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November 5, 2018

VIA eFILING

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

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

Dear Secretary Chiavetta:

Enclosed is the **Reply of PECO Energy Company to the Exceptions of NRG Energy, LLC to the Recommended Decision** ("Reply") in the above-referenced matter.

As evidenced by the Certificate of Service, copies of the Reply are being served on Judge Pell, Judge Brady, the Office of Special Assistants, and all parties of record.

Very truly yours,

A handwritten signature in black ink, appearing to read "Craig Williams", with a horizontal line extending to the right.

W. Craig Williams

Enclosures

cc: Per Certificate of Service (w/encls.)
The Office of Special Assistants (via e-mail only)

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the **Reply of PECO Energy Company to the Exceptions of NRG Energy, LLC to the Recommended Decision** on the following persons in the manner specified in accordance with the requirements of 52 Pa.

Code § 1.54:

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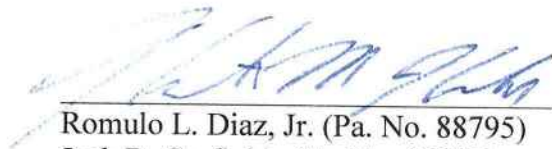
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**REPLY OF
PECO ENERGY COMPANY**

**To the Exceptions of NRG Energy, LLC to the Recommended Decision of
Deputy Chief Administrative Law Judge Christopher P. Pell and
Administrative Law Judge F. Joseph Brady**

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I. INTRODUCTION

On October 9, 2018, Deputy Chief Administrative Law Judge Christopher P. Pell and Administrative Law Judge F. Joseph Brady (the “ALJs”) issued their Recommended Decision (the “RD”) in this formal investigation by the Pennsylvania Public Utility Commission (the “Commission”) of the lawfulness, justness and reasonableness of electric distribution rates proposed by PECO Energy Company (“PECO” or the “Company”) in Tariff Electric – Pa. P.U.C. No. 6.¹ In the RD, the ALJs considered a proposed partial settlement (the “Settlement”) of this proceeding and found that the Settlement was reasonable and in the public interest. The ALJs recommended approval of the Settlement without modification.²

The only contested issue that remained in the proceeding in light of the Settlement was a proposal by NRG Energy, Inc. (“NRG”) to allocate over \$100 million in distribution costs in PECO’s fully projected future test year (“FPFTY”) only to those distribution service customers who receive default service instead of to all distribution customers. After extensive consideration of each of NRG’s arguments and the testimony of its witness, Mr. Chris Peterson, as well as the opposing testimony of witnesses on behalf of PECO and the Office of Consumer Advocate (the “OCA”), the ALJs recommended that NRG’s proposal be rejected in its entirety.³ The ALJs specifically concluded that PECO is properly allocating costs for default service, and recommended that PECO continue to calculate its price-to-compare (“PTC”) as previously approved by the Commission in prior default service and base-rate proceedings and as set out in PECO’s proposed tariff.⁴

¹ See Recommended Decision, *Pa. P.U.C. v. PECO Energy Co.*, Docket Nos. R-2018-3000164 *et al.* (Oct. 9, 2018).

² *Id.*, p. 74.

³ *Id.*, p. 124.

⁴ *Id.*, pp. 124, 130.

For the most part, NRG’s Exceptions repackage the arguments advanced in NRG’s Initial and Reply Briefs that were already considered and discussed by the ALJs and in PECO’s Initial and Reply Briefs, which PECO fully incorporates in these Reply Exceptions and urges the Commission to consider. This Reply will address the principal errors in NRG’s Exceptions and NRG’s assertions regarding the ALJs’ alleged failure to consider its various arguments. Because the ALJs correctly rejected NRG’s proposal, the Commission should deny each of NRG’s Exceptions.

