

ORDER NO. 86881

IN THE MATTER OF THE REVIEW OF
 DELMARVA POWER & LIGHT COMPANY
 STANDARD OFFER SERVICE
 ADMINISTRATIVE CHARGE

IN THE MATTER OF THE REVIEW OF THE
 POTOMAC ELECTRIC POWER COMPANY
 STANDARD OFFER SERVICE
 ADMINISTRATIVE CHARGE

* BEFORE THE
 * PUBLIC SERVICE COMMISSION
 * OF MARYLAND

* CASE NO. 9226

* CASE NO. 9232

Issue Date: March 3, 2015

To: The Parties of Record and Interested Persons

I. Background

On July 31, 2014, the Public Utility Law Judge (“PULJ”) issued a Proposed Order (“PO”) which granted the Joint Motion for Approval and Agreement of Stipulation and Settlement (“2014 Settlement”) in these cases to resolve issues regarding the Companies’ Standard Offer Service (“SOS”) Administrative Charges, including SOS Cash Working Capital (“CWC”) requirements.¹ The Administrative Charge is designed to recover certain costs associated with the procurement of electricity supply, known as SOS. The Office of People’s Counsel (“OPC”) filed an appeal on September 2, 2014, and its Memorandum on Appeal September 12, 2014, (“OPC Appeal”) requesting reversal of the Proposed Order. On October 2, 2014, the Settling Parties, Delmarva Power & Light

¹ The 2014 Settlement was filed on February 4, 2014.

Company (“Delmarva”), Potomac Electric Power Company (“Pepco”, jointly “Companies”), the Public Service Commission Staff (“Staff”) and the Retail Energy Supply Association (“RESA”) filed Reply Memorandums in support of the 2014 Settlement as did Baltimore Gas and Electric Company (“BGE”)² recommending that the Proposed Order be affirmed.

II. 2014 Settlement

The 2014 Settlement provides that the SOS Administrative Charge shall continue to be composed of a utility return component, an incremental cost component, an uncollectibles component and an Administrative Adjustment component for Residential and Non-Residential Type I, Type II and Hourly Priced Service (“HPS”).³ The utility return is set at 1.3 mills (0.0013 \$/ kWh)⁴ for Residential SOS, 2.0 mills for Type I and Type II SOS and 2.25 mills for HPS.⁵ The Companies will recover their actual incremental costs from all customer classes and these actual costs will be used to true-up the estimated incremental costs for that same year, with any over or under collection

² Although BGE has its own SOS Administrative Charge proceeding, Case No. 9221, *In The Matter of a Request By Baltimore Gas and Electric Company For Recovery of Standard Offer Service Related Cash Working Capital Revenue Requirement*, it also separately intervened in these two cases.

³ 2014 Settlement, paragraph 2. According to Table 1 attached to the testimony of Companies’ witness DeVito (filed February 18, 2014), the total Administrative Charge plus Cash Working Capital in the 2014 Settlement will be 4.463 mills for Residential SOS, 6.449 mills for Type I SOS, 6.745 mills for Type II SOS and 3.669 mills for HPS SOS. Her Table 1 is attached as Appendix I. According to the 2003 Settlement the current Administrative Charges, which include the CWC requirement, are 4 mills for Residential SOS, 5.5 mills for Type I SOS, 6 mills for Type II SOS and 2.25 mills to 3.0 mills for HPS. 2003 Settlement, paragraphs 12, 31, 50 and 82. The 2003 Settlement was filed in Case No. 8908 and is Docket Item number 119. Attachment 1 to Staff’s Reply Memorandum (filed October 2, 2014) contains a summary of the 2003 Settlement Administrative Charges and is attached as Appendix II. OPC provided an Administrative Charge comparison with its Memorandum on Appeal (filed September 12, 2014), which compares current, 2014 Settlement and OPC proposed Administrative Charges for Delmarva and Pepco Residential customers. These charts are Appendix 3A (Delmarva) and 3B (Pepco).

⁴ “kWh” is kilowatt hours.

⁵ 2014 Settlement, paragraph 3.

applied to the estimated incremental costs for the next SOS program year. The Companies will use a baseline of 0.2 mills for Residential SOS during the first year.⁶ The uncollectibles component for Residential SOS will consist of the allocation of their uncollectibles to the supply component determined by the Commission in each of the Companies' most recent base distribution rate cases.⁷ For Type I, Type II, and HPS SOS, the Companies will use the methodology that was determined in the 2003 Settlement.⁸

The 2014 Settlement provides that the Residential SOS Administrative Adjustment will be calculated as the total Administrative Charge, (which is 3.5 mills) less incremental costs, uncollectible costs and the utility return component. For Pepco's Residential SOS customers this means the Administrative Adjustment will be 0.41 mills and for Delmarva's Residential customers 0.62 mills for purposes of the effective date of the 2014 Settlement.⁹ Revenues associated with the Administrative Adjustment will be credited to all Residential distribution customers in the form of a per kWh credit. The 2014 Settlement also provides that in the event 35% of Residential peak load contribution migrates to competitive retail supply, Staff will convene a stakeholders meeting to discuss whether the Administrative Adjustment should be reduced pursuant to paragraph 14 of the 2003 Settlement.¹⁰

⁶ 2014 Settlement, paragraph 4.

