

**ORDER NO. 87891**

IN THE MATTER OF A REQUEST BY BALTIMORE GAS AND ELECTRIC COMPANY FOR RECOVERY OF STANDARD OFFER SERVICE RELATED CASH WORKING CAPITAL REVENUE REQUIREMENT <hr style="width: 30%; margin-left: 0;"/>	* * * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND <hr style="width: 10%; margin-left: auto; margin-right: 0;"/>  CASE NO. 9221 <hr style="width: 10%; margin-left: auto; margin-right: 0;"/>
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**Issue Date: November 17, 2016**

This Order affirms in part the *second* Proposed Order (“Proposed Order II”) issued by the Public Utility Law Judge Division (“PULJ”) decision in this case regarding the Incremental Cost, Uncollectible Cost, and CWC Revenue Requirement Cost Components of Baltimore Gas and Electric Company’s (“BGE” or “Company”) Standard Offer Service (“SOS”)<sup>1</sup> Administrative Charge, and reverses the Chief Judge’s decision regarding the Return Component and the elimination of the Administrative Adjustment. Upon review of the record in this case, we determine the cost components of BGE’s Administrative Charge for Residential, Type I, Type II and Hourly Service Customers as follows:

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<sup>1</sup> SOS is electricity supply that a customer purchases from the customer’s electricity company rather than through an electricity supplier. A customer by law receives SOS if the customer does not shop for electric supply or cannot obtain electricity on the open market for a variety of reasons. *Severstal Sparrows Point, LLC v. Pub. Serv. Comm’n of Md.*, 194 Md. App. 601 (2010) (*Severstal*) and Md. Code Ann., Public Utility Article (“PUA”) §7-510.

<b>Components</b>	<b>Residential</b>	<b>Type I</b>	<b>Type II</b>	<b>Hourly<sup>2</sup></b>
Incremental Charge	0.08 mills/kWh	0.08 mills/kWh	0.08 mills/kWh	0.22 mills/kWh
Uncollectible	1.67 mills/kWh	1.03 mills/kWh	0.32 mills/kWh	0.00 mills/kWh
CWC Revenue Requirement	0.95 mills/kWh	0.66 mills/kWh	0.71 mills/kWh	0.63 mills/kWh
Return	0.93 mills/kWh	0.64 mills/kWh	0.69 mills/kWh	0.13 mills/kWh
Administrative Adjustment	0	0	0	0
<b>Total</b>	<b>3.63 mills/kWh</b>	<b>2.41 mills/kWh</b>	<b>1.80 mills/kWh</b>	<b>0.98 mills/kWh</b>

On November 20, 2015, the Chief Judge issued Proposed Order II in this matter following the Commission’s reversal and remand of the *first* Proposed Order (“Proposed Order I”) on November 10, 2014.<sup>3</sup> Following additional proceedings and consistent with the Remand Order, Proposed Order II set forth reevaluated and *reset* costs for the components of BGE’s residential and non-residential SOS Administrative Charges, costs that had been previously negotiated in the 2003 SOS Settlement.<sup>4</sup> The Commission’s Technical Staff (“Staff”), Office of People’s Counsel (“OPC”), BGE, and Retail Energy Supply Association (“RESA”) filed appeals with the Commission.

#### I. Background and Procedural History

In 2003 the Commission approved a settlement agreement in Case No. 8908 (“the 2003 Settlement”) establishing a wholesale competitive procurement methodology to implement utility-provided SOS. The 2003 Settlement adopted, as part of the SOS price, an Administrative Charge, purchase power costs, transmission costs and taxes.<sup>5</sup> At issue

<sup>2</sup> The return component was the only issue raised on appeal concerning commercial customers. Proposed Order II at 39.

<sup>3</sup> Order No. 86703.

<sup>4</sup> *Re Competitive Selection of Electricity Supplier/Standard Offer Service*, Case No. 8908, Order No. 78400, 94 MD PSC 113 (2003).

<sup>5</sup> Retail prices for SOS consist of: “(1) the seasonally-differentiated and, if applicable, time-of-use differentiated load weighted average of the supply contracts for each year; (2) FERC-approved transmission charges and any other PJM charges and costs related to SOS; (3) an Administrative Charge; and (4) applicable taxes.” *Id.* at 18.

in this proceeding is the SOS Administrative Charge, which currently consists of a return, incremental cost, uncollectibles, and the appropriate level of the Administrative Adjustment, if any. The Administrative Adjustment, when applied, is paid by SOS customers according to service type and is credited back – to all eligible distribution customers – by service type.

This segment of the case arises from a November 2009 request by BGE to modify the component of the Company’s Administrative Charge for SOS so that it could recover an increase in the Company’s CWC Revenue Requirement.<sup>6</sup> BGE claimed that it had experienced a material increase in its SOS-related CWC Revenue Requirement due to PJM Interconnection LLC’s<sup>7</sup> shift from a monthly to a weekly settlement schedule, effective June 1, 2009. That shift required BGE to reimburse SOS wholesale suppliers and PJM on a weekly basis for the Company’s SOS commodity-related and transmission costs.