II. BACKGROUND AND SUMMARY OF THE ARGUMENT

In its Exceptions, NRG contends that it “stepped up to the plate”⁵ in PECO’s distribution rate case to fix decades-old improper default service-related cost allocations in PECO’s rates that exist despite prior Commission approvals of PECO’s rates in base rate proceedings and multiple default service plans. NRG asserts that PECO is operating two “separate and distinct businesses” just as it did before electric restructuring in Pennsylvania, with the provision of generation service “precisely the same” as what the Commission now refers to as “default service.”⁶ Relying upon the testimony of Mr. Peterson, NRG argues that PECO’s failure to allocate over \$100 million in indirect expenses – such as the cost of its physical plant and employee salaries and pensions – from distribution customers to distribution customers receiving default service is inconsistent with “widely accepted” accounting principles and the Commission’s default service regulations and policy statement, and also leads to an incorrectly low PTC.⁷ NRG excepts to the RD on the grounds that the ALJs misapplied the burden of proof (after a “cursory analysis” and failure to “afford any level of respect” for the asserted expertise of

⁵ NRG Exceptions, p. 1.

⁶ *See Id.*, pp. 2 & 28-29.

⁷ *See Id.*, pp. 17-22.

Mr. Peterson) and reached an improper conclusion that PECO's PTC recovers all the costs of default service in "disregard" of Commission standards and precedent, including a prior 1997 restructuring decision that addressed indirect expenses and "avoided" costs.⁸

As an initial matter, NRG's assertions that the ALJs engaged in a "cursory analysis" and did not consider its expert's testimony is clearly incorrect: the ALJs devoted more than 50 pages of the RD to a careful summary of NRG's proposal, the testimony of Mr. Peterson and witnesses for PECO and the OCA, and the legal arguments of each party. The ALJs' actual recommendations also include specific findings regarding the flaws of Mr. Peterson's testimony and his proposed cost allocation, as well as specific conclusions that PECO has appropriately allocated both distribution service and default service costs.⁹

As the RD summarized, Mr. Peterson acknowledged that he was unaware of the standard practice of utilities in allocating indirect costs and that "he did not know of any utility in the United States that provides default service through a separate division or allocates indirect expenses as if it operates a separate default service division as he proposed."¹⁰ The ALJs properly noted that Mr. Peterson admitted that he had never allocated public utility costs for ratemaking purposes and found that Mr. Peterson's proposed allocation was inconsistent with principles of cost causation, since "Mr. Peterson has not shown that the costs he has proposed reallocating to default service are caused by, or even vary with, [default service revenue or number of default service customers]."¹¹ The ALJs also found PECO witness Alan B. Cohn "particularly convincing" in explaining that PECO was at risk of not being reimbursed for

⁸ See NRG Exceptions, pp. 2-5.

⁹ See generally RD, pp. 76-130.

¹⁰ *Id.*, p. 109.

¹¹ *Id.*, pp. 103 & 129.

distribution costs under Mr. Peterson’s proposal, and that PECO’s PTC properly included all costs incurred by PECO in providing default service consistent with the Commission’s approval of PECO’s four prior default service plans.¹² The ALJs also concluded that the 1997 Restructuring Order¹³ relied upon by NRG to support its theory of indirect cost allocation to default service customers was unpersuasive since the 1997 Restructuring Order was addressing the “actual separation” of PECO’s generation business and not “a hypothetical separation of functions that PECO performs as a distribution company.”¹⁴

The record in this proceeding and the explicit findings of the ALJs make clear that NRG’s four exceptions to the RD are without merit. The ALJs correctly concluded that PECO carried its burden of proof and NRG’s proposal was not reasonable. Testimony in this proceeding also established that PECO was properly recovering all costs of providing default service. In addition, the ALJs explicitly considered NRG’s arguments regarding the 1997 decision, and determined properly that it was not applicable. The Commission should therefore adopt the Recommended Decision and deny NRG’s Exceptions.

¹² *Id.*, pp. 127-29.

¹³ Opinion and Order, *Application of PECO Energy Co. for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement*, Docket No. P-00971265 (Order entered Dec. 29, 1997) (the “1997 Restructuring Order”).

¹⁴ RD, pp. 129-30.

