

COMMONWEALTH OF PENNSYLVANIA



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September 17, 2018

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Reply Brief in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully Submitted,

A handwritten signature in blue ink that reads "Hayley E. Dunn".

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Enclosure

cc: Honorable Christopher P. Pell, ALJ
Honorable F. Joseph Brady, ALJ
Certificate of Service

*258921

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate’s Reply Brief, upon parties of record in this processing in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 17th day of September 2018.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY BRIEF OF THE
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Dated: September 17, 2018

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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. The OCA’s Main Brief details the various components of the Company’s filing. See OCA M.B. at 1. Through the course of discovery, testimony, evidentiary hearings, and settlement negotiations, this case has been reduced to a single contested issue: NRG Energy, Inc.’s (NRG) proposal to reallocate what it refers to as “indirect” costs to default service generation. On August 28, 2018, the parties to this proceeding filed a Joint Petition for Partial Settlement addressing the settled issues. Subsequently, on September 7, 2018, the Office of Consumer Advocate (OCA), PECO, and NRG filed Main Briefs addressing NRG’s proposal to reallocate “indirect” costs to default service.

II. STATEMENT OF THE CASE

The OCA's Main Brief sets forth a complete Statement of the Case in this proceeding.

See OCA M.B. at 3-5.

III. SUMMARY OF ARGUMENT

In this Reply Brief, the OCA responds to the arguments raised in NRG's Main Brief. The OCA notes that many of the arguments raised in NRG's Main Brief were addressed fully in the OCA's Main Brief and the OCA will not address these arguments again here. The OCA further notes that no averments in any of the parties' Main Briefs alter the OCA's position in this proceeding. The OCA submits that NRG's proposed allocation is fundamentally flawed in that it ignores PECO's role as a default service provider, reallocates costs that are not avoidable, and contains other inconsistencies. The OCA further submits that NRG's proposal results in the recovery of costs from default service customers that is not supported by Commission policy or Pennsylvania law. For the reasons set forth in this Reply Brief and in the OCA's Main Brief, the OCA respectfully requests that the Commission reject NRG's proposal and approve the August 28, 2018 Joint Petition for Partial Settlement without modification.

IV. ARGUMENT

A. Overview of NRG Proposal

The OCA's Main Brief sets forth a complete overview of NRG's proposal to reallocate costs to default service generation. See OCA M.B. at 7-9.

B. PECO's Provision of Default Service and Applicable Law

In its Main Brief, NRG inaccurately characterized default service. NRG stated, "Customers who do not select an EGS receive generation service, called default service, from their default service providers which are currently the EDCs." NRG M.B. at 14; see also NRG. M.B. at 13 ("If they do not select an EGS, they receive such supply from the default service provider, which is currently the incumbent EDC in the respective service territory"). The OCA submits that NRG's characterization of default service is fundamentally flawed; default service exists for *all customers*, both shopping and non-shopping.

An EDC is obligated to provide default service (1) "if a customer does not choose an alternative electric generation supplier," (2) "if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide service," and (3) "if a customer chooses an alternative supplier and subsequently desires to return to the local distribution company for generation service."¹ 66 Pa. C.S. § 2807(e)(3.1); 52 Pa. Code§ 54.188(g). As PECO witness Alan B. Cohn noted, as an EDC, "The Company is required to be able to provide default service to all distribution customers under Pennsylvania law and the Order of the Commission, regardless of whether the customer shops or doesn't shop for electricity." PECO St. 9R at 9-10. In other words, PECO is required to stand ready to serve **100%** of its distribution customers, including those who receive generation supply from an EGS, at all times. See OCA M.B. at 8-9, 10.

¹ As part of its obligation to serve, PECO is required to procure a prudent mix of power to ensure adequate and reliable service at the least cost to customers over time. 66 Pa. C.S. §§ 2807(e)(3.2), (3.4).

The OCA submits that a proper understanding of the concept of default service is of critical importance, particularly here where NRG proposes an unprecedented and dramatic shift in the allocation of PECO's costs based on a flawed understanding of the requirements of default service. See gen'ly OCA St. 3R, PECO St. 9R.

C. NRG's Proposal to Reallocate Costs

1. Qualifications of Mr. Peterson

The OCA's Main Brief fully addresses the qualifications of NRG witness Peterson. See OCA M.B. at 9-10.

2. NRG's Alternative Cost Allocation

a. NRG's Proposal Ignores PECO's Role as a Default Service Provider and Allocates Unavoidable Costs to Default Service.

As noted above, NRG's characterization of default service is fundamentally flawed. See supra Section IV.B; NRG M.B. at 13, 14. Based on this flawed characterization of default service, NRG proposes to allocate claimed "indirect" costs to default service, ignoring PECO's obligations as a default service provider and failing to take into account that none of the costs it seeks to allocate to default service are avoidable costs.² NRG M.B. at 9, 28-30, 46-50.