According to BGE, this change led to a material increase in the Company’s SOS-related CWC Revenue Requirement, which it claims precludes its ability to provide SOS at a market price that permits recovery plus a reasonable return of the verifiable, prudently incurred costs to procure or produce electricity. Therefore, BGE requested that the Commission review the increase in the Company’s Residential, Type I, Type II, and Hourly SOS-related CWC Revenue Requirement, and allow an adjustment to the

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<sup>6</sup> CWC Revenue Requirement is the cost associated with the capital BGE must get to finance the working Capital necessary to provide BGE customers with SOS-related services. Direct Testimony of David M. Vahos at 6.

<sup>7</sup> PJM is the regional electricity grid operator for Maryland.

Company's SOS cost recovery mechanism.<sup>8</sup> On February 26, 2010, the Commission delegated this matter to the Commission's Public Utility Law Judge ("PULJ" or "Judge") Division, and expanded the scope of the proceeding to permit a full investigation of all components of the residential and non-residential SOS Administrative Charge.<sup>9</sup>

On May 31, 2011, following an evidentiary proceeding, the Presiding PULJ issued Proposed Order I in this matter, which concluded that the 2003 Settlement was not intended to create a permanent SOS structure, but rather was intended to represent a step towards a competitive electricity supply market. In Proposed Order I, the Judge also noted that SOS carries very little risk. Moreover, he noted that "SOS cannot exist without distribution services, and it is a part of a normal utility service, with the same level of risk as the Companies' overall risk level."<sup>10</sup>

In Proposed Order I, the Judge further determined that because all customers require distribution services, non-SOS customers are not overcharged by having some SOS costs embedded in distribution rates. He concluded that since the retail supply market is "fully mature and functional there is no need in a competitive market to try to benefit any segment of the competitive market at the expense of competitors,"<sup>11</sup> which the Administrative Charge causes. Therefore, in that decision, the PULJ found that: 1) the Administrative Adjustment and the Return Component should be eliminated; 2) all SOS costs and revenues should be considered as part of the BGE's standard operations in

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<sup>8</sup> Type I Customers are small-usage commercial customers; customer that do not exceed 25kW. Type II Customers are larger-usage commercial customers, not eligible for Type I Service but whose peak load contribution is less than 600 kW. *Severstal*, 19 Md. 601 at 606.

<sup>9</sup> Order No. 83176.

<sup>10</sup> Proposed Order I at 17.

<sup>11</sup> *Id.* at 18.

their next rate case; and 3) CWC Revenue Requirement should be recovered dollar for dollar by the Company and earn a rate of return set at the authorized rate of return as set in BGE's last rate case. The PULJ also concluded that the Administrative Charge should be subject to an annual review proceeding for true-up purposes. All the active parties in the proceeding appealed Proposed Order I, and upon consideration of the matter, on November 10, 2014, the Commission reversed Proposed Order I and remanded the matter back to the PULJ Division.

In our Remand Order, we directed that the PULJ:

... render a determination of the total Administrative Charge costs and rate for [Baltimore Gas and Electric Company ("BGE")] broken down by the individual Components; namely, incremental costs, uncollectible costs, return and CWC whether stated together or separately, and if appropriate, an Administrative Adjustment.<sup>12</sup>

We further found that there was substantial disagreement concerning calculation of the return and the form in which it is to be collected; whether that return is separately stated, included as part of the CWC requirement, or is considered within overall context of the Company's rate or return. We ordered the PULJ to make a finding as to whether CWC should be included in the Return Component, or whether the return and CWC should be separately stated.

Following full evidentiary proceedings on remand, in Proposed Order II, the Chief Judge ordered that the component of the Administrative Charge be set as follows:

1) Incremental Costs set to actual costs of 0.08 mills/kWh with a 3 times/year true up through Rider 10 process; 2) Uncollectible Costs set to actual costs of 1.67 mills/kWh with a 3 times/year true up through the Rider 10 process; 3) creation of CWC Revenue

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<sup>12</sup> Order No. 86703.

Requirement set at BGE's authorized rate of return (grossed up for taxes) at 0.95 mills/kWh; 4) Return Component set on the basis of charges in the Consumer Price Index ("CPI") for electricity prices in the amount of 0.18 mills/kWh; and 5) elimination of the Administrative Adjustment Component. Staff, OPC, BGE, and RESA each appealed Proposed Order II. By this order, the Commission affirms in part, and reverses in part, Proposed Order II.

