average increase and, therefore, would not be consistent with the principle of **gradualism**.¹⁸

The Partial Settlement provides for a \$198.3 million distribution rate increase, which is approximately 68.77% of the amount requested by PECO in its filed case. A proportional scaleback of the **OCA's** full requirement increase for Rate GS would produce a rate increase for that class of about \$65.412 million. In contrast, a proportional scaleback of the **OSBA's** litigation proposal (after the FDR shown in Schedule BK-8) would produce a rate increase for Rate GS of about \$54.525 million.

¹⁵ OSBA Statement No. 1 at 10.

¹⁶ OSBA Statement No. 1 at 10 and at Schedule BK-8.

¹⁷ OCA Statement No. 3 at 27.

¹⁸ OSBA Statement No 2 at 9.

Under the Partial Settlement, Rate GS would receive a distribution increase of **\$60.6** million, which is approximately midway between the litigation positions of the OSBA and the **OCA**.¹⁹ Therefore, the Partial Settlement would move Rate GS closer to cost of service while mitigating the rate shock inherent in the **OCA's** proposal.

C. Transmission Rates

In its filed case, PECO proposed to begin collecting transmission costs through a surcharge, the Transmission Service Charge ("TSC"), rather than through base rates. PJM bills the same type of transmission costs to both PECO and electric generation suppliers ("EGSs") operating in the PECO service **territory**. Under **PECO's** proposal, the Company would impose the TSC on default service customers (to recover PJM's charges to PECO) while an **EGS** would bill shopping customers directly (to recover **PJM's** charges to that EGS). As a further step to avoid distorting the incentive to shop, PECO also proposed to set each class' transmission rate at full cost of **service**.²⁰

In his direct testimony, OSBA witness Mr. Kalcic agreed that **PECO's** proposed transmission service revenue allocation is **appropriate**.²¹ In support of that conclusion, Mr. Kalcic explained that customers would receive artificial incentives to shop, or to stay on default service, if each class' transmission rate were not set at cost. For example, if a class' transmission rate were set above cost, a customer in that class would have an incentive to shop in order to **pay** a market-based transmission charge from an EGS and avoid paying an inflated transmission charge to PECO. On the other hand, if a class' transmission rate were set **below** cost, a customer

¹⁹ Partial Settlement at Exhibit 3.

²⁰ PECO Statement No. 9 at 24-27

²¹ OSBA Statement No. 1 at 5.

in that class would have an incentive to stay on default service, in that the market-based transmission charge **from** the EGS would be higher than the amount charged by PECO for **transmission.**²²

In contrast to Mr. Kalcic, OCA witness Mr. Johnson opposed PECO's proposed transmission revenue allocation. As an alternative, Mr. Johnson proposed to allocate the transmission revenue requirement on the basis of each class' contribution to PECO's twelve monthly coincident peaks ("12CP") rather than on the basis of each class' contribution to the Company's single coincident peak ("1CP").²³

In rebuttal, Mr. Kalcic reiterated the OSBA's support for the Company's transmission revenue allocation methodology. As Mr. Kalcic pointed out, PJM bills PECO and EGSs on a 1CP basis. Therefore, adopting Mr. Johnson's 12CP allocation approach would create the artificial incentives to shop, or not to shop, about which Mr. Kalcic had warned in his direct **testimony.**²⁴

The Partial Settlement adopts the 1CP allocation methodology proposed by PECO and supported by Mr. **Kalcic.**²⁵

D. Security Deposits

In the Company's initial filing, PECO proposed to modify Section 5.5 of its current Rules and Regulations, relating to the Company's obligation to return security deposits. Specifically, the Company proposed to add the following new language to Section 5.5 (new language is in

²² OSBA Statement No. 1 at 4-5.

²³ OCA Statement No. 3 at 18-20.

²⁴ OSBA Statement No. 2 at 6-8.