III. REPLIES TO NRG'S EXCEPTIONS

A. The ALJs Properly Concluded That The Settlement Rates Were Just And Reasonable Without NRG's Proposed Re-Allocation Of Over \$100 Million In Indirect Expenses To Distribution Customers Receiving Default Service (NRG Exception No. 1)

1. The ALJs Correctly Stated The Applicable Burden Of Proof.

In the RD, the ALJs set forth the burden of proof applied by this Commission in accordance with Pennsylvania law.¹⁵ There are no significant differences in the standard of proof stated in the RD and the standard NRG offers in its Exceptions, and NRG agrees that “the party proposing an adjustment to a ratemaking claim” – which NRG has done – “bears the burden only of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment.”¹⁶ As discussed *infra*, NRG failed to demonstrate that its proposed adjustment was reasonable, and there is no ambiguity (as NRG implies) regarding the ALJs’ conclusion that PECO carried its burden in light of the RD’s explicit findings that PECO properly allocated distribution and default service costs.¹⁷

2. The RD Makes Clear That PECO Properly Allocates Indirect Costs And NRG's Proposal Was Unreasonable.

At the heart of NRG’s proposal are two assertions, namely (1) PECO operates two “separate and distinct” businesses providing distribution service and default service that requires the allocation of PECO’s indirect expenses between distribution customers who receive default electric generation service and those who shop with electric generation suppliers (“EGSs”); and

¹⁵ *Id.*, pp. 30-32.

¹⁶ *Cf.* RD, p. 31; NRG Exceptions, p. 8 (internal quotations omitted).

¹⁷ NRG also errs in contending that the ALJs’ reference to the costs allocated by Mr. Peterson as “fixed” instead of “indirect” demonstrates a flaw in the ALJs’ analysis. *Compare* RD, p. 128 & NRG Exceptions, pp. 10-11. In this proceeding, NRG is seeking to reallocate distribution costs, and the ALJs’ reference to such costs as “fixed” is consistent with the Commission’s view of such costs. *See, e.g.*, Proposed Policy Statement, *Fixed Utility Distribution Rates Policy Statement*, Docket No. M-2015-2518883 (May 23, 2018), p. 16 (explaining that “the costs of the distribution system, in the short run, are fixed”).

(2) the allocation of those indirect expenses should be based upon PECO's default service revenues and the number of customers receiving default service.¹⁸ The applicable law and evidence in this proceeding clearly support the ALJs' conclusions that NRG's assertions are flawed.

Under the Pennsylvania Public Utility Code (the "Code"), PECO has an obligation to serve all distribution customers with default generation supply service.¹⁹ Default service is provided to those customers who do not select an EGS or who return to default service after being served by an EGS that becomes unable or unwilling to serve them.²⁰ Every customer who receives default service from PECO is a distribution service customer, and PECO provides electric distribution service without regard to whether a customer also receives default service.²¹ Contrary to NRG's claim that the ALJs failed to explain why they did not view default service and distribution service as "separate businesses" operated by PECO,²² the ALJs clearly concluded that "default service exists for all customers, both shopping and non-shopping, and . . . the Code requires PECO to stand ready to service 100% of customers' power needs on a moment's notice."²³

Even when NRG's witness emphasized that distribution service and default service should be viewed as "distinct functions," NRG entirely failed to provide a reasonable basis to conclude that those functions "should be treated as such for purposes of allocating indirect

¹⁸ See RD, pp. 76 & 95.

¹⁹ *Id.*, p. 125; 66 Pa.C.S. § 2807(e)(3.1).

²⁰ RD, p. 125.

²¹ See *Id.*, p. 99; PECO Initial Br., p. 10.

²² NRG Exceptions, pp. 9-10.

²³ RD, p. 125; see also RD, p. 99.

costs.”²⁴ Mr. Peterson conceded that he was unaware of any other utility that actually allocates indirect costs as he has proposed despite his assertions that such allocations reflect “widely accepted principles.”²⁵ And the undisputed evidence in this proceeding established that PECO manages its interactions with wholesale electric markets to support **both** default service and electric choice in a single organization, the Energy Acquisition team (“EA”), which is responsible for “matching each distribution customer’s load responsibility to their retail provider, be it an EGS or PECO as the default service provider.”²⁶ Since the EA team supports both shopping and default customers, the ALJs found that PECO properly included the costs of the EA team in distribution rates.²⁷

Similarly, even if default service were a “separate business” to which indirect costs should be allocated as NRG proposed, the ALJs found that Mr. Peterson had failed to show that his approach was consistent with principles of cost allocation, because the costs he chose to allocate were not driven by default service.²⁸ Under Mr. Peterson’s approach, such costs as

²⁴ NRG Exceptions, p. 9.