## II. Positions of the Parties

### A. OPC

OPC appeals the Chief Judge's decision in Proposed Order II to include CWC Revenue Requirement as a new and separate component of the Administrative Charge. OPC claims that at the time sections 6(a), and (b)(1)(d) of Chapter 5 of Acts of the General Assembly of the Special Session of 2006 ("SB1" or "Senate Bill 1") had been enacted, the Return Component of the Administrative Charge was comprised of the "return" and the "CWC Revenue Requirement".<sup>13</sup> According to OPC, Senate Bill 1 expressly precludes BGE from collecting a return until the end of 2016.<sup>14</sup> Thus, OPC claims that since the Return Component consisted of both the return and CWC Revenue Requirement at the time the Legislature passed Senate Bill 1, the Legislature intended for CWC Revenue Requirement to be considered a "return" that cannot be collected by BGE until after 2016.<sup>15</sup>

OPC also disagrees with the Chief Judge's decision to set the CWC Revenue Requirement at the Company's currently authorized rate of return. OPC asserts that the

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<sup>13</sup> OPC Memorandum on Appeal at 6-7.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 6-9.

record below shows that BGE had the ability to finance CWC Revenue Requirement using short-term debt.<sup>16</sup> OPC argues that before ruling to set the CWC Revenue Requirement at the Company's currently authorized rate of return, the Chief Judge should have required BGE to show that financing CWC with a short-term debt is inconsistent with sound utility management rather than finding that it was within sound utility management for the Company to finance CWC Revenue Requirement with the Company's authorized rate of return.<sup>17</sup>

Finally, OPC argues that the Chief Judge should have adopted the Return Component as the difference between calculating the revenue requirement for the SOS-related CWC compensation at the cost of short-term debt and calculating the Revenue Requirement at the full rate of return, as OPC had proposed.<sup>18</sup> OPC argues that because Proposed Order II did not do so, BGE was granted a full return on the CWC Revenue Requirement Component and an additional return on that same investment in the Return Component.<sup>19</sup> According to OPC, Proposed Order II unreasonably compensates BGE by allowing it to recover additional fees for providing a basic distribution utility function over the full rate of return on the CWC asset.<sup>20</sup>

#### B. Staff

Staff appeals Proposed Order II because it eliminates the Administrative Adjustment Component for residential customers.<sup>21</sup> Staff also asks for clarification as to whether Proposed Order II eliminated the Administrative Adjustment for commercial

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<sup>16</sup> *Id.* at 10-11.

<sup>17</sup> *Id.* at 11.

<sup>18</sup> *Id.* at 12 and 13.

<sup>19</sup> *Id.* at 13.

<sup>20</sup> *Id.* at 14.

<sup>21</sup> Staff's Second Memorandum of Appeal at 6.

customers (Type I and Type II SOS).<sup>22</sup> According to Staff there was no substantial evidence in the record below that supported the elimination of the Administrative Adjustment Component.<sup>23</sup> Additionally Staff argues that the record below substantiates that the Administrative Adjustment Component is needed to promote and preserve retail competitiveness.<sup>24</sup> Staff opines that the customer choice and the competitive electricity market would be strongly hindered without the Administrative Adjustment Component.<sup>25</sup> On appeal, Staff not only recommends that the Commission reinstitute the Administrative Adjustment Component, but also advocates that the Commission require BGE to include in its next rate case a cost of service study and detailed analysis regarding which part of its operating costs are attributable to SOS.<sup>26</sup>

### C. BGE

BGE appeals the Chief Judge's decision in Proposed Order II regarding the Return Component. In its appeal, BGE contends that it was improper for the Chief Judge to decide the Return Component using the CPI. BGE argues that no party to the case advocated the use of the CPI to determine the Return Component.<sup>27</sup> Additionally, the Company argues that because the Chief Judge used the CPI in determining the Return Component, she inappropriately considered the Company's capital investment for determining the Company's return on SOS.<sup>28</sup>

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<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 10.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 6-7.

<sup>27</sup> BGE Memorandum on Appeal at 6-7.

<sup>28</sup> *Id.* at 8-9.



BGE claims that in considering the Company’s investment, the Chief Judge applied the “just and reasonable” standard used for traditional rate making referred to in PUA § 4-101.<sup>29</sup> The Company claims the “market standard” set out in PUA §7-510 (c)(3), which it argues exclusively applies to SOS, should have been applied in this case. BGE bolsters its position by citing to *Severstal* claiming that the case supports the Company’s argument.

The Company further opposes the proposed Return Component because, it asserts: CPI does not provide a market price return; it is at times negative; it can provide results below the low end of the range of margins of electricity suppliers that offer a product similar to SOS (not a market price); and it lies below the range of reasonable returns for comparable businesses in other sectors of the economy.<sup>30</sup>

Finally, BGE appeals the elimination of the Administration Adjustment Component for the reasons stated by Staff and RESA. The Company opines that the elimination of the Administrative Adjustment Component prevents the creation of a competitive retail electricity supply market, and asserts that it does not comport with market price standard set out in PUA § 7-510 (c)(3)(ii)(2).<sup>31</sup> BGE argues that the Chief Judge made a fact-finding error when she found “[o]ther than anecdotal testimony... neither RESA nor any other party presented evidence to support that competitive suppliers indeed include specific overhead expenses (or the exact nature of those

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 10-15.

<sup>31</sup> *Id.* at 16-18.

expenses) in determining rates,” even though BGE witness showed that suppliers do include administrative expenses in their rate recovery.<sup>32</sup>

#### D. RESA

RESA also appeals the elimination of the Administrative Adjustment. According to RESA the Administrative Adjustment is “‘a proxy for full scope of costs that should be reflected in SOS rates’ and is substantive for full unbundling” and that without it the Order fails to make SOS rates competitive with retail market prices.<sup>33</sup> RESA, thus, claims that the elimination of the Administrative Adjustment Component and the failure to account for Administrative and General (“A&G”) costs in the Administrative Charge violates PUA § 7-510 (c)(3)(ii)(2).

