

COMMONWEALTH OF PENNSYLVANIA



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November 5, 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 Exceptions in the above-referenced proceeding

Copies have been served per the attached Certificate of Service.

Respectfully Submitted,

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Enclosure

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

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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 Exceptions, 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:

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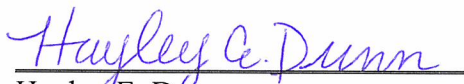
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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REPLY EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE

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Dated: November 5, 2018

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## I. INTRODUCTION

All issues raised in PECO Energy Company's (PECO or the Company) base rate proceeding were resolved by a Partial Settlement with the exception of a single, contested issue regarding PECO's allocation of "indirect costs" to distribution service. Throughout the proceeding, NRG Energy, Inc. (NRG) argued that PECO improperly allocated \$101 million of what NRG witness Chris Peterson referred to as "indirect costs" to distribution service. NRG proposed a major reallocation of these costs from distribution service to default service.

As discussed in the OCA's Main and Reply Briefs, NRG erroneously seeks to reallocate costs that are not avoidable and fails to recognize PECO's role as a default service provider. OCA M.B. at 10-12; OCA R.B. at 5-6. Costs are avoidable only where the costs are not incurred by the default service provider when a customer shops. Id. PECO's default service costs at issue here are not avoidable because PECO must stand ready to service both shopping and non-shopping customers at all times. Id. Moreover, contrary to NRG's claims, the reallocation proposal is not supported by the 1997 unbundling proceeding and is inconsistent with sound ratemaking principles and Commission policy. OCA M.B. at 12-17; OCA R.B. at 6-11. Therefore, the OCA argued that NRG's proposal to reallocate "indirect costs" to default service should be rejected.

On October 18, 2018, Deputy Chief Administrative Law Judge Christopher P. Pell and Administrative Law Judge F. Joseph Brady (ALJs) issued a Recommended Decision. The ALJs determined that "PECO is properly allocating costs for the provision of default service," reasoning that "the Code requires PECO to stand ready to serv[e] 100% of customers' power needs on a moment's notice" and "the fixed costs NRG witness Peterson seeks to allocate to default service are not avoided by PECO when a customer switches to an alternative supplier." R.D. at 124, 125, 128. The ALJs further determined that "NRG's reliance on the 1997 unbundling proceeding is

misplaced.” R.D. at 30. Accordingly, the ALJs recommended that “PECO continue to calculate its price-to-compare as previously approved by the Commission” and that NRG’s “proposed modifications to the allocation of costs between distribution service and default service be denied.” R.D. at 130, 131. The OCA agrees with the well-reasoned decision of the ALJs.

On October 29, 2018, NRG filed Exceptions to the Recommended Decision. NRG argued that the ALJs erred by determining that (1) PECO has met its burden of proof, (2) the PTC recovers all costs of default service, (3) the 1997 unbundling proceeding does not support NRG’s proposal, and (4) only avoidable costs may be allocated to the PTC. See gen’ly NRG Exc. For these reasons, NRG maintained that the Public Utility Commission (Commission) should adopt its reallocation proposal. NRG Exc. at 40. The OCA respectfully requests that the Commission deny NRG’s Exceptions and adopt the ALJs’ recommendation to reject NRG’s proposal for the reasons set forth in the Recommended Decision and herein.



## II. REPLY EXCEPTIONS

Reply To NRG Exception No. 1: The ALJs Correctly Determined That PECO Has Met Its Burden Of Proof. R.D. at 30-32, 131; OCA M.B. at 1-2, 7-9, 11, 16-18; OCA R.B. at 4-5; 8-9.

In the Recommended Decision, the ALJs noted that, “while the ultimate burden of proof does not shift from the utility, a party proposing an adjustment to a ratemaking claim bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment.” R.D. at 31-32. The ALJs determined that “the burden of proof in a ratemaking proceeding is on the public utility” and that “PECO has met its burden of proof and demonstrated that the costs at issue in the calculation of its PTC are properly allocated.” R.D. at 131.