⁷ 2014 Settlement, paragraph 5.

⁸ 2014 Settlement, paragraph 5. The 2003 Settlement provides that actual incremental costs for Type I, Type II and HPS SOS include actual uncollectibles that are not being recovered in a Utility's distribution rates. Paragraphs 31, 50, 82.

⁹ 2014 Settlement, paragraph 7.

¹⁰ According to the Commission's Electric Choice Enrollment Monthly Reports for October 2014, 25% of Pepco's Residential peak load obligation is served by electric suppliers and 18.7% of Delmarva's Residential peak load is served by suppliers. Paragraph 14a of the 2003 Settlement also provides that when 50% of Residential load migrates to suppliers that the Administrative Adjustment will be eliminated and the Administrative Charge will be reduced commensurately.

The 2014 Settlement provides that the Companies will recover their actual SOS CWC requirements and that the CWC will be calculated *separately* from the Administrative Charge. The CWC revenue requirement associated with each class of SOS will use the Companies' total weighted cost of capital grossed up for income taxes and will be trued-up annually consistent with the incremental cost true-up.¹¹

III. Proposed Order¹²

The PULJ noted that only OPC opposes the 2014 Settlement and that OPC raised three concerns, the rate of interest on CWC; what amount, if any, should be allowed as a separate utility return; and whether to include an Administrative Adjustment in the Administrative Charge.¹³ Addressing these issues, the PULJ noted that OPC opines that SOS procurement is simply a series of short-term obligations. Conversely, the Settling Parties view the CWC requirement as a continuing obligation that consequently should be recovered at the Companies' overall authorized rate of return.¹⁴ The PULJ stated that the Companies use a mix of borrowing, which is then converted to a long-term rate. He found this efficient and concluded that the CWC requirement should be viewed as a long-term obligation, which he found reasonable and in the public interest.¹⁵

The PULJ stated that “the correct interpretation of the language of PUC Section

¹¹ 2014 Settlement, paragraph 7.

¹² The PULJ discusses the standard of review at pages 14-16 of the Proposed Order. Because we remand this matter to the PULJ for further proceedings, we need not address this issue.

¹³ PO at 13.

¹⁴ PO at 16.

¹⁵ PO at 17.

7-510(c)(3)(ii)(2) requires a return.”¹⁶ He stated that the language “plus a reasonable return” would not be in the statute “if it was to have no meaning.”¹⁷ The PULJ concluded that the amount of the return in the 2014 Settlement “falls within the range of what is reasonable (although it is at the top end of that range).”¹⁸ Finally, he concluded that the agreed upon return “covers the risks associated with providing SOS, at a generous but acceptable level.”¹⁹

The PULJ found the Administrative Adjustment included in the 2014 Settlement “the most troubling aspect.”²⁰ He questioned whether it is needed to adjust costs to create a market rate. Further, he stated that it is “speculation” as to how large it needs to be to serve as a proxy for costs that suppliers also must cover. However, he concluded that the Administrative Adjustment “does not push the settlement out of the range of reasonable.”²¹

The PULJ concluded that the 2014 Settlement “is in the public interest because the benefits to be obtained by rejecting it and litigating this case may not exceed the costs and benefits obtained by that process.”²² The PULJ stated that the 2014 Settlement “is generous to both the companies and the suppliers but not so burdensome to ratepayers to require that it be rejected.”²³

¹⁶ PO at 17.

¹⁷ PO at 17.

¹⁸ PO at 17.

¹⁹ PO at 17.

²⁰ PO at 17.

²¹ PO at 18.

²² PO at 18.

²³ PO at 18.

IV. Parties' Positions

A. OPC's Appeal²⁴

OPC appeals the PULJ's findings regarding three issues, the rate of return on CWC, inclusion of a separate utility return for procuring SOS, and including an Administrative Adjustment in the Administrative Charge.²⁵

1. Cash Working Capital Requirement

OPC asserts that the return for SOS CWC in the 2014 Settlement is "excessive and unsupported by the record."²⁶ OPC states that the compensation for CWC should reflect the least-cost option.²⁷ OPC states that the Companies' revenue lag is only 39.96 days for Delmarva and 35.91 days for Pepco.²⁸ For these reasons OPC concludes that the short-term debt ("STD") rate is the most reasonable CWC return rate. Moreover, OPC states the record does not support a finding that there is efficiency in viewing CWC financing as a long-term debt ("LTD") noting that LTD costs more.²⁹ OPC states that the Companies' capacity for short-term borrowing exceeds \$2 billion, which is more than enough to satisfy their CWC obligation of \$70 million (\$47.5M Pepco; \$21.7M Delmarva).³⁰ OPC states that the Companies' actual costs for STD is 0.20% to 0.40%, which is below OPC's recommended CWC rate of 3.25%.³¹ OPC asserted that the

²⁴ OPC argues that the PULJ did not make a decision on the merits based upon substantial evidence in the record. OPC Appeal at 4-8. Because we remand these cases to the PULJ for further consideration of the contested issues raised by OPC, we need not address this allegation.

²⁵ OPC stated that there "is no dispute between the parties regarding the Agreement's treatment of the incremental cost and uncollectible components." OPC Appeal at 2, footnote 5.

²⁶ OPC Appeal at 8.

²⁷ OPC Appeal at 9.