Second, RESA claims the Chief Judge erred in not requiring BGE to present in its next base rate case a Cost of Service Study (“COSS”) that will allow the Commission to properly allocate to BGE’s SOS rates SOS-related costs that the Company is currently reflecting in its regulated distribution rates.<sup>34</sup> Finally, RESA disputes the way in which Proposed Order II sets the Return Component; that is, RESA challenges the way in which the Chief Judge decided the Return Component with the use of the CPI. RESA claims the Return Component as decided by the Chief Judge was too low and prevents a level playing field between SOS and retail suppliers.<sup>35</sup>

### III. Commission Decision

This case was initiated in 2009 in response to BGE’s request for an increase in its

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<sup>32</sup> *Id.* at 8.

<sup>33</sup> RESA Memorandum on Appeal at 5-6.

<sup>34</sup> *Id.* at 13-14.

<sup>35</sup> *Id.* at 14-15.

Administrative Charge due to purported increases in CWC costs. Based upon the recommendations of Staff and OPC, we expanded the investigation to include a review of all the Administrative Charge Costs Components.

Initially, the PULJ who decided the case proposed that the SOS Administrative Charge be eliminated, however by Order No. 86703 we reversed and directed a further detailed examination of the Administrative Charge Cost Components. Specifically, for the Return Component, we ordered that a record be developed that would permit the PULJ to determine specific dollar and kWh rate figures. We also directed that the PULJ make a finding as to whether CWC Revenue Requirement should be included in the Return Component, or whether the Return and CWC Revenue Requirement should be separately stated. We also stated that an examination as to whether CWC can be financed exclusively using short-term debt should be conducted, and we directed that an examination should be conducted concerning whether the Administrative Adjustment should be retained.

Finally, we directed the PULJ to render a determination of the total Administrative Charge Costs and rates for BGE broken down by the individual components, namely: incremental costs; uncollectible costs; return and CWC (whether stated together or separately); and if appropriate, an Administrative Adjustment. Following a second round of proceedings, on November 20, 2015 Proposed Order II was issued in this matter. We have reviewed Proposed Order II and the parties' appeals and hereby *specifically* affirm and modify in part and reverse in part Proposed Order II as discussed below.

A. Incremental Costs and Uncollectible Costs Components

No party on appeal opposed the Chief Judge's decision regarding the Incremental Cost Component. We find, as did the Chief Judge, that the change in the recovery of the Incremental Cost Component for Residential SOS to actual costs is reasonable and ensures that BGE neither over-collects or under-collects its SOS-related incremental costs over any length of time. The change to actual incremental costs from a fixed rate is also consistent with our decision in the PEPCO/DPL Settlement Order.<sup>36</sup> We further find that a true-up three times a year using the Rider 10 process, as proposed by BGE, is appropriate. Finally, we find that 0.08 mills per kWh is the appropriate initial rate for the Incremental Costs Component of the Residential, Type I, and Type II Administrative Charge.

As no party on appeal opposed the Uncollectible Costs Component set forth in Proposed Order II, we find that the Uncollectible Costs Component of the residential Administrative Charge shall be set based on the actual uncollectible costs similar to the determination of the Uncollectible Costs Component in the non-residential Administrative Charges. As with the Incremental Costs Component, the Uncollectible Costs shall be trued up every four months using a Rider 10 process. We further find insufficient evidence to establish any relationship between the late-payment revenue and the Uncollectible Costs that are SOS-related. Accordingly, at this time we adopt an Uncollectible Costs Component rate for Residential Customers of 1.67 mills per kWh, a rate of 1.03 mills per kWh for Type I Customers, and a rate of 0.32 mills per kWh for Type II Customers until the first true up occurs.

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<sup>36</sup> Proposed Order II at 8 (Citing Order No. 86881, Slip Opinion at 18).

## B. Cash Working Capital Revenue Requirement

In Proposed Order II, the Chief Judge found that it was appropriate to create an additional component of the Administrative Charge, the CWC Revenue Requirement Component. The only party on appeal that challenges this portion of the decision is OPC. OPC claims that when the SOS Settlement was adopted, CWC Revenue Requirement was accounted for in the return component. Subsequently, the Legislature enacted Senate Bill 1 [enumerated and amended PUA § 7-510(c)(3)(ii)(2)], which expressly precludes electric distribution companies from collecting a return on SOS. OPC claims that since the Return Component comprised of the “return” and the CWC Revenue Requirement, the CWC Revenue Requirement is a “return” that has been prohibited for BGE to collect until the end of 2016. BGE opposes OPC’s argument. Rather, BGE insists that Senate Bill 1 does not prohibit it from recovering its CWC Revenue Requirement.<sup>37</sup>

BGE claims that OPC’s contention is not supported expressly by Senate Bill 1 or the legislative history. BGE acknowledges that it must refund the residential return through December 2016, but insists that CWC Revenue Requirement is a cost that can be recovered.<sup>38</sup> Staff also urges that OPC’s interpretation of Senate Bill 1 is inaccurate because the 2003 Settlement that brought forth the Administrative Charge was not based upon retail sales margins, but a negotiated result and that the General Assembly use of the phrase “reasonable return” in PUA § 7-510 (c)(3)(ii)(2) is ambiguous.