²⁵ RD, p. 109.

²⁶ *Id.*, p. 125. In its Exceptions (p. 9), NRG introduced a new argument that the “possibility of an entity other than the electric distribution company (“EDC”) serving in the default service provider role” is “further evidence” that PECO’s default service should be treated as a separate business. *See* 52 Pa. Code § 54.183. The Commission has yet to select an alternative default service provider, and that possibility (or the fact that default service rates are established in a default service proceeding) provides no grounds to support Mr. Peterson’s proposed allocation of costs that the ALJs found are not caused by, or even vary with, his chosen allocators of default service revenue and number of customers receiving default service. *See Id.*, p. 129.

²⁷ *Id.*, p. 125. The undisputed evidence established that the actual costs incurred by PECO’s EA team in processing automatically-generated invoices and payments to wholesale default service providers were limited, and PECO also does not charge EGSs for the EA team’s services. *See Id.*, p. 102. NRG’s new assertion that the EA team’s activities raise issues under the Federal Energy Regulatory Commission’s Standards of Conduct or Section 2811(d) of the Code (*see* NRG Exceptions, p. 24) is entirely without merit. There is nothing in the record to suggest that the EA team performs a transmission function (it does not) or is engaged in anticompetitive or discriminatory conduct. Moreover, the FERC Standards of Conduct cited and the article hyperlinked by NRG relate to rules that were superseded by FERC in 2003. FERC’s Order No. 2004, FERC Stats. & Regs. ¶ 31,155 (2003) (subsequent history omitted), removed 18 C.F.R. § 37.4 from FERC’s regulations. FERC’s Order No. 717, FERC Stats. & Regs. ¶ 31,280 (2008) (subsequent history omitted) revised the Standards of Conduct yet again, adopting the currently-effective version in 18 C.F.R. Part 358.

²⁸ *Id.*, p. 129.

PECO's depreciation and amortization for general, common and intangible plant and employee salaries and pension expense for all PECO employees would be allocated to customers receiving default service based upon either the ratio of PECO's projected FPFTY default service revenues to its total distribution revenues (43%) or the ratio of the number of customers Mr. Peterson believes will be receiving default service in 2019 to the total number of projected PECO distribution customers (66%).²⁹ PECO witness Alan Cohn explained that these costs – which Mr. Peterson asserted were over \$100 million in PECO's FPFTY – did not vary with default service revenues or number of default service customers served, since virtually all default service revenues are paid directly to wholesale suppliers under wholesale default service supply contracts and those suppliers are responsible for managing the varying energy requirements of default customers.³⁰ After finding Mr. Cohn's testimony that Mr. Peterson's proposal would leave PECO at risk for not recovering its costs of providing distribution service "particularly convincing," the ALJs agreed.³¹

NRG's repeated claims that the ALJs somehow failed to conclude that PECO met its requisite burden of proof or "ignored" NRG's arguments or Mr. Peterson's testimony also lack merit. As noted in Section III.A.1, the RD contains an extensive discussion of the proper burden of proof, and the ALJs both considered NRG's various theories and made specific findings regarding the correctness of PECO's cost allocations and the flaws in Mr. Peterson's proposal.³²

²⁹ *Id.*, pp. 94-95; PECO Initial Br., pp. 4-5.

³⁰ RD, pp. 100-02.

³¹ *Id.*, pp. 128-29.

³² Compare, e.g., NRG Exceptions, p. 11 (asserting that the RD does not discuss "the widely accepted accounting principles" relied on by NRG and the RD, p. 85 (noting NRG's claim that PECO is not shielded from following "widely accepted accounting practices"); NRG Exceptions, p. 14 n.28 (asserting that the RD does not identify the cost allocators proposed by Mr. Peterson) and the RD, pp. 95 & 129 (discussing Mr. Peterson's cost allocators); NRG Exceptions, p. 15 (asserting the ALJs dismissed Mr. Peterson's "fresh perspective" on cost allocation) and the RD, p. 129 (concluding that the costs Mr. Peterson chose to allocate did not vary with his chosen cost allocators). NRG's additional contention that the ALJs should have given Mr. Peterson's views more "respect" (NRG

Having failed to demonstrate that the ALJs erred in concluding that PECO had properly allocated its indirect costs, NRG's subsequent argument that a higher PTC based on those costs would be in the interest of customers and permit "apples-to-apples" comparisons collapses.³³ The Commission should deny NRG's Exception No. 1 in its entirety.