²⁸ OPC Appeal at 11. *See also* OPC footnote 44.

²⁹ OPC Appeal at 8.

³⁰ OPC Appeal at 9 and OPC witness Hill's Reply Testimony at 23-24.

³¹ OPC Appeal at 9 and Hill Reply at 28.

amount of the Companies' STD can be quickly scaled to match CWC needs.³² OPC concludes that the Companies "never produced evidence showing that actual financing costs for SOS-related CWC exceed the short-term debt rate."³³

2. Return Component

OPC argues that the Companies are not entitled to an additional return beyond their CWC "return".³⁴ OPC states that the Proposed Order would allow the Companies to collect an additional return of \$12 million annually, which OPC argues is "unreasonable".³⁵ OPC notes that § 7-510(c)(3)(ii)(2) states that utilities are to receive their "verifiable, prudently incurred costs, plus a reasonable return" for providing SOS. OPC states that recovery of incremental and uncollectible costs satisfies the cost requirement. Because CWC is the only type of investment utilities make in providing SOS, OPC argues the CWC return satisfies the reasonable return requirement. Consequently, no other return is justified.³⁶

OPC also states that the Companies failed to provide any evidence that there are risks associated with providing SOS and the PULJ provided no analysis of alleged risks.³⁷ OPC states that the Companies spend approximately \$70 million (of which \$50 million is for Residential SOS) prior to receipt of customer funds for SOS supply. However, the Companies are seeking \$5.39 million per year in compensation in the CWC component.

³² OPC Appeal at 8.

³³ OPC Appeal at 9.

³⁴ OPC Appeal at 10-13.

³⁵ OPC Appeal at 10.

³⁶ OPC Appeal at 10.

³⁷ OPC Appeal at 11.

Combined with the \$12 million in requested return, this amounts to \$17.39 million per year as compensation for providing approximately \$70 million in capital, which is a 24.8% combined return.³⁸ OPC concludes that “the utility’s only obligation in providing SOS is to carry-out the Commission’s instructions.”³⁹

OPC also argues that purchasing SOS supply is a normal utility risk, which is included in the Companies’ distribution rates of return. Specifically, OPC asserts that the proxy groups used to estimate the Companies’ risk in their most recent rate cases include companies with significant purchased power obligations as well as ownership of generation. Therefore, OPC argues that an additional \$12 million for return would result in an ROE of 11.5% for both Pepco and Delmarva, well above their authorized returns.⁴⁰

3. Administrative Adjustment

OPC notes that the Administrative Adjustment is a fee that is charged to SOS customers and then redistributed to all distribution customers. OPC states that it functions to transfer monies from SOS customers to those engaged in retail shopping. As such, OPC states that the Adjustment “raises the cost of SOS service but is neither a utility cost nor a return as described in PUA § 7-510(c)(3)(ii)(2) and therefore should not be charged to Maryland’s ratepayers.”⁴¹ Moreover, OPC asserts that no witness attempted to quantify these costs and neither did the PULJ.⁴² OPC concludes that the

³⁸ OPC Appeal at 11-12.

³⁹ OPC Appeal at 13.

⁴⁰ OPC Appeal at 13.

⁴¹ OPC Appeal at 14.

⁴² OPC Appeal at 13-14.

Administrative Adjustment is “unsupported” and “thus is not just, reasonable, nor in the public interest.”⁴³

B. Reply of Settling Parties and BGE

1. Cash Working Capital Requirement

The Companies assert that their (overall) authorized rates of return are the appropriate return for SOS CWC.⁴⁴ According to the Companies, their CWC requirements for distribution service, transmission service and SOS are financed together on a legal entity basis.⁴⁵ Because they aggregate all SOS customers’ CWC requirements and because payment patterns are constant, the Companies argue that their CWC financing needs are permanent and so are the related financing costs.⁴⁶ The Companies note that the PULJ concurred, finding “how they finance their operations persuasive, as to the efficiency of looking at it as a long term obligation” which, he also found to be “reasonable and in the public interest.”⁴⁷

The Companies state that many complexities and inefficiencies would result if OPC’s short-term debt proposal was adopted and that using the overall rate of return (“ROR”) permits them to use STD to fund CWC changes until it is financially beneficial to replace it with LTD. Further, they argue that there would be rating agency and credit facility implications if STD is used exclusively to fund SOS CWC requirements. They state that no other utility uses STD exclusively to fund SOS purchases nor does Pepco Holdings, Inc. (“PHI”)⁴⁸ do so in other jurisdictions. The Companies state that their

⁴³ OPC Appeal at 14.

⁴⁴ Companies’ Reply at 4.

⁴⁵ Companies’ Reply at 4-5.

⁴⁶ Companies’ Reply at 7.

⁴⁷ Companies Reply at 4, citing the PO at 17.