The record reflects that BGE’s Chief Financial Officer and Treasurer David M. Vahos testified that CWC Revenue Requirement “represents the cost associated with the

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<sup>37</sup> BGE Reply Memorandum on Appeal at 2-3.

<sup>38</sup> *Id.* at 3.

capital the Company must obtain in order to finance the working capital necessary to provide BGE customers with SOS-related services.”<sup>39</sup> On June 1, 2009, PJM changed its monthly settlement process, in accordance with which BGE paid suppliers and PJM for generation and transmission of energy to provide to SOS customers, to a weekly settlement.<sup>40</sup> The revenues obtained for the recovery of CWC costs reimbursed the Company for its permanent SOS financing requirement due to the timing difference between the purchase of SOS power and transmission costs on a weekly basis and the customers’ monthly payments.<sup>41</sup>

Staff Witness Phillip E. VanderHeyden testified in favor of creating a separate CWC Revenue Requirement Component. He opined that separating the return and CWC Revenue Requirement from the Return Component allows the Commission, when necessary, to adjust each item independently.<sup>42</sup> Coincidentally, OPC Witness Jonathan Wallach also recommended the adoption of a separate CWC Revenue Requirement Component for residential customers and urged that it be initially set at 0.02 mills/kWh.<sup>43</sup>

We agree with the Chief Judge’s decision to create a separate component of the Administrative Charge for CWC Revenue Requirement. CWC Revenue Requirement is a cost that BGE and other utilities incur when providing SOS service. There is no statutory basis to prohibit the inclusion of a CWC Revenue Requirement to the Administrative Charge. In fact PUA § 7-510 (c)(3)(ii)(2) states:

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<sup>39</sup> Direct Testimony of David M. Vahos at 6.

<sup>40</sup> Supplemental Direct Testimony of David M. Vahos at 7.

<sup>41</sup> *Id.*

<sup>42</sup> Reply Testimony of Phillip VanderHeyden at 10.

<sup>43</sup> Second Reply Testimony of Jonathan Wallach at 4-5.

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.

CWC Revenue Requirement permits recovery of this cost.

Based upon the law and testimony in this case, we find that BGE provides SOS service and is therefore allowed a recovery of SOS “costs”. As we previously stated in Order No. 86881,<sup>44</sup> CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS. We conclude that a CWC cost requirement and a utility return (profit) separately is beneficial because it promotes transparency. The next issue that must be resolved is how BGE’s CWC Revenue Requirement Component should be calculated.

In Proposed Order II, the Chief Judge decided that it would be appropriate to calculate CWC Revenue Requirement by using BGE’s most recently authorized rate of return (grossed up for taxes). She found that this approach is the least cost possible consistent with sound utility management practices.<sup>45</sup>

On appeal OPC opposes the Chief Judge’s decision to set CWC Revenue Requirement at BGE’s most recently authorized rate of return. OPC argues that the record shows BGE had the ability to finance CWC through short-term debt and the Company failed to show that it was inconsistent with sound utility management. In his Reply Testimony, OPC Witness Steve Hill testified that BGE should be required to

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<sup>44</sup> *Re the Review of Delmarva Power and Light Company Standard Offer Service Administrative Charge and Re the Review of Potomac Electric Power Company Standard Offer Service Administrative Charge Case Nos. 9226 and 9232*, Order No. 86881.

<sup>45</sup> Proposed Order II at 16.

finance CWC with short-term debt rather than long-term debt because the Company's SOS financial needs are short-term in nature.<sup>46</sup> Mr. Hill recognized that BGE receives payment from SOS customers a month after the time the Company is required to pay electricity suppliers for SOS transmission and generation, but opined that the lowest cost method to finance CWC Revenue Requirement is through the use of short-term debt.<sup>47</sup> Staff Witness VanderHeyden also questioned the necessity of providing CWC expense at BGE's full rate of return or the post-tax weighted average cost of capital, especially since the CWC Revenue Requirement was being separated from the return.<sup>48</sup>

In response to OPC's argument, BGE comments that although short-term debt is now less expensive, OPC's argument relies solely on the vagaries of the short-term debt market and the Company's CWC Revenue Requirement should be recovered at BGE's authorized rate of return.<sup>49</sup> Additionally, BGE alleges that if it did use the short-term debt market it would violate the directive in Order No. 86881, which it asserts requires the use of the lowest cost possible consistent with sound utility practices.<sup>50</sup>

During the proceeding, BGE provided testimony from Company Witness Kurt G. Strunk asserting that although short-term debt could be the lowest cost to finance CWC, it would not be sound utility management to do so.<sup>51</sup> Mr. Strunk further stated that in the current market it was possible for BGE to finance CWC Revenue Requirement with short-term debt, but it was not advisable to do so. Mr. Strunk insist that his opinion is based on relevant financial textbooks and the known fact that rating agencies would

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<sup>46</sup> Second Reply Testimony of Steve Hill at 20.