In its Exceptions, NRG agreed with the burden of proof standard set forth by the ALJs. NRG Exc. at 7-8, 11. NRG argued, however, that the ALJs failed to require PECO to prove the justness and reasonableness of every aspect of its proposed rate increase and that, because PECO’s proposed allocation overlooked the “default service side of its business,” the evidence presented by NRG “tended to demonstrate the reasonableness of its proposal.” NRG Exc. at 11.

PECO’s default service it is not a separate operating division of PECO as NRG claimed. PECO St. 9R at 10; OCA M.B. at 9; see infra Reply to NRG Exception No. 3. PECO witness Alan B. Cohn explained that “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.” PECO St. 9R at 14; OCA M.B. at 11, 17; see OCA R.B. at 4-5. As OCA witness Clarence L. Johnson noted, “Mr. Peterson has not identified any avoidable costs of providing default service which are improperly recovered from customers of competitive EGS providers.” OCA St. 3R. at 4-5; OCA M.B. at 11; see infra Reply to NRG Exception No. 4. NRG witness Peterson identified only unavoidable costs and none of

such costs can be reallocated to default service. As such, PECO's proposed allocation is appropriate. The Company has sufficiently demonstrated that the costs NRG seeks to reallocate to the PTC are properly allocated to distribution service.

Further, NRG's reallocation proposal reflects a misunderstanding of default service. PECO St. 9R at 2; OCA M.B. at 7-9; OCA R.B. at 4-5. In particular, "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; OCA R.B. at 8. NRG's proposal would "allocate fixed costs to default service in a manner that would result in the company losing money as more people shop for power." Tr. at 442; OCA M.B. at 11. Under NRG's proposal, "if all PECO's customers decide to shop . . . PECO would not recover any distribution business expenses . . . even though all the costs would still remain with PECO." PECO St. 9R at 17; OCA M.B. at 11; OCA R.B. at 9. Therefore, NRG's reallocation proposal is illogical. OCA M.B. at 11; see OCA R.B. at 9. NRG has not provided evidence tending to demonstrate the reasonableness of its proposal and its proposal must be rejected.

The ALJs properly concluded that "PECO has met its burden of proof and demonstrated that the costs at issue in the calculation of the PTC are properly allocated between default service and distribution service" and rejected NRG's allocation proposal as unreasonable. R.D. at 131. Therefore, the OCA submits that the Commission should deny NRG Exception No. 1.

Reply To NRG Exception No. 2: The ALJs Correctly Determined That The PTC Recovers All Costs Of Providing Default Service. R.D. at 125-127; OCA M.B. at 16-18; OCA R.B. at 8-10.

In the Recommended Decision, the ALJs determined that "the PTC currently includes all costs incurred by PECO in providing default service." R.D. at 127. The ALJs also found that "the

costs that NRG proposes reallocating to default service are properly included in PECO's distribution rates and not the PTC." R.D. at 129.

In its Exceptions, NRG argued that the ALJs erred by determining that PECO properly recovers all costs associated with providing default service through its PTC. NRG Exc. at 19. NRG claimed that PECO's PTC does not reflect "costs that are incurred to provide default service to customers who are not served by an EGS" and that PECO omitted "indirect expenses to operate a business" from its methodology. NRG Exc. at 19.

As discussed in the OCA's Main and Reply Briefs, PECO properly quantifies and collects from default service customers the direct expense of providing default service. OCA St. 3R at 4; OCA M.B. at 11. OCA witness Johnson explained that these costs include "the acquired power cost, the cost of compliance with the law, transmission and ancillary service costs and the administration costs of operating the solicitation process." OCA St. 3R at 4-5; OCA M.B. at 11. OCA witness Johnson further explained, "Given that most of the default service cost is a pure pass through of purchased power, the magnitude of this re-allocation appears to be unreasonable." OCA St. 3R at 6-7; OCA M.B. at 13. Moreover, NRG "has not identified any avoidable costs of providing default service which are improperly recovered from customers of competitive EGS providers" and distribution costs in rates cannot be allocated to the PTC as NRG proposed. OCA St. 3R at 4-5; OCA M.B. at 11; *see infra* Reply to NRG Exception No. 4.