⁴⁸ PHI is the parent company of Pepco and Delmarva.

aggregate financing approach allows them to use excess cash from one business segment to finance shortfalls in others, which OPC's proposal would preclude.⁴⁹ Finally, they assert that the segmentation of the SOS business that would be required to implement OPC's proposal "would require dramatic and inefficient changes" to the Companies' processes, which would increase costs to other business segments and ultimately to customers.⁵⁰

The Companies also argue that OPC's proposal would subject them and their customers to the volatility of short-term rates noting that there have been times when STD rates have exceeded LTD rates. The Companies state that if they were to finance their continuing CWC requirement with LTD to avoid volatility, but were limited to a STD return, they would not be able to recover their actual CWC costs.⁵¹ Furthermore, although OPC argues that the Companies can quickly scale STD needs to match CWC needs, the Companies state that there are limits to their ability to borrow. The Companies assert they need to maintain flexible borrowing authority in case credit markets become constrained, which could cause significantly higher lending costs.⁵²

Staff argues that the Companies' overall rate of return is the appropriate CWC return because they do not finance SOS CWC in a different manner than their other CWC or physical investment capital requirements. Not only does the 2014 Settlement recognize this reality but there is long-standing Commission precedent for using a

⁴⁹ Companies Reply at 5-6.

⁵⁰ Companies' Reply at 6.

⁵¹ Companies' Reply at 7-8.

⁵² Companies' Reply at 8-9.

utility's overall ROR to calculate its CWC revenue requirements. Moreover, Staff states that OPC acknowledged that the rationale for using the overall ROR is that CWC is an expense that never goes away.⁵³ BGE also supported the Companies' arguments.⁵⁴

2. Return Component

The Companies state that the "language is clear" in § 7-510(c)(3)(ii)(2) that they are permitted SOS cost recovery *plus a reasonable return*.⁵⁵ They note that the PULJ concurred, finding that this language would not have been included in the statute if it was to have no meaning.⁵⁶ Although OPC argues that the Companies do not make any capital investments in providing SOS other than providing CWC, the Companies argue that the statute does not limit the utility return component in such a manner. The Companies assert that "[t]he plain and unambiguous language of PUA Section 7-510(c)(3)(ii)(2) provides that the Companies are permitted to earn a return on the provision of SOS, with no mention of any 'investment' by the Companies to provide SOS."⁵⁷ Moreover, the Companies argue that CWC costs "are not a true return or compensation but in fact are real costs incurred by the Companies as part of the SOS procurement process, and therefore cannot constitute the statutorily permitted return to be earned by the Companies for providing SOS."⁵⁸ The Companies emphasize that OPC's own witness agreed that the CWC return "represents the **cost** to finance that capital during the lag period."⁵⁹

The Companies note that OPC argues that a separate utility return is unreasonable

⁵³ Staff Reply at 9.

⁵⁴ BGE Reply at 2-5.

⁵⁵ Companies' Reply at 10. Emphasis by the Companies.

⁵⁶ Companies' Reply at 10, citing the PO at 17.

⁵⁷ Companies' Reply at 11.

⁵⁸ Companies' Reply at 12-13.

⁵⁹ Companies' Reply at 13. Emphasis by the Companies.

because any SOS risks are fully compensated for in their distribution rates. However, the Companies state that this position is at odds with Commission Order No. 85797, which found that SOS issues should be addressed separately from a distribution rate case.⁶⁰ Additionally, the Companies state that OPC has not sought to include in distribution rates a return for SOS. Therefore, OPC's position is inconsistent with Order No. 85797 and is also factually incorrect.⁶¹

Although OPC argues that the Companies have not provided evidence of any SOS risks, they counter that there is considerable evidence of such risk. However, the amount of the return in the 2014 Settlement is “essentially the same as the prior utility return component established in the 2003 Settlement”, which the Commission approved.⁶² Further, the Companies point out that the return in the 2014 Settlement is less than 2% of their \$700 million expenditure for SOS in 2013. Since third party supplier profits range from 5% to over 20% the Companies' argue the proposed return in the 2014 Settlement is consistent with the requirement to provide SOS at a market price and therefore is “undoubtedly reasonable.”⁶³

BGE states that OPC's proposal to limit the return to the CWC return is inconsistent with law as the PUA expressly provides for a return for utilities providing SOS. BGE asserts that its witness provided incontrovertible evidence of the risks utilities face in providing SOS including:

⁶⁰ In Order No. 85797 the Commission remanded these cases on August 21, 2013, to the PULJ for further proceedings, which are the subject of this appeal.

⁶¹ Companies' Reply at 12.

⁶² Companies' Reply at 13. This argument is a bit disingenuous as the Residential SOS Return of 1.5 mills in the 2003 Settlement (paragraph 12a) was deemed to include the CWC revenue requirement (para. 12b). Combined, the Residential return and CWC is 2.18 mills for Pepco and 2.26 mills for Delmarva in the 2014 Settlement.

⁶³ Companies' Reply at 14.

1) the under-recovery of CWC costs due to the PJM change, which have persisted for half a decade; 2) potential for significant spikes in power prices; 3) transmission constraints that reduce the ability of a utility to import power; 4) environmental regulatory actions that have the potential to reduce the number of generating units in the PJM Interconnection, resulting in increased power prices; 5) extreme weather events, and 6) legislative and regulatory actions in Maryland, such as the 2006 amendment to the PUA that requires [the] Commission review and hold hearings for rate increases in excess of 20%.⁶⁴

BGE concludes that because there is an evidentiary basis for utility risk, the return contemplated by the 2014 Settlement and the Proposed Order approving that return should be affirmed.⁶⁵

RESA argues that retail suppliers must earn returns to stay in business and if SOS does not include a return, suppliers will be forced to compete against their largest competitor who does not have to earn a return. RESA concludes that this would result in an artificially low and below-market SOS price.⁶⁶ Furthermore, RESA asserts it could have reasonably argued that the 2014 Settlement should have included a higher return as “retail suppliers would hope to earn a return that is higher than the Settlement’s return... and many do just that.”⁶⁷ RESA concludes that OPC’s proposal to eliminate a separate utility return would harm the further development of Maryland’s competitive electricity market, which would harm customers by decreasing the number of products and services available.⁶⁸

Staff states that the return component of the 2014 Settlement is reasonable and

⁶⁴ BGE Reply at 5-6. BGE cites §7-510(c)(7)(i).