B. The ALJs Correctly Determined That The PTC Recovers PECO's Costs Of Providing Default Service (NRG Exception No. 2)

In its second Exception, NRG contends that the ALJs erred by concluding that PECO recovers all costs of providing default service through the PTC. After recounting the Commission's regulations, default service Policy Statement, and excerpts from the Commission's final order in the Retail Markets Investigation, NRG contends that PECO's PTC methodology is flawed because it does not include administrative costs and other expenses that Mr. Peterson believes should be attributed to default service.³⁴ As with Mr. Peterson's other cost allocation proposals, his allegations regarding PECO's PTC were properly rejected in the RD.

PECO witness Cohn provided detailed testimony about the nature of the Company's default service costs and how they are recovered through PECO's PTC, which the ALJs summarized in the RD. Mr. Cohn explained that, in accordance with the default service plans approved by the Commission, PECO conducts competitive procurements and enters into wholesale power contracts and associated services for three different default service customer

Exceptions, p. 14) is undermined by Mr. Peterson's own testimony regarding his lack of relevant utility experience and personal knowledge regarding various PECO programs and Commission proceedings, as well as his erroneous claim that PECO earns a return on distribution charges. *See* RD, pp. 103-105, PECO Initial Br., pp. 10-12 & Reply Br., pp. 7-9.

³³ *See* NRG Exceptions, pp. 15-17. NRG's additional offer (*see* NRG Exceptions, p. 17) to revise its proposal at this stage of the proceedings to address its admitted failure to allocate indirect expenses to all customer classes instead of only residential customers cannot make its current proposal reasonable.

³⁴ *Id.*, pp. 17-23.

classes.³⁵ Under these contracts, the winning bidders in PECO's competitive procurements are responsible for assuming, managing, and covering the financial costs and risks associated with electricity supply for their respective percentages of residential customers, including all required energy, capacity, and ancillary services, as well as alternative energy credits required for compliance with the Alternative Energy Portfolio Standards Act.³⁶

Consistent with Commission requirements, PECO recovers all of the costs of the wholesale power contracts in the PTC as well as default service administrative costs (including the cost of an independent evaluator to oversee the procurement process), working capital, information technology costs, and regulatory and litigation costs associated with PECO's default service plan.³⁷ In accordance with the Commission's regulations, PECO recovers only its actual cost to furnish default service, and is prohibited from recovering the costs of default service in its distribution rates or any profit. To enforce compliance with its regulations, the Commission audits the Company's PTC annually.³⁸

As explained in Section III.A *supra*, NRG's proposal to reallocate PECO's administrative costs (including expenses for human resources, information technology, and other costs described by NRG in its second Exception) to default service customers on the ground that PECO operates a "separate" default service was properly rejected by the ALJs. Contrary to NRG's claims that PECO operates a "massive default service business" based on default service revenues and customers,³⁹ virtually all default service revenues are paid directly to default

³⁵ PECO St. No. 9-R, p. 3.

³⁶ *Id.*, p. 4.

³⁷ See 52 Pa. Code. § 54.187(e); 52 Pa. Code § 69.1808; PECO St. No. 9-R, pp. 5-6.

³⁸ See RD, p. 127; 52 Pa. Code § 54.187(e) & (f); 66 Pa.C.S. § 1307(d); PECO Reply Br., p. 15 n.62 (noting that Mr. Peterson was unaware of Commission audits of PECO's PTC).