Only avoidable costs can be properly allocated to PECO's Price-to-Compare (PTC). OCA St. 3R at 4-5. As discussed fully in the OCA's Main Brief, costs are avoidable only where the costs are not incurred by the default service provider when a customer switches to an electric generation supplier. See OCA M.B. at 10-11. PECO's costs are designed to meet its obligation to serve 100% of customers' power needs and service needs on a moment's notice and, as such, the Company's default service costs are *unavoidable*, meaning that they remain the same when

² In its Main Brief, NRG argued that PECO did not properly include in the PTC costs identified in the Commission's policy statement, 52 Pa. Code § 69.1808. NRG M.B. at 36. As noted in the OCA's Main Brief, PECO's PTC includes each of these types of costs. See OCA M.B. at 17; see PECO St. 9R at 5-8.

customers shop. OCA St. 3R at 3-4; 66 Pa. C.S. § 2807(e)(3.1). OCA witness Clarence L. Johnson explained, “PECO’s costs are not avoidable as PECO must stand ready to serve at all times.” OCA St. 3R at 3-4. In other words, because PECO must stand ready to provide default service to even those customers that receive electric generation supply – if an EGS abruptly ceases to provide service or if an EGS customer suddenly elects to return to default service – none of the costs identified by NRG are avoidable. OCA St. 3R at 4-5. Therefore, none of these costs can be reallocated to default service.

The OCA submits that NRG’s allocation proposal ignores PECO’s role as a default service provider and impermissibly seeks to allocate unavoidable costs to default service and, therefore, the Commission should reject NRG’s proposal.

b. The Restructuring Order is Not Related to NRG’s Proposal and Does Not Support NRG’s Proposal.

In its Main Brief, NRG relied on the Commission’s 1997 Restructuring Order to support its proposal. NRG M.B. at 17-20, 41-43; see Application of PECO Energy Co. for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code, Docket No. P-00971265, 1997 Pa. PUC LEXIS 51 (Order entered December 23, 1997) (Restructuring Order). NRG stated, “Consistent with the approach taken by the Commission in the *1997 Restructuring Order*, NRG proposes to reallocate indirect expenses in a way that more accurately reflects the costs that PECO incurs to support all of PECO’s residential operations, including both default service and distribution service.” NRG M.B. at 41. NRG’s proposal to allocate expenses “in way that resembles the costs that PECO would incur if it operated a separate default service division,” however, is not related to the Restructuring Order. See OCA M.B. at 14-16.

As discussed fully in the OCA’s Main Brief, the Commission’s Restructuring Order, or the unbundling proceeding, separated generation from transmission and distribution.³ See OCA M.B. at 14-16. In the Restructuring Order, the Commission stated:

When we refer to the unbundling of PECO’s rates, we are splitting the existing and approved single rate which encompasses all of PECO’s services into its separate components of generation, transmission and distribution. As we discuss the different components of distribution service, references to generation will mean that sector of PECO’s operations related to the production of energy. Contrasted to this is PECO’s transmission and distribution function which encompasses those services used to transport and deliver the energy produced.

Restructuring Order at 74. The Commission further noted, that “[t]he shopping consumer pays only the T&D rate . . . to the EDC when purchasing generation in the competitive market.” Id. at 64. As PECO witness Cohn explained, PECO no longer has a generation business and “all PECO customers – whether they receive electric generations supply from EGSs or from PECO – are distribution customers.” PECO St. 9R at 12, 14; OCA M.B. at 15, 17. Therefore, it is not appropriate to rely on the Restructuring Order to advocate that distribution service to EGS customers should be separated from distribution service to default service customers.

Even if the Restructuring Order was related to NRG’s proposal, it would not support NRG’s proposal.⁴ The Restructuring Order established distribution only rates. Restructuring

³ As PECO stated in its Main Brief, the Restructuring Order addressed “a very different company, with two distinct business groups,” generation and distribution. PECO M.B. at 17.

⁴ The Restructuring Order demonstrates that all of PECO’s distribution costs are distribution costs and that there are no generation costs in the Company’s distribution costs. In the Restructuring Order, the Commission stated:

[T]he process by which the Commission is obligated to unbundle the company’s rates into generation, transmission and distribution components is fundamentally a ratemaking process, a process in which the Commission is called upon to determine the company’s total cost of service . . . to properly allocate those costs among the generation, transmission and distribution portions of the company’s operations and to translate those costs into individual rates.

...

Order at 65-66. Accordingly, there are no costs of default service improperly included in distribution rates as NRG suggested. As PECO witness Cohn testified, all of the Company's costs related to default service, including those identified in the Commission's policy statement at 52 Pa. Code § 69.1808, are properly in the PTC. PECO St. 9R at 5-8.

Therefore, the OCA submits that the Restructuring Order is not related to NRG's proposal to reallocate "indirect" costs to default service and, even if the Order was related to NRG's proposal, it would not support the proposal, rather it would refute it.