⁶⁵ BGE Reply at 5-6.

⁶⁶ RESA Reply at 5.

⁶⁷ RESA Reply at 5-6.

⁶⁸ RESA Reply at 6.

complies with statutory requirements.⁶⁹ Although OPC asserts that the Companies' distribution ROR compensates them for providing SOS, Staff argues that if this were true then the Commission would have to explicitly address SOS revenues and returns in distribution rates cases. Staff states that to the best of its knowledge the Commission has never addressed the ROR for providing SOS in a distribution case. Staff notes that in Order No. 85797 the Commission clearly stated that distribution rates and SOS issues should be addressed separately.⁷⁰

3. Administrative Adjustment

RESA states that the Administrative Adjustment does not function to transfer money from SOS customers to retail shopping customers, nor does it artificially raise the price of SOS as OPC suggests. RESA argues that the Adjustment is a reasonable method to address the fact that the Companies recover certain SOS-related costs in distribution rates, which is a historic artifact of the restructuring process.⁷¹ Specifically, RESA states that the Adjustment reflects the fact that certain costs – including legal and regulatory costs, customer service representatives, call centers, websites, metering and more – are recovered 100% in distribution rates. Further, shopping customers would pay such costs twice without the Adjustment, once in distribution rates and again in supplier rates. RESA concludes that the credit mechanism of the Adjustment “ensures that no customer, whether an SOS customer or a shopping customer, pays for certain generation service

⁶⁹ Staff Reply at 9-12.

⁷⁰ Staff Reply at 10-11.

⁷¹ RESA Reply at 7-8.

related costs twice”.⁷² Moreover, RESA asserts that the Adjustment is consistent with the regulatory principle of cost causation, that supplier customers rightfully receive a credit for costs in distribution service that they no longer receive from the utility. RESA states that the Administrative Adjustment and credit mechanism “is intended to keep all customers neutral financially, does not harm anyone, and facilitates competitive markets which the Commission is statutorily obligated to create and develop.”⁷³

According to RESA, the testimony regarding Staff’s former Allocated Cost proposal indicates that the potentially avoidable SOS costs are much higher than the amount of the Administrative Adjustments in the 2014 Settlement, which makes them reasonable. Furthermore, RESA asserts that the “proposed Administrative Adjustments are intended to represent proxy amounts, recognizing that a full-scale unbundling would be difficult, complex, unnecessary, and command numerous resources.”⁷⁴ RESA states that “the Administrative Adjustment ensures that the SOS rate reflects all of the Companies’ costs incurred to provide that service while at the same time preventing subsidization of SOS rates by shopping customers.”⁷⁵ RESA concludes that OPC’s position is inconsistent with Maryland law and Commission policy, which favors a competitive electricity market.⁷⁶

Staff states that the purpose of the Administrative Adjustment is to recover from SOS customers a portion of the costs of providing SOS that remain in distribution rates. Staff argues that eliminating the Adjustment would not result in just and reasonable SOS

⁷² RESA Reply at 8.

⁷³ RESA Reply at 9.

⁷⁴ RESA Reply at 10-12.

⁷⁵ RESA Reply at 12.

⁷⁶ RESA Reply at 12-13.

rates because: 1) the function that generates 75% of the Companies' revenues – SOS supply – would bear zero percent of the Companies' joint and common costs while the distribution portion, which provides 25% of their revenues, would bear 100% of joint and common costs; 2) customers who take alternative supply would pay the same share of joint and common costs as SOS customers and pay (again) the same sort of costs embedded in supplier prices; and 3) as a result of 1 and 2, the competitive playing field would be tilted in favor of SOS. Consequently, Staff concludes that it would not be reasonable to provide SOS without allocating a portion of customer costs to SOS.⁷⁷

According to Staff the Administrative Adjustment has served as a substitute for fully litigating which costs should be allocated between distribution service and SOS and how they should be allocated.⁷⁸ Staff states that, in order to maintain a competitive market, suppliers need to be able to compete in the market which would be difficult if SOS rates are kept below cost.⁷⁹ Although OPC now argues including the Administrative Adjustment in the Administrative Charge is inappropriate, Staff notes that in approving the 2003 Settlement, which OPC signed, the Commission stated that the “Administrative Adjustment is designed to have a neutral impact on the customer, whether or not they shop for electric supply, which should stimulate Maryland’s retail electric market.”⁸⁰ Staff states that the “Commission’s finding in 2003 remains as true today as it was

⁷⁷ Staff Reply at 12.

⁷⁸ Staff Reply at 13.

⁷⁹ Staff Reply at 14.