³⁹ NRG Exceptions, p. 3.

service suppliers who are responsible for providing electric generation service for all default service customers. As Mr. Cohn testified (and as the ALJs so found), PECO's actual default service costs, including associated administrative costs, are fully included and recovered in PECO's PTC,⁴⁰ with the costs of the EA team properly included in distribution rates because the EA team is responsible for managing all of PECO's wholesale market interactions for both shopping and non-shopping customers.⁴¹ While it may be "unfathomable" to NRG that PECO's current PTC does not include certain costs, neither NRG nor Mr. Peterson investigated whether the additional costs they want to allocate to the PTC were actually caused by any default service function.⁴²

The remainder of NRG's contentions regarding costs that should be included in the PTC are either speculative or simply wrong. For example, NRG asserts that PECO's failure to include education costs in the PTC is "unreasonable" based on entirely unsupported and erroneous claims that PECO's energy efficiency and conservation ("EE&C") programs "give PECO an opportunity to educate consumers about default service."⁴³ And NRG's "astonishment" regarding a negative expense in the administrative component of PECO's PTC continues because NRG refuses to acknowledge the correct application of retail market

⁴⁰ RD, p. 127.

⁴¹ *Id.*, p. 125. NRG's suggestion that this is just a matter of convenience (NRG Exceptions, p. 23) is unfounded; as Mr. Cohn's testimony made clear, PECO must match its customer load with wholesale market supply, regardless of whether that supply is from an EGS or a default service wholesale supplier. Tr. 439-41.

⁴² See NRG Exceptions, pp. 22-23 & RD, p. 106. For example, NRG asserts that default service requires a "call center infrastructure," see NRG Exceptions at 20, but Mr. Peterson provided no evidence to conclude that PECO's call center costs were driven by default service. RD, p. 106; Tr. 441-42 & 498. As noted previously, Mr. Peterson also lacked personal knowledge of the PECO programs he thought were related to default service. See *supra* n.32.

⁴³ See *Id.*, p. 22.

enhancements resulting in a credit to the PTC, as the ALJs correctly noted.⁴⁴ The Commission should therefore deny NRG's second Exception.

C. The ALJs Properly Concluded That The 1997 Restructuring Order Did Not Establish The Standard For How To Allocate Costs Between Distribution And Default Service (NRG Exception No. 3)

In its third Exception, NRG contends that (1) the 1997 Restructuring Order established an unbundling standard that requires indirect costs to be allocated as if PECO operated a separate default service division; and (2) the ALJs allegedly disregarded that standard when rejecting NRG's cost allocation proposal. As discussed below, the 1997 Restructuring Order does not apply to the allocation of costs between distribution and default service functions and there is simply no record evidence that this Commission has *ever* applied the alleged "standard" in a default service context. The ALJs properly focused on the default service statutes and regulations and principles of cost causation to assess whether the Company has appropriately allocated distribution and default service costs.

NRG's contention that the cost allocation issues in this proceeding are "identical"⁴⁵ to those considered at the time of restructuring is without support. The 1997 Restructuring Order took place in a different context and considered different issues. The underlying docket was dedicated to PECO's restructuring following the enactment of the Electricity Generation Customer Choice and Competition Act (the "Competition Act"),⁴⁶ which required unbundling the Company's generation service from regulated transmission and distribution service. At that time, PECO owned a number of large generating plants, employed thousands of employees to operate and support those generating plants, and the generation business had significant income

⁴⁴ Compare NRG Exceptions, p. 23 & RD, pp. 112-113.

⁴⁵ NRG Exceptions., p. 24.

⁴⁶ 66 Pa.C.S. § 2801 *et seq.*

on a stand-alone basis.⁴⁷ In the 1997 Restructuring Order, the Commission implemented the unbundling of generation rates from distribution and transmission rates as mandated by the Competition Act and, therefore, had to consider how to allocate total-Company administrative costs between PECO's operations related to the *production* of energy and its distribution operations.⁴⁸ The Commission agreed with the OCA that such costs should be allocated as if PECO were to separate the operation of generation facilities and the operation of distribution and transmission facilities into "functionally separate divisions."⁴⁹

PECO's operations as a default service provider are clearly not analogous to its prior ownership and operation of generating facilities that were used in the production of electricity. PECO does not generate any of the electricity it delivers to its customers, whether or not those customers receive default service. Instead of employing thousands of employees to operate and support generation plants, PECO now only solicits and manages the contracts whereby wholesale suppliers procure and provide default service supply to customers.⁵⁰ In addition, the legal framework is different. PECO's recovery of the costs it incurs to provide default service is governed by specific provisions of the Pennsylvania Public Utility Code and the Commission's applicable regulations.⁵¹ When the Commission reviews the costs included in PECO's default service rates, it refers to these specific legal requirements – not the alleged "standard"

⁴⁷ Tr. 443.