Pursuant to the Customer Choice Act, PECO is permitted "to recover on a full and current basis . . . all reasonable costs incurred under this section and a commission-approved competitive procurement plan." 66 Pa. C.S. § 2807(e)(3.9); OCA M.B. at 16. The costs "under this section" are the costs of providing default service. *Id.* PECO is not permitted to earn a profit for providing default service. PECO St. 9R at 4; OCA M.B. at 16. NRG's proposed allocation would inflate

the PTC by allocating hypothetical costs to default service generation.<sup>1</sup> PECO St. 9R at 14-15; OCA M.B. at 18; OCA R.B. at 8-10. An artificially inflated PTC will likely result in increased EGS prices, thereby harming both non-shopping and shopping customers. OCA R.B. at 10.

The ALJs properly concluded that “the PTC currently includes all costs incurred by PECO in providing default service” and that “the costs that NRG proposes reallocating to default service are properly included in PECO’s distribution rates and not the PTC.” R.D. at 127, 129. Therefore, the OCA submits that the Commission should deny NRG Exception No. 2.

Reply To NRG Exception No. 3: The ALJs Correctly Determined That The 1997 Unbundling Proceeding Does Not Support NRG’s Proposal. R.D. at 129-130; OCA M.B. at 9, 14-16; OCA R.B. at 6-8.

In the Recommended Decision, the ALJs concluded that “NRG’s reliance on the 1997 unbundling proceeding is misplaced,” reasoning that the “unbundling proceeding separated generation from transmission and distribution” and “did not divide costs with an understanding of what it would cost to provide default service.” R.D. at 129-130. Moreover, the ALJs explained that, in the unbundling proceeding, the Commission did not address “a hypothetical separation of functions that PECO performs as a distribution Company.” R.D. at 130.

In its Exceptions, NRG argued that the problem addressed in the unbundling proceeding is “identical” to that which it identified in this proceeding. NRG Exc. at 24. NRG claimed that PECO’s default service is “separate and distinct” from its distribution service. NRG Exc. at 27.

As discussed in the OCA’s Main and Reply Briefs, the 1997 unbundling proceeding, which concluded with the Restructuring Order, is unrelated to NRG’s proposal. OCA M.B. at 14-16;

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<sup>1</sup> The Commonwealth Court has provided: “[A] utility may pass along to its customers only those expenses or costs it actually incurs. Any other approach would permit the utility, by charging higher rates than necessary, to gain a profit from its customers under the guise of recovering operating expenses.” Cohen v. Pa. PUC, 468 A.2d 1143, 1150 (Pa. Commw. 1983) (citations omitted); see OCA M.B. at 18. Similarly, the Pennsylvania Supreme Court has stated that, “the Commission has no authority to permit, in the rate-making process, the inclusion of *hypothetical expenses* not actually incurred.” Barasch v. Pa. PUC, 493 A.2d 653, 655 (Pa. 1985) (emphasis added); see OCA M.B. at 18.

OCA R.B. at 6-8; 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). 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 49; OCA R.B. at 7. The Commission further noted, "The shopping consumer pays only the T&D rate . . . to the EDC when purchasing generation in the competitive market." Restructuring Order at 42; OCA R.B. at 7. As PECO witness Cohn explained, in the unbundling proceeding, "the Commission was addressing the actual separation of PECO's generation business which had thousands of employees and generated significant income on a stand-alone basis and the distribution business, not a hypothetical separation of functions PECO performs as a distribution Company." Tr. at 443; OCA M.B. at 14.