⁸⁰ Staff Reply at 14-15, quoting from Case No. 8908, *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, 94 Md. P.S.C. 113, 148 (2003).

then.”⁸¹ The Companies support RESA’s and Staff’s positions.⁸²

IV. Commission Decision

These cases were initiated upon the Companies’ requests for increases in their Administrative Charges due to purported increases in cash working capital costs. Upon the recommendations of OPC and Staff we expanded these investigations to include a review of all of the Administrative Charge cost components because, except for uncollectibles, the cost components have not been examined since the Administrative Charge was instituted as part of the SOS 2003 Settlement in Case No. 8908 over a decade ago.⁸³ Initially, the PULJ proposed that the SOS Administrative Charge be eliminated but by Order No. 85797 we reversed and directed a further, detailed examination of the Administrative Charge cost components. Specifically, we directed that actual incremental and uncollectible costs be determined as well as kWh rates to recover these costs. Likewise, we directed that a record be developed so that specific dollar and kWh rate figures could be ascertained for the return and CWC and additionally whether the CWC requirement should be included in the return or stated separately. We also stated that an examination as to whether CWC can be financed exclusively using short-term debt should be conducted. Finally, we directed that an examination should be conducted concerning whether the Administrative Adjustment should be retained, and if so, the appropriate cost and rate.⁸⁴

⁸¹ Staff Reply at 15.

⁸² Companies’ Reply at 14-15.

⁸³ See Order No. 78400 issued in Case No. 8908 on April 29, 2003.

⁸⁴ Order No. 85797 at 32-35.

Although the 2014 Settlement may reach a just and reasonable result, we cannot reach such a conclusion on this record. The return and Administrative Adjustment components represent negotiated figures and lack the financial analysis we believe is required a decade later. Further, we find that the Companies have not, so far, adequately supported their proposal to use their overall rate of return to recover their CWC requirement. Consequently, we remand these issues to the PULJ for further investigation.⁸⁵

1. Incremental and Uncollectibles Costs

Paragraph Four of the 2014 Settlement provides that the Companies will recover their *actual* incremental SOS costs for *all* customer classes.⁸⁶ No party contests this provision. We find that this is an improvement over the 2003 Settlement, which had established the Residential SOS incremental costs component at 0.5 mills rather than at actual cost.⁸⁷ The 2014 Settlement provides that Residential SOS incremental costs shall be estimated at 0.2 mills for the first year and trued-up thereafter.

The Residential uncollectibles component “will consist of the allocation of their uncollectibles to the supply component determined by the Commission in each of the Companies’ most recent base distribution rate cases.”⁸⁸ This is consistent with the 2003 Settlement.⁸⁹ For Non-Residential Type I, Type II and HPS SOS the Companies will use the methodology that was determined in the 2003 Settlement, which recovers “actual

⁸⁵ This determination is also consistent with Order No. 86703 recently issued in Case No. 9221, BGE’s SOS Administrative Charge proceeding, which likewise requires a detailed analysis of Administrative Charge component costs and rates.

⁸⁶ Emphasis added.

⁸⁷ 2003 Settlement, paragraph 12(b).

⁸⁸ 2014 Settlement, paragraph 5.

⁸⁹ 2003 Settlement paragraph 12(c).

uncollectibles that are not being recovered in a Utility's distribution rates."⁹⁰ No party contests the uncollectible cost component of the Administrative Charge and we find it reasonable as well.⁹¹

2. Cash Working Capital Requirement and Utility Return Component

OPC asserts that the Companies are not entitled to a return for providing SOS separate and apart from their CWC revenue requirement. Additionally, OPC argues that the CWC revenue requirement should be calculated based upon the short-term debt rate. The Settling Parties disagree.

PUA Section 7-510(c)(3)(ii)(2) states:

On and after July 1, 2003, an electric company continues to have the obligation to provide standard offer service to residential and small commercial customers at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return.

Based upon this section, we find that it is clear that utilities are allowed a "reasonable return" in addition to the recovery of SOS "costs". Further, we agree with the Settling Parties that CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS. If a "return" is not included in the CWC revenue requirement then it must be included elsewhere. We conclude that stating a CWC cost requirement and a utility return (profit) separately is beneficial because it promotes transparency. Consequently, we approve the inclusion of a return component in the

⁹⁰ 2003 Settlement, paragraphs 31, 50 and 82.

⁹¹ OPC witness Wallach raised a concern at pages 11-12 of his Reply testimony. We expect OPC and the Companies to resolve any concerns prior to the implementation of new Administrative Charges.

Administrative Charge along with a separately stated CWC cost requirement for SOS to be recovered outside of the Administrative Charge. However, in no way should this determination be regarded as an endorsement of the CWC revenue requirement or of the rate of return embodied in the 2014 Settlement.

As for the CWC revenue requirement, we find that the Companies' summary of the inefficiencies and complexities they would face if OPC's short-term debt proposal is adopted lacks the appropriate financial analysis and support. CWC cost recovery should reflect the lowest cost possible consistent with sound utility management practices. Short-term debt rates are very low and according to OPC the Companies' short-term borrowing exceeds \$2 billion, whereas only \$70 million is required to satisfy their SOS-related CWC obligations. We expect the Companies to examine whether they can increase the use of STD to finance SOS CWC requirements. In sum, the burden is on the Companies to demonstrate that they are utilizing practices to minimize SOS costs in a responsible manner.

