

**ORDER NO. 88719**

IN THE MATTER OF THE APPLICATION OF POTOMAC ELECTRIC POWER COMPANY FOR ADJUSTMENTS TO ITS RETAIL RATES FOR THE DISTRIBUTION OF ELECTRIC ENERGY	* * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND <hr/> CASE NO. 9472 <hr/>
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**Issue Date: May 31, 2018**

**I. INTRODUCTION AND EXECUTIVE SUMMARY**

In this Order, we approve a *Joint Motion for Approval of Agreement of Stipulation and Settlement* (the “Settlement”). The Settlement resolves all issues in this case.<sup>1</sup> We approve the Settlement because we find that, under the circumstances and on the record before us, the Settlement will result in just and reasonable rates for Pepco and its customers and is consistent with the public interest. The Settlement results in a base rate decrease of \$15,000,000. Although the Company revised its original request of \$41,439,000 to \$3,252,000, based largely on the impact of the Tax Cuts and Jobs Act of 2017 (“TCJA”), the rate decrease of the magnitude approved by this Order is significant.

As part of approving this overall Settlement, we agree to the Parties’ allocation of the base rate revenue requirement utilizing the four-step method described in the Settlement, and with the Customer Charge remaining unchanged for all classes except

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<sup>1</sup> The Settling Parties include: Potomac Electric Power Company (“Pepco” or “Company”), Commission Technical Staff, Office of People’s Counsel, the Apartment and Office Building Association of Metropolitan Washington; Montgomery County, Maryland, and the City of Gaithersburg. Although not a signatory to the Settlement Agreement, the U.S. General Services Administration does not oppose the settlement.

Time Metered Rapid Transit Service (Schedule TM-RT) such that the base rate revenue reduction is reflected in the volumetric and demand rate components.<sup>2</sup> We find the additional revenue requirement related items and regulatory asset items contained in the Settlement reasonable. We also find the one-time bill credit of \$9.7 million, which for residential customers is estimated to be \$10.09, to be reasonable and in the public interest.

## **II. BACKGROUND**

On January 2, 2018, pursuant to §§ 4-203 and 4-204 of the Public Utilities Article of the *Annotated, Code of Maryland* (“PUA”), Pepco filed an Application to increase its retail rates for the distribution of electric energy in Maryland (“Application”). By Order No. 88521 issued January 5, 2018, the Commission suspended the proposed rates for an initial period of 150 days from February 1, 2018. The Commission partially approved Pepco’s last application for an electric rate increase seven months ago in October 2017.<sup>3</sup> In the Application, Pepco initially asked the Commission for authority to increase its rates for providing electric distribution services to its customers in Maryland by \$41.439 million. Pepco’s request was based on a 12-month test year ending December 31, 2017, which at the time of filing included eight (8) months of actual data and four (4) months of forecasted data.<sup>4</sup>

Pepco submitted supplemental testimony on February 5, 2018, which took into account the impact of the TCJA, and reduced its requested proposed increase in electric

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<sup>2</sup> Settlement, p. 3-4.

<sup>3</sup> *In the Matter of the Application of Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy*, Case No. 9443, Order No. 88432 (October 27, 2017).

<sup>4</sup> Settlement Testimony of Jamie A. Smith, p. 2.

distribution base rates to \$10.729 million.<sup>5</sup> Pepco submitted additional supplemental testimony on March 8, 2018 reflecting the actual data for the 12-month period ending December 31, 2017. Pepco's use of actual data caused its proposed increase in electric distribution base rates to decrease again to \$3.252 million.<sup>6</sup>

The Parties conducted discovery with respect to Pepco's pre-filed testimony, and entered into settlement discussions.<sup>7</sup> On April 12, 2018, the Parties requested a suspension of the procedural schedule. The *Joint Motion for Approval of Agreement of Stipulation and Settlement* (the "Settlement") was filed on April 20, 2018. Testimony in support of the Settlement was filed on April 27, 2018 by the Company; Apartment and Office Building Association of Metropolitan Washington ("AOBA"); Montgomery County, Maryland ("Montgomery"); Office of People's Counsel ("OPC"); and Commission Technical Staff ("Staff").<sup>8</sup>

The Commission held an evidentiary hearing on the Settlement in its offices on May 16, 2018 ("Settlement Hearing"). Additionally, evening public comment hearings were held on May 14 and 22, 2018, in Largo, Maryland and Rockville, Maryland, respectively, for the purpose of receiving public comments on the Settlement.