PECO witness Cohn further explained that "the Commission at the time agreed with testimony of a witness for the Office of Consumer Advocate ("OCA") that the unbundling of generation, transmission, and distribution rates in restructuring 'should produce results that should look like what functional costs would be if PECO were to separate itself into functionally separate divisions.'" PECO St. 9R at 11; Restructuring Order at 58; OCA M.B. at 15. The testimony of the OCA in the unbundling proceeding, however, is not applicable to the instant proceeding as NRG witness Peterson suggested. OCA St. 3R at 7; OCA M.B. at 15-16. In this regard, the unbundling

proceeding was considering stranded costs for generation plant owned by PECO. OCA witness Johnson explained the difference as follows:

Unlike purchase power acquired for default service, these generation plants incurred significant labor costs, which in turn requires significant indirect costs for employee benefits and supervision. The OCA's testimony in that case proposed a labor allocation for A&G expense, which is comparable to the S&W allocation method used for most A&G expense in the current CCOSS. Because the generation plants were labor intensive, 66% of direct labor expense was associated with generation at the time. However, as previously noted, little if any wage cost is incurred for default service.

OCA St. 3R at 7 (footnote omitted); OCA M.B. at 15-16. OCA witness Johnson further noted that that "purpose of the unbundling proceeding was unrelated to Mr. Peterson's objective of allocating distribution costs to default service rates." OCA St. 3R at 7; OCA M.B. at 14.

The unbundling proceeding established distribution only rates and, as such, 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. OCA R.B. at 7-8, n. 4. 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.

. . .

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 43; OCA R.B. at 7-8, n. 4.

As PECO noted in its Main Brief, the unbundling proceeding addressed “a very different company, with two distinct business groups,” generation and distribution. PECO M.B. at 17; OCA R.B. at 7, n. 3. PECO witness Cohn explained:

What Mr. Peterson ignores in his discussion of the 1997 Restructuring Order is that at the time, PECO was a very different company – one that included generation operations with twice the employees of its distribution operations. The 1997 Restructuring Order reflects the Commission concern regarding the allocation of administrative expense between two different business groups with significant administrative requirements. Notably, the allocator adopted by the Commission to address the administrative expense of PECO’s generation and distribution operations was neither revenues nor customers, nor some hybrid of the two, as Mr. Peterson proposes in this proceeding; instead, the Commission allocated administrative expense based upon the number of employees working in generation and operations.

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

PECO St. 9R at 12 (footnotes omitted); OCA M.B. at 15.

PECO witness Cohn further explained that, now, “all PECO customers – whether they receive electric generation supply from EGSs or from PECO – are distribution customers.” PECO St. 9R at 12, 14; OCA M.B. at 15; OCA R.B. at 7. In other words, “PECO customers are not distribution customers or default service customers; they are distribution customers who may or may not receive default service.” PECO St. 9R at 10 (emphasis omitted); OCA M.B. at 9. There is no “separate and distinct” distribution service for default service customers and EGS customers as NRG argued. OCA M.B. at 9. As such, it is not appropriate to rely on the unbundling proceeding to argue that distribution service to default service customers should be separated from distribution service to EGS customers. OCA R.B. at 7.

Further, the costs of default service are already included in the PTC. PECO witness Cohn discussed the requirements of the Commission's policy statement regarding default service and retail electric markets, 52 Pa. Code § 69.1808, and explained as follows:

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

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

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

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

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

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

(5) Applicable taxes, excluding Sales Tax.

(6) Costs for alternative energy portfolio standard compliance.

PECO St. 9R at 5; OCA M.B. at 16-17. PECO witness Cohn further explained that PECO' PTC includes each of these types of costs. See PECO St. 9R at 5-8; OCA M.B. at 17.

The ALJs properly were "not persuaded by NRG's reliance on the 1997 unbundling proceeding in support of its proposal" and properly concluded that "based on the purpose of the



1997 unbundling proceeding . . . NRG’s reliance on the 1997 unbundling proceeding is misplaced.” R.D. at 129, 130 (footnote omitted). Therefore, the OCA submits that the Commission should deny NRG Exception No. 3.

Reply To NRG Exception No. 4: The ALJs Correctly Determined That Only Avoidable Costs May Be Allocated To The PTC. R.D. at 128-129; OCA M.B.at 8-9, 10-12, 13-14; 16-17; OCA R.B. at 5-6.