⁴⁸ 1997 Restructuring Order, p. 49.

⁴⁹ *Id.*, p. 58. Notably, the Commission approved allocation of administrative expenses between generation and distribution based upon a labor allocator in 1997, and that decision provides no support for allocation of administrative expenses based on default service revenues or the number of customers served, as Mr. Peterson advocates. *See* RD, pp. 108-109 & 121-122; *see also* PECO Reply Br., p. 11.

⁵⁰ *See* RD, pp. 99-102; PECO St. No. 9-R, pp. 3-4 (describing how PECO meets its default service obligations).

⁵¹ PECO Initial Br., p. 8.

concerning functional separation found in the 1997 Restructuring Order.⁵² It is notable that NRG has not identified a single instance where the Commission has applied this “standard” in the default service context and has also been unable to identify *any utility in the United States* that actually operates a separate default service division.⁵³

NRG tries to downplay the clear differences between these two proceedings by repeatedly stating that the ALJs failed to realize that there was no “actual” separation addressed in the 1997 Restructuring Order.⁵⁴ While it is true that this particular order did not implement the “actual” separation of PECO’s generation business, the transfer of PECO’s generation assets was approved just a few months later in the very same docket when the Commission approved a Joint Petition for Settlement:⁵⁵

[T]he Commission hereby approves without condition all aspects of PECO’s transfer or assignment of its generation assets and liabilities and the wholesale power contracts as set forth in the settlement. The transfer or assignment may be, in PECO’s discretion, to an entity that is an affiliate or subsidiary of PECO, or a non-affiliate.

Furthermore, the functional separation that was implemented in the 1997 Restructuring Order was followed by the physical separation of PECO’s generating assets on January 1, 2001, when PECO’s entire generation operations, including all of its generating assets and associated

⁵² See, e.g., *Petition of PECO Energy Co. for Approval of its Default Serv. Program for the Period from June 1, 2017 through May 31, 2021*, Docket No. P-2016-2534980 (Order entered Dec. 8, 2016); *Pennsylvania Pub. Util. Comm’n v. PECO Energy Co.*, Docket No. R-2015-2468981 (Order entered Dec. 17, 2015); *Petition of PECO Energy Co. for Approval of its Default Serv. Program for the Period from June 1, 2015 through May 31, 2017*, Docket No. P-2014-2409362 (Order entered Dec. 4, 2014).

⁵³ PECO St. No. 9-R, p. 11 & Exhibit ABC-2.

⁵⁴ See, e.g., NRG Exceptions, pp. 28-30.

⁵⁵ *In Re PECO Energy Co.*, 186 P.U.R. 4th 105 (May 14, 1998).

employees, were transferred to a separate corporate entity pursuant to a detailed corporate restructuring plan approved by the Commission.⁵⁶

For all of these reasons, the ALJs properly rejected NRG's interpretation of the 1997 Restructuring Order, and therefore NRG's third Exception should be denied.

D. The ALJs Properly Rejected NRG's Flawed Analysis Because It Was Not Based On Cost Causation Principles (NRG Exception No. 4)

In its fourth Exception, NRG argues that the ALJs' rejection of NRG's proposal improperly relied upon an "avoided cost theory" rather than cost causation principles.⁵⁷ In fact, the RD explains clearly that the ALJs rejected NRG's proposal only after a careful review of the record evidence concerning the nature and cause of the costs that NRG claims are default service-related and argues should be recovered through PECO's PTC. Contrary to NRG's contention, the ALJs properly applied well-accepted principles of cost-causation regularly employed by this Commission to allocate utility costs, as evidenced by their finding that "[t]he costs that Mr. Peterson proposes reallocating are not caused by customers being default service customers, but rather, by them being distribution customers, which all default customers are as well."⁵⁸

Mr. Peterson proposes to reallocate costs that PECO incurs to furnish distribution service because he contends a portion of those costs would "reasonably support" PECO's provision of default service if default service were deemed to be a separate division within PECO.⁵⁹ Notably,

⁵⁶ See Opinion and Order, *Application of PECO Energy Co. Pursuant to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code for Approval of (1) a Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation*, Docket No. A-00110550F0147 (June 22, 2000).