### **III. SETTLEMENT AGREEMENT**

The Settlement results in a \$15.0 million decrease in Pepco's annual electric distribution revenues with the new distribution rates becoming effective on and after June

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<sup>5</sup> Settlement Testimony of Jamie A. Smith, p. 2.

<sup>6</sup> Settlement Testimony of Jamie A. Smith, p. 3.

<sup>7</sup> Settlement, p. 2.

<sup>8</sup> U.S. General Services Administration ("GSA") filed a letter stating that it did not intend to oppose the Settlement.

1, 2018.<sup>9</sup> In addition to the \$15.0 million decrease, Pepco's TCJA regulatory liability, accrued from January 1, 2018 through May 31, 2018, will provide a \$9.7 million one-time bill credit to customers within 60 days.<sup>10</sup> The TCJA regulatory liability reflects the decrease in Pepco's authorized revenue requirement from Case No. 9443 based on the change in the federal corporate income tax rate from 35 percent to 21 percent along with the amortization associated with the property related plant excess accumulated deferred income taxes ("EDIT").<sup>11</sup> Had this rate case not been filed and resolved by the Settlement, Pepco estimated that the total over-collection during calendar year 2018 would have been \$23.3 million.<sup>12</sup> The amount of this over-collection was calculated at \$9.7 million through May 2018.<sup>13</sup> The one-time \$9.7 million bill credit will first be allocated in proportion to each class' distribution revenues as approved in Case No. 9443, then credited to customers in each class. For residential rate classes, the one-time tax credit will be returned on a per customer basis, and for larger commercial classes a customer specific credit will be calculated based on volumetric usage and demand as percentages of the entire class.<sup>14</sup> For residential customers the resulting credit will be approximately \$10.09.<sup>15</sup> If additional tax savings are identified by Pepco related to the TCJA, Pepco will make a filing with the Commission providing a proposal on how to return those savings to customers as soon as possible on a prospective basis.<sup>16</sup>

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<sup>9</sup> Settlement Testimony of Jamie A. Smith, p. 3.

<sup>10</sup> Settlement Testimony of Jamie A. Smith, p. 3.

<sup>11</sup> Settlement Testimony of Jamie A. Smith, p. 3.

<sup>12</sup> Transcript of Settlement Hearing ("Tr."), p. 60; Supplemental Direct Testimony of Jay C. Ziminsky, Schedule (JCZ-SD)-2, p. 1.

<sup>13</sup> Supplemental Direct Testimony of Jay C. Ziminsky, Schedule (JCZ-SD)-2, p. 1.

<sup>14</sup> Tr., p. 12, 30-31.

<sup>15</sup> Settlement Testimony of K.M. McGowan, p. 5.

<sup>16</sup> Settlement Testimony of Jamie A. Smith, p. 3-4.