In the Recommended Decision, the ALJs concluded that “only avoidable costs, which are those costs that PECO avoids when a customer switches to an alternative supplier, are properly allocated to its PTC” and that the costs NRG seeks to allocate are “not avoided by PECO when a customer switches to an alternative supplier.” R.D. at 128. The ALJs further concluded that they “agree with PECO witness Cohn that the primary goal in cost allocation is appropriate recognition of cost causality, and that Mr. Peterson has not shown that the costs he has proposed reallocating to default service are caused by, or even vary with, his chosen allocators.” R.D. at 129.

In its Exceptions, NRG argued that the ALJs improperly considered that the costs NRG seeks to allocate to default service are unavoidable costs. NRG Exc. at 36. In addition, NRG claimed that the Commission has rejected the avoided cost approach and that the Commission should follow cost causation principles, despite the fact that its proposal does not adhere to cost causation principles. NRG Exc. at 35, 37.

NRG’s claim that the Commission has rejected the avoided cost theory is based on a flawed reading of the Restructuring Order. In the Restructuring Order, the Commission concluded, “Unbundling [generation and distribution] costs should produce results that should look like what functional costs would be if PECO were to separate itself into functionally separate divisions.” Restructuring Order at 58. As discussed earlier, this statement does *not* apply to PECO’s default service as default service. See supra Reply to NRG Exception No. 3. In the unbundling

proceeding, the Commission separated two functions – generation and distribution. Here, it is that distribution function, which was already separated from any generation function, that NRG seeks to reallocate.

As discussed in the OCA’s Main and Reply Briefs, only avoidable costs, that is costs that are not incurred by the default service provider when a customer shops, can be properly allocated to the PTC. OCA M.B. at 10-11; OCA R.B. at 5-6. OCA witness Johnson explained, NRG “has not identified any avoidable costs of providing default service which are improperly recovered from customers of competitive EGS providers.” OCA St. 3R at 4-5; OCA M.B. at 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 customers shop. OCA St. 3R at 3-4; OCA R.B. at 5-6. As OCA witness Johnson stated, “PECO’s costs are not avoidable as PECO must stand ready to serve at all times.” OCA St. 3R at 3-4; OCA M.B. at 8; OCA R.B. at 6. 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; OCA R.B. at 6. Additionally, as noted earlier, PECO’s PTC presently includes each of the types of costs identified in the Commission’s policy statement regarding default service and retail electric markets, 52 Pa. Code § 69.1808. See supra Reply to NRG Exception No. 3.

Further, with regard to cost causation, NRG attempts to allocate costs to default service that are *not* costs of default service. PECO St. 9R at 16-17; OCA R.B. at 8. PECO witness Cohn noted that NRG witness Peterson “has not shown that the costs he allocates are caused by or even vary with his chosen allocators.” Tr. at 44; OCA M.B. at 13-14. PECO witness Cohn further

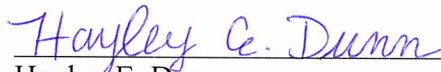
explained that “the distribution business costs Mr. Peterson proposed to allocate to default service customers are not a function of the number of distribution customers that receive default service or the amount such customers pay for default service.” PECO St. 9R at 16-17; OCA M.B. at 11; OCA R.B. at 9. For instance, in its Main Brief, PECO noted that “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); OCA R.B. at 9. PECO also noted that “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.’” Id. As such, as PECO witness Cohn found, Mr. Peterson’s reallocation proposal does not reflect cost causality. Tr. at 442; OCA M.B. at 13-14.

The ALJs properly determined that only avoidable costs can be allocated to the PTC and that the costs NRG seeks to reallocate are unavoidable and cannot be allocated to default service. Therefore, the OCA submits that the Commission should deny NRG Exception No. 4.

III. CONCLUSION

For the reasons set forth above, the OCA respectfully requests that the Commission deny NRG's Exceptions and adopt the ALJs' recommendation to reject NRG's proposed modification to the allocation of costs between distribution service and default service customers.

Respectfully Submitted,



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