⁵⁷ NRG Exceptions, pp. 34-40.

⁵⁸ RD, p. 129.

⁵⁹ *Id.*, p. 89; NRG St. No. 1, pp. 17-18.

NRG's proposal is not based upon any assessment of the actual costs of PECO's provision of default service.⁶⁰ Indeed, Mr. Peterson developed his proposal before conducting any discovery in this proceeding and, therefore, before he could have investigated how PECO actually provides default service to distribution customers.⁶¹

PECO witness Jiang Ding explained in her direct testimony that each of the cost categories identified by Mr. Peterson was properly functionalized and assigned to distribution customers.⁶² The ALJs' evaluation of the evidence concerning the Company's distribution costs, default service costs, and NRG's hypothetical allocations was grounded in the cost causation principles that NRG incorrectly states are missing from the RD:

We also 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. The costs that Mr. Peterson proposes reallocating are not caused by customers being default service customers, but rather, by them being distribution customers, which all default customers are as well. PECO would incur the same costs to distribute electricity even if every customer shopped for electricity and there were no default service customers.⁶³

The ALJs' reference to "avoidable costs" in the RD does not mean that they departed from sound cost-causation principles, as NRG contends. Consistent with principles of cost-causation, these "avoidable costs" are properly included in the PTC rather than distribution rates.⁶⁴

⁶⁰ See Tr. 472; see also NRG Initial Br., p. 47 ("Of the total indirect expenses that [Mr. Peterson] deemed necessary to reallocate, he identified \$101,951,549, which is currently allocated entirely to distribution service, and should be attributed to default service. This represents approximately 51.5 percent of the total pool of indirect expenses.") (emphasis added).

⁶¹ Tr. 485.

⁶² See PECO St. No. 6, pp. 14-25.

⁶³ RD, p. 129.

⁶⁴ NRG's reliance on the Commission's allocation of its own actual costs as required by statute (*see* NRG Exceptions, p. 39) is inapposite. Notably, when considering indirect costs with respect to EGSS, the Commission made clear that its allocation method is intended to address the time Commission staff spent on supplier activities

Mr. Cohn further explained that the allocation method proposed by NRG created a significant risk that the Company would not recover its actual fixed costs of providing distribution service to all of its customers:

Under Mr. Peterson’s allocation method, if all customers became default service customers, large amounts of PECO distribution system costs (including depreciation and amortization for general, common and intangible plant) would need to be recovered from those customers. Alternatively, if all of PECO’s customers decide to shop (which they are free to do), 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.⁶⁵

As the ALJs found, Mr. Peterson’s allocation method would create a material risk “of [PECO] not being reimbursed for costs it incurs as the customers’ distribution company.”⁶⁶ Mr. Peterson did not consider the extent of possible losses arising from his method, and NRG’s recommendation that PECO come back to the Commission to address any losses underscores NRG’s failure to demonstrate the reasonableness of its proposal.⁶⁷ The Commission should also deny NRG’s fourth Exception.

related to the oversight of NGSs/EGSs and tied to direct costs – not activities assumed under a hypothetical “separate business” as proposed by Mr. Peterson. *See* Final Implementation Order, *Implementation Act 155 of 2014*, Docket No. M-2014-2448825 (Order entered Apr. 24, 2015), pp. 4-6.

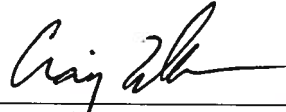
⁶⁵ *Id.* (quoting PECO St. No. 9-R, p. 17).

⁶⁶ RD, p. 128.

⁶⁷ *Id.*, p. 110 (noting testimony by Mr. Peterson that he could only guess as to what level of customer shopping would make his proposal unreasonable).

IV. CONCLUSION

For the reasons set forth above and in the Company's Initial and Reply Briefs, the Commission should deny NRG's Exceptions and adopt the ALJs' Recommended Decision.



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