As for the return component of the Administrative Charge we begin by noting the PULJ's initial conclusion "that the history of SOS has shown that it carries very little risk."⁹² The PULJ stated in his most recent Proposed Order that the return component in the 2014 Settlement "covers the risks associated with providing SOS, at a generous but acceptable level."⁹³ Given these broad conclusions, we direct the Companies to enumerate, and quantify to the extent possible, the specific SOS procurement and cost

⁹² Proposed Order of Hearing Examiner at 17. See Docket Number 78 in Case No. 9226 and Docket No. 49 in Case No. 9232.

⁹³ Proposed Order at 17. See Docket No. 146 in Case No. 9226 and Docket No. 124 in Case No. 9232.

recovery risks they have encountered over the last decade. To be clear, we do not reach any conclusions at this time concerning the degree of risk, if any, the Companies face in providing SOS. In fact, it is for this reason that we require the Companies to conduct a more thorough analysis.

3. Administrative Adjustment

The Administrative Adjustment in the 2003 Settlement is a residual amount, which is determined by first deducting the incremental costs, CWC costs, uncollectibles and the utility return from the total Administrative Charge of each class, except for HPS, which has no Administrative Adjustment.⁹⁴ Likewise, the Administrative Adjustment in the 2014 Settlement is a residual amount, which is derived after first deducting incremental and uncollectible costs and the utility return components.⁹⁵ Curiously, the 2014 Settlement provides that HPS is to have an Administrative Adjustment component even though it has not had one for the past decade.

In Order No. 85797 we stated that the PULJ should develop a record and make a finding regarding whether the Administrative Charge should continue to include an Administrative Adjustment.⁹⁶ In his Proposed Order he noted his finding that “the inclusion of the administrative adjustment [is] the most troubling aspect of the settlement agreement.”⁹⁷ Further he noted that it is “speculation” as to how large, if any, it needs to be. We believe that after a decade it is appropriate to examine this issue in more detail.

⁹⁴ 2003 Settlement, paragraphs 12(c), 31(b), 50(b), and 82(b). Due to the phrasing of the 2003 Settlement, the CWC and uncollectibles amounts are sometimes reflected in the incremental costs and return.

⁹⁵ 2014 Settlement, paragraphs 2 and 6. The CWC requirement is to be recovered separately from the Administrative Charge. Settlement, paragraph 7.

⁹⁶ Order No. 85797 at 34-35.

⁹⁷ PO at 17.

Consequently, we direct the Companies to file an analysis that provides a basis for any SOS costs that may be included in present distribution rates.⁹⁸ Parties may also wish to address the legal basis, if any, for the assignment of costs to SOS. Lastly, we expect the parties to address why, after a decade, HPS should include an Administrative Adjustment.

4. Conclusions

We find, as stated in Order No. 85797, that after a decade it is time to critically examine the individual cost components of the SOS Administrative Charges so that up to date actual costs and appropriate Administrative Charges may be determined. To assist in this endeavor, the Companies are required to furnish the SOS cost assignment analysis required herein. We remind the Companies that the burden of proof is on them to justify their recommended CWC requirements and the utility return. We expect a more critical examination of how CWC can be financed at the least possible cost, consistent with sound utility management and a more thorough examination of actual risks, if any, the Companies have encountered in the last decade. Meanwhile, the Companies' SOS Administrative Charges shall remain unchanged.

IT IS THEREFORE, this 3rd day of March, in the year Two Thousand and Fifteen, by the Public Service Commission of Maryland,

ORDERED: (1) That the 2014 Settlement is rejected;

(2) That this matter is remanded to the Public Utility Law Judge for further

⁹⁸ A fully distributed Cost of Service Study ("COSS") is not required, but a study that can provide a reasonable basis for assigning SOS costs currently in distribution rates, if any, to SOS is expected.

proceedings consistent with this Order; and

(3) That all motions not granted herein are denied.

/s/ W. Kevin Hughes _____

/s/ Harold D. Williams _____

/s/ Lawrence Brenner _____

/s/ Kelly Speakes-Backman _____

/s/ Anne E. Hoskins _____
Commissioners

APPENDIX I

DPL Case 9226
 PEPCO Case 9232
 Table 1
 Attachment to Testimony
 Susan A. Devito

Delmarva - MD - Proposed Admin Components				
Customer Types	Residential	Type I	Type II	Hourly
Admin Charge Components	\$/kWh	\$/kWh	\$/kWh	\$/kWh
Admin Credit Revenue	\$ 0.0006200	\$ 0.0027820	\$ 0.0032680	\$ 0.0001500
mills	0.620	2.782	3.268	0.150
Utility Return Rate	\$ 0.0013000	\$ 0.0020000	\$ 0.0020000	\$ 0.0022500
mills	1.300	2.000	2.000	2.250
Incremental Cost	\$ 0.0002000	\$ 0.0005500	\$ 0.0005500	\$ 0.0004450
mills	0.200	0.550	0.550	0.445
Uncollectibles Cost	\$ 0.0013800	\$ 0.0001680	\$ 0.0001820	\$ 0.0001550
mills	1.380	0.168	0.182	0.155
Admin Charge	\$ 0.0035000	\$ 0.0055000	\$ 0.0060000	\$ 0.0030000
mills	3.500	5.500	6.000	3.000
Cash Working Capital	\$ 0.0009630	\$ 0.0009490	\$ 0.0007450	\$ 0.0006690
mills	0.963	0.949	0.745	0.669
TOTAL	\$ 0.0044630	\$ 0.0064490	\$ 0.0067450	\$ 0.0036690
mills	4.463	6.449	6.745	3.669