²⁵ Partial Settlement at 6.

bold print):

5.5 RETURN OF DEPOSIT: Deposits secured from a residential Customer shall be returned with accrued interest, in accordance with 66 Pa. C.S. §1404(C) and applicable Pennsylvania Public Utility Commission regulations. For non-residential customers such **refunds** or credit will be made at the time the customer becomes creditworthy. In case of discontinuance of service, deposits will be returned with accrued interest upon payment of all service charges and guarantees or with deduction of unpaid accounts. **Any residential or commercial customer having secured the return of a deposit may be required to make another deposit, in accordance with Commission statutes, regulations, or Federal Bankruptcy Law, if the Customer demonstrates bad credit or lacks creditworthiness subsequent to the return of the initial deposit.**²⁶

OSBA witness Mr. Kalcic testified that PECO is currently permitted to require a customer that has obtained the return of an initial security deposit to make a new deposit only under very limited circumstances, *i.e.*, the service has been discontinued and the customer's credit standing impaired through failure to comply with tariff provisions. According to Mr. Kalcic, the new tariff language in Section 5.5 would allow the Company significantly greater latitude in requiring a new deposit from an existing customer, because **PECO's** proposed tariff does not delineate the types of conditions and/or customer account activity that would constitute a customer having "bad credit" or a "lack of **creditworthiness**."²⁷

Mr. Kalcic also took issue with the length of time PECO retains small commercial and industrial customers' security deposits. According to **PECO's** interrogatory response to OSBA-

²⁶ PECO Statement **No.** 10 at 16.

²⁷ OSBA Statement **No.** 1 at 16-17.

II-4(c), PECO reviews all non-residential accounts annually, starting with the third anniversary of the date on which the deposit was paid in full. The Company will return the deposit if the review determines that the account was assessed fewer than three late payment charges in the previous 36 months. However, PECO's credit specialists have the authority to review accounts and return a deposit within the initial 36-month period, depending upon individual account circumstances.²⁸

Mr. Kalcic made two recommendations. First, Mr. Kalcic recommended that the current language of PECO's Rules and Regulations which determines when PECO is permitted to require a new deposit from a customer (that has previously obtained the return of a deposit) should be retained. Second, Mr. Kalcic recommended that the same deposit hold period and timely payment history standards applied to residential customers should be used for PECO's customers served on Rate GS.²⁹

In rebuttal, PECO's witness Mr. Stephen Xander testified that PECO's tariff includes a definition of "creditworthy" that was overlooked by Mr. Kalcic.³⁰ However, Mr. Xander did agree to modify PECO's policy on the length of time a non-residential customer deposit is held.³¹ Specifically, Mr. Xander testified that PECO would change its current policy so that a non-residential deposit would be returned if a review of a customer's account showed fewer than two late payments in the previous 24 months (in place of the current standard of three late payment!;

²⁸ OSBA Statement No. 1 at 17.

²⁹ OSBA Statement No. 1 at 18-19.

³⁰ PECO Statement No. 10-R at 4.

³¹ PECO Statement No. 10-R at 6.

in the previous 36 months).³² Also, PECO agreed that the initial annual review would occur 24 months (rather than 36 months) after the initial deposit date. This policy change is in line with protections afforded to residential customers.

In surrebuttal, Mr. Kalcic testified that the definition of "creditworthy" is beneficial, but it appears that PECO would retain a significant degree of discretion in determining whether or not a non-residential account is creditworthy.³³ However, he stated that the OSBA is willing to go forward with PECO's proposed changes to Section 5.5 (as modified in PECO Statement No. 10-R) at this time and reserve its right to contest the language in Section 5.5 in a future rate proceeding if the OSBA continues to receive complaints from small business customers that suggest that PECO is exercising too much discretion in determining the creditworthiness of an account. Mr. Kalcic also testified that PECO's willingness to modify its policy for the length of time a non-residential customer deposit is held is acceptable to the OSBA.³⁴

The Partial Settlement memorializes Mr. Xander's agreement to modify PECO's policy on the length of time a non-residential customer deposit is held.³⁵ The Partial Settlement provides non-residential customers the same protections provided to residential customers in receiving a return of their security deposit. Due to the downturn in the economy, many small businesses are having a hard time staying afloat. The OSBA receives many consumer phone calls regarding when small businesses can get their security deposit back. PECO's change in

³² PECO Statement No. 10-R at 6.

³³ OSBA Statement No 3 at 6.

³⁴ OSBA Statement No 3 at 6.

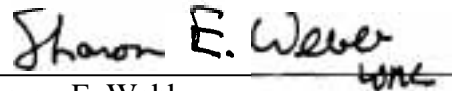
³⁵ Partial Settlement at 8.

policy will help return small business customers' security deposits sooner, which may in turn help those customers pay other bills and avoid layoffs or closure.

V. Conclusion

For the reasons set forth in the Partial Settlement, as well as the additional factors enumerated in this statement, the OSBA supports the proposed Partial Settlement and respectfully requests that the AW and the Commission approve the Partial Settlement in its entirety.

Respectfully submitted,



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