3. Effects of NRG's Proposal

NRG proposes to allocate \$101 million in "indirect" costs to default service. NRG M.B. at 2. NRG did not properly consider the principles of cost causation or the effect its proposal to shift a significant amount of costs will have on PECO's distribution service. See OCA M.B. at 11; PECO M.B. at 14. Moreover, NRG's proposal would result in the PTC not reflecting the cost of providing default service. See OCA M.B. at 16-18.

NRG states that the Commission "follows cost causation principles," although its proposal does not adhere to cost causation principles. NRG M.B. at 45. NRG attempts to allocate costs to default service that are *not* costs of default service. PECO St. 9R at 16-17. As PECO witness Cohn stated, "the distribution business costs Mr. Peterson proposed 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. 9R at 16-17; OCA M.B. at 11.

The major difference in this process is that once the generation-related costs and rates are developed, the company's customers will be able to choose alternative suppliers for the generation portion of their electric service.

Restructuring Order at 65-66.

For instance, as PECO stated in its Main Brief, “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, 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.” PECO M.B. at 14 (footnotes omitted). It is illogical to allocate nearly half of PECO’s employee salaries and pension expense to default service. Further, as PECO pointed out, “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 the scope of what [he] was requested to do.’” PECO M.B. at 14 (footnote omitted).

Moreover, if NRG’s proposal was accepted, PECO would not recover all of the costs that it currently incurs for distribution service. PECO witness Cohn explained that, “if all of PECO’s customers decide to shop . . . PECO would not recover any distribution business expenses under Mr. Peterson’s allocation method that are allocated to default service even though all the costs would still remain with PECO.” PECO St. 9R at 17; see OCA M.B. at 11; see PECO M.B. at 19. As discussed above, because NRG proposes to allocate unavoidable costs to default service, these costs would remain when customers switch from default service to an EGS and, if all customers switched to an EGS, PECO would not recover the costs to provide distribution service.⁵ See supra Section IV.C.2.a. As PECO noted in its Main Brief, “Mr. Peterson’s failure to consider the effects of shopping on his cost allocation is a significant omission.” PECO M.B. at 19.

⁵ NRG claimed that PECO is seeking to compete with EGSs, although it makes no profit from default service. NRG M.B. at 34-35; see OCA M.B. at 16. NRG’s proposal attempts to limit such (nonexistent) competition. The proposal, however, would actually incentivize PECO to retain more default service customers as the Company would not recover its distribution costs when customers switch to an EGS since distribution costs would be placed on default service.

Lastly, as discussed in the OCA's Main Brief, NRG's proposal inflates the PTC by allocating hypothetical expenses to defaults service.⁶ See OCA M.B. at 16-17. PECO similarly acknowledged that "[a]llocating costs to default service that artificially inflate the PTC is fundamentally inconsistent with principles that should guide the development of a competitive retail electricity market." PECO M.B. at 18. The OCA further notes that an increased PTC will likely result in increased EGS prices, thereby harming both non-shopping and shopping customers.

Therefore, the OCA submits that NRG did not properly consider the principles of cost causation or the effect its proposal on PECO's distribution service. The OCA further submits that NRG's proposal would result in PECO's PTC not reflecting the cost of providing default service.

4. Additional Issues

a. NRG's Policy Argument Should be Rejected.

As PECO witness Cohn pointed out, "Mr. Peterson cannot identify a single U.S. electric utility that provides residential default service through a separate default service division, nor can he identify any electric utility that allocates indirect expenses associated with residential default service using any of the approaches he has recommended in this proceeding." PECO St. 9R at 11, NRG M.B. at 43. NRG argues that Pennsylvania should take the lead in adopting the allocation methodology proposed by NRG witness Peterson. NRG M.B. at 43. This argument is flawed.

The OCA notes that this is a policy argument rather than a legal argument supporting the basis for NRG's legal claim, which is that PECO improperly allocated "indirect" costs to distribution service. NRG M.B. at 8, 51. Further, as PECO noted in its Main Brief:

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, he provides no evidence

⁶ NRG's proposal is limited to non-shopping residential customers. OCA St. 3R at 5; OCA M.B. at 12. The OCA notes that NRG's proposal is inequitable and discriminatory against non-shopping residential customers and does not address commercial and industrial default service.

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 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.

PECO M.B. at 18 (footnote omitted).

Therefore, the OCA submits that the Commission should reject NRG's policy arguments that it should adopt NRG's proposal and reject NRG's proposal to reallocate "indirect" costs to default service in its entirety.

D. Summary

As discussed herein and in the OCA's Main Brief, the OCA submits that NRG's proposed allocation is fundamentally flawed in that it ignores PECO's role as a default service provider, reallocates costs that are not avoidable, and contains other inconsistencies. The OCA further submits that NRG's proposal results in the recovery of costs from default service customers that is not supported by Commission policy or Pennsylvania law.

V. CONCLUSION

For the reasons set forth in this Reply Brief and in the OCA's Main Brief, the OCA respectfully requests that the Commission reject NRG's proposal to reallocate indirect costs to default service and approve the Joint Petition for Partial Settlement without modification.

Respectfully Submitted,



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