Pepco - MD - Proposed Admin Components				
Customer Types	Residential	Type I	Type II	Hourly
Admin Charge Components	\$/kWh	\$/kWh	\$/kWh	\$/kWh
Admin Credit Revenue	\$ 0.0004102	\$ 0.0026606	\$ 0.0036536	\$ 0.0001500
mills	0.410	2.661	3.654	0.150
Utility Return Rate	\$ 0.0013000	\$ 0.0020000	\$ 0.0020000	\$ 0.0022500
mills	1.300	2.000	2.000	2.250
Incremental Cost	\$ 0.0002000	\$ 0.0003140	\$ 0.0003140	\$ 0.0004500
mills	0.200	0.314	0.314	0.450
Uncollectibles Cost	\$ 0.0015898	\$ 0.0005254	\$ 0.0000324	\$ 0.0001500
mills	1.590	0.525	0.032	0.150
Admin Charge	\$ 0.0035000	\$ 0.0055000	\$ 0.0060000	\$ 0.0030000
mills	3.500	5.500	6.000	3.000
Cash Working Capital	\$ 0.0008790	\$ 0.0007654	\$ 0.0005893	\$ 0.0006887
mills	0.879	0.765	0.589	0.689
TOTAL	\$ 0.004379	\$ 0.006265	\$ 0.006589	\$ 0.003689
mills	4.379	6.265	6.589	3.689

Attachment 1**Current SOS Administrative Charges per
Case No. 8908 Phase I Settlement**

Residential - 4 mills per kWh total, of which the return is 1.5 mills, the incremental cost component is 0.5 mills, and the Administrative Adjustment is 2.0 mills;

Type I Non-Residential - 5.5 mills per kWh total, of which the return is 2.0 mills, and the remaining 3.5 mills split such that the Administrative Adjustment is the amount left over after payment of actual incremental costs;

Type II Non-Residential - 6.0 mills per kWh total, of which the return is 2.0 mills, and the remaining 4.0 mills split such that the Administrative Adjustment is the amount left over after payment of actual incremental costs;

Hourly-Priced Non-Residential Service - 2.25 mills to 3.0 mills per kWh total, of which 2.25 mills is the return component and the remaining amount up to 0.75 mills is to cover incremental costs - there is no Administrative Adjustment for this service.⁷⁵

The portion of the CWC recovered through the incremental cost component of the Administrative Charge is capped at 0.15 mills per kWh for all of the non-residential SOS types.⁷⁶

The portion of the CWC recovered through the incremental cost component of the Administrative Charge is capped at 0.15 mills per kWh for all of the non-residential SOS types.⁷⁷

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

DELMARVA POWER & LIGHT
Overview of SOS Administrative Charge Components for Residential Customers
(mills/kWh, unless otherwise stated)

Component	Current	Agreement	OPC
Incremental Costs	0.5	0.2	0.2
Uncollectible Costs	1.38	1.38	1.38
Utility Return/CWC	1.5	2.26	0.29
Administrative Adjustment	0.62	0.62	0.0
Total	4.0	4.46	1.87
Yearly Bill Impact	\$48.00	\$53.52	\$22.44

Numbers in the “Current” column are derived from *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, 94 Md.P.S.C. 113 (2003); the Administrative Adjustment is the difference between the set Administrative Charge and the other components, thus with a stated Administrative Adjustment of 0.62, POPULJ at p. 9, the Uncollectible Costs is 1.38.

Numbers in the “Agreement” column are derived from Direct Testimony of Susan Devito, PHI Ex. 7, Table 1 Attached to Testimony.

Numbers in the “OPC” column are derived from the Reply Testimony of Jon Wallach, OPC Ex. 36, Table 1 at p. 5.

The “Yearly Bill Impact” is calculated by multiplying the total charge by the average residential customer’s usage of 1,000 kWh/month by 12 months.

PEPCO
Overview of SOS Administrative Charge Components for Residential Customers
(mills/kWh, unless otherwise stated)

Component	Current	Agreement	OPC
Incremental Costs	0.5	0.2	0.2
Uncollectible Costs	1.59	1.59	1.59
Utility Return/CWC	1.5	2.18	0.26
Administrative Adjustment	0.41	0.41	0.0
Total	4.0	4.38	2.05
Yearly Bill Impact	\$48.00	\$52.56	\$24.60

Numbers in the “Current” column are derived from *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, 94 Md.P.S.C. 113 (2003); the Administrative Adjustment is the difference between the set Administrative Charge and the other components, thus with a stated Administrative Adjustment of 0.41, POPULJ at p. 9, the Uncollectible Costs is 1.59.

Numbers in the “Agreement” column are derived from Direct Testimony of Susan Devito, PHI Ex. 7, Table 1 Attached to Testimony.

Numbers in the “OPC” column are derived from the Reply Testimony of Jon Wallach, OPC Ex. 36, Table 1 at p. 5.

The “Yearly Bill Impact” is calculated by multiplying the total charge by the average residential customer’s usage of 1,000 kWh/month by 12 months.