The Company's cost of equity will remain at 9.50 percent and Pepco will not file a base rate case earlier than December 15, 2018.<sup>17</sup> The EDIT created by the TCJA will flow back to customers in the following manner: protected property related plant EDIT by the use of the Average Rate Assumption Method ("ARAM"); non-protected property related plant EDIT by the use of a 20-year amortization period; and non-property related plant EDIT by the use of a 7-year amortization period.<sup>18</sup> Pepco will continue to use flow through tax accounting for pre-1981 plant cost of removal ("COR"), but will use the dispersion method rather than using an 85 percent allocation method.<sup>19</sup> The Settlement reflects this one-time adjustment.<sup>20</sup> Based on the dispersion method, the pre-1981 plant COR allocation is approximately 18 percent.<sup>21</sup> The Settlement reflects post test-year reliability plant closings through March 31, 2018.<sup>22</sup> The Settlement allows for the interim, non-binding use of a 10-year amortization period of the Benning Road \$3.9 million environmental Remedial Investigation/Feasibility Study costs incurred to date; litigation of this issue is deferred until Pepco's next rate case.<sup>23</sup> Pepco will create a regulatory asset for actual Derecho and Hurricane Sandy remaining unamortized storm costs of approximately \$1.333 million amortized over one-year. If there is an over-recovery of the unamortized storm costs, Pepco will track those costs and return over-recovered amounts to customers in the next base rate case.<sup>24</sup> Pepco Witness McGowan testified at the Settlement Hearing that Pepco expects to continue to file rate cases on an

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<sup>17</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>18</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>19</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>20</sup> Tr., p. 14-15.

<sup>21</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>22</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>23</sup> Settlement Testimony of Jamie A. Smith, p. 4.

<sup>24</sup> Settlement Testimony of Jamie A. Smith, p. 4.

annual basis.<sup>25</sup> If Pepco files soon after the December 15, 2018 limitation established in the Settlement, the amount of any storm-related over-recovery will be small.<sup>26</sup> Actual current rate case expenses of \$56,310 will be amortized over 3 years.<sup>27</sup> Witness McGowan testified that current rate case expenses relate to the hiring of an outside expert to testify regarding return on equity, and printing and other miscellaneous costs.<sup>28</sup>

The allocation of the \$15 million distribution revenue reduction is based on each rate class' unitized rate of return ("UROR") as determined by Pepco's Class Cost of Service Study ("CCOSS").<sup>29</sup> The proposed revenue allocation methodology is a four-step methodology:

1) Exclude rate classes from a revenue change, if appropriate. No rate classes were excluded in Step 1.

2) If a rate class is within the band of reasonableness, (+/-) 10 percent of the system UROR (UROR = 0.90 to 1.10), then these classes receive the system average percentage decrease. The system average percentage revenue decrease is the percent that distribution revenue decreased for Pepco in the Settlement.

3) If a rate class is over earning (UROR>1.10), then incremental revenues are allocated to over earning classes by multiplying the classes' URORs by the system average percentage decrease by the classes' annualized current distribution revenue. The annualized current distribution revenue is the revenue expected to be recovered from the rate class before the revenue reduction.

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<sup>25</sup> Tr., p. 18-19.

<sup>26</sup> See Tr. at 26-27.

<sup>27</sup> Settlement Testimony of Jamie A. Smith, p. 5.

<sup>28</sup> Tr., p. 27.

<sup>29</sup> Settlement Testimony of Benjamin Baker, p. 2.

4) The remaining revenue decrease is allocated to under earning classes (UROR<0.90) based on the current annualized distribution revenue of these classes.<sup>30</sup>

In the past few Pepco rate cases, a two-step process for allocating rate increases and determining inter-class rates has been used. As a first step, a portion of the approved revenue increase is allocated to those under-earning rate classes with URORs below 1.0, to move them closer toward 1.0, the system average. In the second step, the remainder of the revenue increase is apportioned to all customer classes, based upon the proportion of their class revenues compared to overall system revenues. Classes that are significantly over-earning may be excluded from this second step. Pepco used this two-step process, while maintaining three constraints: 1) Limit the maximum percentage increase to any schedule to 1.5 times the overall average percentage increase; 2) Ensure rate classes with a UROR below 1.0 did not rise above 1.0; and 3) Ensure rate classes with a UROR above 1.0 did not fall below 1.0.<sup>31</sup>

In the present case, Pepco Witness Blazunas suggested the four-step methodology after taking into consideration the approach used by Baltimore Gas and Electric Company (“BGE”) in its recent rate cases.<sup>32</sup> He stated that the four-step methodology is consistent with methods authorized by the Commission.<sup>33</sup> Staff Witness Baker noted the flexibility the four-step method provides to the rate designer to better ensure stronger improvements in UROR, aligning the principals of cost causation and gradually eliminating intra class subsidization.<sup>34</sup> The UROR for all rate classes either remains unchanged or moves closer

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<sup>30</sup> Settlement Testimony of Benjamin Baker, p. 2-3.