<sup>47</sup> *Id.* at 20-21.

<sup>48</sup> Reply Testimony of Phillip VanderHeyden at 14.

<sup>49</sup> BGE Reply Memorandum at 3-5.

<sup>50</sup> *Id.*

<sup>51</sup> Tr. at 78-79.



consider on-going financing of cash needs with just short-term debt would give the impression that the Company was involved in a risky, aggressive activity. He also opined that short-term debt could in the future become impossible to obtain, which he asserts could force BGE to refinance CWC Revenue Requirement with more expensive long-term debt that would have higher than normal rates.<sup>52</sup> Overall Mr. Strunk testified that it was against “best” corporate practices to finance BGE’s SOS operations with short-term debt, even if the corporation presently receives lower financing costs for using short-term debt.<sup>53</sup>

We find that the testimony and arguments presented by BGE on this issue is persuasive. From a logistical point of view, to require BGE to finance CWC Revenue Requirement on a monthly basis by issuing commercial paper, short-term debt financing, or construct a hypothetical capital structure to calculate the SOS CWC Revenue Requirement would not be based on sound utility judgment and could actually cost BGE and its customers more money due to secondary effects. CWC is an on-going permanent expense<sup>54</sup> which the Company does not typically finance with short-term debt.<sup>55</sup> BGE establishes a “permanent” CWC Revenue Requirement based on the average of 12 months of CWC. According to the Company’s testimony, BGE does not have separate accounts to segregate monies that flow into its operations.<sup>56</sup> We find that BGE has presented credible evidence to demonstrate that it has utilized practices that minimize SOS costs in a responsible manner and find that BGE’s calculation of the CWC Revenue

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<sup>52</sup> Tr. at 79-82.

<sup>53</sup> Tr. at 82-83.

<sup>54</sup> Tr. at 197-198.

<sup>55</sup> Tr. 198-200..

<sup>56</sup> Direct Testimony of David M. Vahos at 7-8.

Requirement for SOS using its most recently authorized rate of return (grossed up for taxes) is the least cost possible consistent with sound utility management practices.

### C. Return Component

BGE has challenged the Chief Judge's decision to set the Return Component at 0.18 mills per kWh for Residential Customers and 0.13 mills per kWh for SOS Type I and Type II Customers based upon the CPI, less than the amount BGE sought. During the proceeding, Staff and OPC advocated that the return component should be the difference between the return rate used to calculate CWC Revenue Requirement and BGE's most recently rate of return, which is 0.92 mill per kWh for Residential Customers.<sup>57</sup> Additionally, Staff on reply noted that the record also contained substantial evidence to support providing BGE a return component lower than what the Chief Judge decided using CPI.<sup>58</sup> For reasons discussed below, we reverse this portion of Proposed Order II and set the Return Component based on the proposals of OPC and Staff.

PUA § 7-510(c)(3) states that "on or after July 1, 2003, an electric company continues to have the obligation of providing SOS 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." The question raised by BGE in this case is what is a "reasonable return."

BGE argues the Return Component set forth in Proposed Order II, which was devised using the CPI, does not satisfy what the statute means by a "reasonable return." BGE further argues that a "reasonable return" is not derived through the application of

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<sup>57</sup> See Proposed Order at 23, Staff's Reply Memorandum at 3.

<sup>58</sup> Staff's Reply Memorandum at 3.

PUA § 4-101(3), or determined by the fair value of BGE’s property used and useful in providing service. BGE argues that a reasonable return is something that is not unreasonable, a measure that does not provide a negative return, and something that is not below the low end of the range of margins of third party suppliers.<sup>59</sup> BGE amplifies its argument against the use of PUA §4-101(3) to determine a “reasonable return” by citing to *Severstal*. Additionally, through the testimony of Witness Strunk, the Company tried to convince the Chief Judge that the appropriate return authorized by PUA §7-510 could only be determined by using BGE’s application of the Return on Sales Methodology.<sup>60</sup>

Staff argues that a “reasonable return” stated in PUA §7-510(c)(3) means what the term “unreasonable return” has meant in other utility regulatory matters, i. e. a return on invested capital as stated and applied by PUA §4-101(3).<sup>61</sup> OPC insists that BGE misuses *Severstal* to promote its argument, and agrees with Staff that PUA §4-101(3) should be applied.<sup>62</sup> OPC also argues that *Severstal* never reached the issue of what “reasonable return” means and thus BGE inappropriately relies on *Severstal* to support that claim.<sup>63</sup> RESA also claims that the term “reasonable return” is not ambiguous and it means that the Commission is “to adopt orders and policies that foster competition, benefit customers economically, and which are fair to all stakeholders.”

We have looked throughout the Electric Customer Choice Act to determine the Legislature’s intended meaning of “reasonable return” and find it ambiguous. We have also reviewed *Severstal*, which does not address the issue either. We find that the Return

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<sup>59</sup> BGE Memorandum on Appeal at 5, 10-12

<sup>60</sup> Direct of Kurt Strunk at 2 and Rebuttal of Strunk at 4.

<sup>61</sup> Second Reply Memorandum on Appeal and Request for Clarification of the State of the Public Service Commission of Maryland at 4-5.

<sup>62</sup> OPC Reply Memorandum on Appeal at 3.

<sup>63</sup> *Id.*

Component alone does not by itself set “market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return” for BGE SOS services, but the Administrative Charge as a whole – along with the other elements that make up SOS prices – perform that measure.

After reviewing the evidence and arguments made by all parties, we adopt the Return Component proposed by OPC and Staff. We are convinced that “reasonable return” in PUA §7-510 means a return on capital investment. As OPC Witness Hill notes in his testimony, SOS is a traditional utility service. The electricity that it provides is purchased by the electric company and it is delivered through the company’s distribution system.<sup>64</sup> He notes that there is no difference between a “market standard” and a “regulatory standard” for determining a return on utility service.<sup>65</sup> The goal of regulatory oversight as provided by PUA §7-510 is to achieve a competitive environment of companies that have similar risks.<sup>66</sup> For that reason as stated by OPC and Staff, the Return Component should be determined by the cost of capital on regulated assets using capital market data of similar risk.<sup>67</sup> In order for there to be a return there must be a tangible investment as the basis for the return, which in this case is CWC.<sup>68</sup> Thus, we do not find a difference between the traditional utility regulatory standard for return and a market standard for return.

Absent the argument regarding the different standards of return applicable to this case, we also are not convinced that the return proposed by BGE is proper. BGE used the

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<sup>64</sup> Reply Testimony of Stephen G. Hill at 7-8.

<sup>65</sup> *Id.* at 9.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 10-11.

Return on Sale Methodology; however, that method is used to determine rates for the hauling of waste and intrastate trucking industries rather than the retail electricity supply industry or other companies that provide retail products comparable to SOS.<sup>69</sup> We do not believe that such a method is appropriate for determining the market return for the sale of SOS services. Had BGE provided us with other methods of determining a return for SOS services that are utilized by other jurisdictions similar to Maryland's electricity supply market, we may have given them some credence. However, to urge us to adopt a method that has not been used by a company that provides SOS service not only goes against our precedent but also does not prove to provide an adequate return referenced by PUA §7-510.

In this instance, we accept the Return Component as proposed by Staff which takes into consideration the capital BGE used in providing SOS services – CWC. Accordingly, we modify Proposed Order II by setting the Return Component at 0.93 mills per kWh for Residential Customers, 0.64 mills per kWh for SOS Type I Customers, and at 0.69 mills per kWh for SOS Type II Customers.

D. Administrative Adjustment Component

In Proposed Order II, the Chief Judge found that there was no evidence in the record to support the continuation of the Administrative Adjustment Component. Staff, BGE and RESA appealed this finding. Upon consideration of this matter, we find support in the record to keep the Administrative Adjustment part of the SOS Administrative Charge.

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<sup>69</sup> Rebuttal Testimony of Kurt Strunk at 4.

The purpose of the Electric Customer Choice Act, codified in PUA §7-501 *et seq.* is to establish customer choice of electricity supply and to create a competitive retail electricity supply and services.<sup>70</sup> The Administrative Adjustment serves as a proxy for A&G costs retail suppliers must include in their rates, which for the utility are embedded in BGE's distribution rates.<sup>71</sup> More directly, it places into SOS costs – costs that retail suppliers bear and report on FERC reporting forms – that are not fully represented by the incremental costs recovered in the Administrative Charge, such as: costs for billing, marketing and advertisement for customer acquisition; call center operations; product and price formation; hedging supply commitments; electronic data information; PJM membership fees; staffing for human resources; and policy and legal services.<sup>72</sup> The Administrative Adjustment Component was meant to unbundle those incremental costs for SOS that are weaved into BGE's distribution rates while also keeping the Company's SOS prices competitive with retail energy suppliers' costs and prices.<sup>73</sup>

Additionally, BGE, Staff, and RESA provided evidence showing that SOS providers intermingle incremental costs from SOS service with distribution service. The Administrative Adjustment Component coupled with the Incremental Cost Component, represents BGE costs to provide SOS.<sup>74</sup> The effect of doing that allows distribution customers to subsidize the price of SOS customers.<sup>75</sup> As a result, independent energy retailers would not be allowed to compete on a level playing field given the fact that they

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<sup>70</sup> *Severstal*, 194 Md. App. at 604-605.

<sup>71</sup> RESA Ex. 2 at 4, 7-11; BGE Ex. 22 at 11-12; Tr. at 41-47.

<sup>72</sup> Rebuttal Testimony of William P. Pino at 4-5, Supplemental Direct Testimony of David M. Vahos at 14 and 15, Reply Testimony of Phillip E. VanderHeyden at 34 and 35.

<sup>73</sup> Rebuttal Testimony of William B. Pino at 4-5.

<sup>74</sup> *Id.* at 6.

<sup>75</sup> *Id.* at 5.

pay those incremental costs and factor them into their prices, while electricity companies integrate those incremental expenses for SOS in their distribution rates.<sup>76</sup>

Thus, in support of continuing the use of the Administrative Adjustment Component Staff Witness VanderHeyden testified that it is typical regulatory practice to divide common costs in proportion to the portions that separate types of service or customer classes impose on the total cost.<sup>77</sup> SOS and distribution service provide separate services, so it is appropriate that both services share a portion of the costs to provide utility service.<sup>78</sup> The Administrative Adjustment does not reflect an artificial increase in SOS costs, but continues the means to approximate the proper allocation of customer costs that are incurred by the utility but are currently fully recovered through base rates.<sup>79</sup> In order to provide a market-based price, inclusive of the costs typically borne by retail suppliers, there must be an Administrative Adjustment Component.<sup>80</sup> According to BGE Witness Pino, the Administrative Adjustment does not create an unfair pricing advantage for retail supplies, but provides neutrality between SOS and the competitive retail market.<sup>81</sup> Without the Administrative Adjustment Component, SOS service would have an unfair pricing advantage over retail suppliers and Maryland's competitive retail market would not continue to be robust.<sup>82</sup>

In support of the Chief Judge's decision on this issue, OPC argues that the Administrative Adjustment should be eliminated. OPC claims that there was insufficient

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<sup>76</sup> *Id.* at 5-6.

<sup>77</sup> Reply Testimony of Phillip E. VanderHeyden at 33.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.* at 35.

<sup>80</sup> Rebuttal Testimony of William B. Pino at 5.

<sup>81</sup> *Id.* at 6.

<sup>82</sup> *Id.*

evidence in the record to support the continuation of the Administration Adjustment. According to OPC, using the Administrative Adjustment in an attempt to level the playing field to reflect retailers' costs is not mandated by statute and is discretionary.<sup>83</sup> OPC also contends on appeal, as it did below, that there was insufficient evidence from retailers to determine the amount and types of cost incurred that BGE should collect to make the energy retail market a level playing field. According to OPC Witness Wallach, the retail market has become competitive and has matured enough so that the artificial competitive edge the Administrative Adjustment Component created for retail suppliers is no longer needed.<sup>84</sup>

After considering all of the arguments and testimony provided by the parties, we agree with BGE, Staff, and RESA that the Administrative Adjustment should be retained. We conclude that the elimination of the Administrative Adjustment Component would cause BGE distribution customers to subsidize costs for BGE customers who receive SOS services. We also conclude that the elimination of the Administrative Adjustment Component would put energy retailers at a slight disadvantage and on an uneven playing field relative to BGE. One of the best ways to ensure that retail suppliers' prices remain competitive with BGE's SOS is to factor into BGE's SOS prices the costs that retailers pay and place into the SOS rate, which BGE receives from its embedded distribution rates.

However, on this record, we are unable to glean what a reasonably precise Administrative Adjustment should be at this present time. Therefore, the only way for us

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<sup>83</sup> Second Testimony of Jonathan Wallach at 21.

<sup>84</sup> *Id.* at 23.



to implement the Administrative Adjustment Component at this time, given the state of the evidence in the record before us, is to set its cost at 0 mills/kWh. The issue of the precise amount of the Administrative Adjustment Component should be taken up in connection with BGE's next general rate case, in which a cost of service study should be presented to reflect more precisely which costs should be properly allocated in distribution rates and which costs should be properly allocated to SOS prices.

#### Conclusion

After considering the evidence in the record, we find that an Administrative Charge is the appropriate method to allow recovery by BGE of its "variable, prudently incurred costs associated with the procurement or production of electricity plus a reasonable return." Therefore, for the reasons set forth herein, BGE's SOS Administrative Charge cost components for residential, Type I, Type II, and Hourly service are modified accordingly, as stated herein.

Until the end of 2016, BGE shall not collect the Return Component of the Residential Administrative Charge, but may collect the residential SOS CWC Revenue Requirement Component.

**IT IS THEREFORE**, this 17<sup>th</sup> day of November, in the year Two Thousand and Sixteen, by the Public Service Commission of Maryland,

**ORDERED:** (1) That the *second* Proposed Order of the Chief Public Utility Law Judge is affirmed in part and reversed in part;

(2) That Baltimore Gas and Electric Company may recover costs through an Administrative Charge for residential and non-residential SOS containing the following components: actual SOS-related Incremental Costs; actual SOS-related Uncollectible

Costs; Cash Working Capital; a Return; and an Administrative Adjustment Component, with the initial rate for each component as set forth herein. Except for the Return, an adjustment or true up of actual costs shall occur every four months to set the Administrative Charge. An adjustment of the Return shall occur annually. BGE shall not collect the Return Component of the Residential Administrative Charge until the end of 2016;

(3) That the initial Administrative Adjustment Component shall be set at 0 mills/kWh. It may be modified at a future time based upon the Company's Cost of Service Study created at the Company's next rate case setting forth the Company's expenses attributed to SOS service, distribution service, or both operations; and

(4) That all Motions not granted herein are denied.

/s/ W. Kevin Hughes

/s/ Harold D. Williams

/s/ Jeannette M. Mills  
Commissioners\*

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\* Commissioners Michael T. Richard and Anthony J. O'Donnell did not participate in the Commission's decision in this matter.