<sup>31</sup> Settlement Testimony of Benjamin Baker, p. 3-4.

<sup>32</sup> Direct Testimony of Peter R. Blazunas, p. 5.

<sup>33</sup> Direct Testimony of Peter R. Blazunas, p. 5.

<sup>34</sup> Settlement Testimony of Benjamin Baker, p. 6.

to 1.0.<sup>35</sup> Staff Witness Baker said the four-step methodology “should be considered for use in future rate cases.”<sup>36</sup>

At the Settlement Hearing, Pepco Witness McGowan maintained that for the average residential customer, the rate impact would be a reduction of \$1.64 per month.<sup>37</sup> While there may be an effective reduction in rates, certain classes of customers, including residential customers, will not see a decrease from their current bills. For all classes, the impact of the combined income tax expense/ADIT decrease and changes in regulated plant and O&M and related expenses (since Pepco’s last rate case) is a decrease in regulated sales revenue.<sup>38</sup> However, the prices per kWh for some classes will increase over the tariffed prices that are in effect from Case No. 9443 as a result of Pepco’s Bill Stabilization Adjustment (“BSA”), which increases or decreases the base rate based on a formula that stabilizes Pepco’s monthly distribution revenue.<sup>39</sup> The BSA lowers rates if the Company is receiving more revenue than has been authorized, and increases rates if the Company is receiving less revenue than has been authorized. Current rates are not providing Pepco with the revenue it was authorized in its most recent rate case, Case No. 9443.<sup>40</sup> The accrued BSA amount based on the amount of authorized revenue exceeds the amount of the revenue requirement decrease allocated to certain classes as a result of the Settlement.<sup>41</sup> Thus, despite the significant revenue reduction, for certain classes,

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<sup>35</sup> Settlement Testimony of Benjamin Baker, p. 10.

<sup>36</sup> Settlement Testimony of Benjamin Baker, p. 5.

<sup>37</sup> Tr., p. 13.

<sup>38</sup> Settlement Testimony of Phillip E. VanderHeyden, p. 7.

<sup>39</sup> Settlement Testimony of Phillip E. VanderHeyden, p. 7. (The BSA is a “de-coupling” rate design policy that is intended to support Maryland’s energy efficiency and conservation policies, and the expansion of State distributed “clean energy” resources while minimizing adverse financial impacts on the State’s electric utilities.)

<sup>40</sup> Tr., p. 37.

<sup>41</sup> Settlement Testimony of P.R. Blazunas, p. 4.



customer bills will actually increase per Kwh from their current amount.<sup>42</sup> As Staff Witness Baker explained, “the current rates became effective October 20, 2017. Since the new proposed rates will take effect June 1, 2018, the customer will have almost never experienced the summer rates that were approved in Case 9443.”<sup>43</sup> Residential customers will experience a reduction, not from their current bills, but from what their monthly bills would have been absent the Settlement.<sup>44</sup>

At both evening public hearings, customers expressed concerns about their high electric bills and unresponsiveness of Pepco’s customer service representatives to telephone inquiries. Pepco Witness McGowan assured the Commission that the Company would contact such customers directly and attempt to address their concerns.<sup>45</sup>

#### **IV. COMMISSION DECISION**

Though settlement of rate cases of this magnitude are rare,<sup>46</sup> the Commission has considered and approved settlements proposed by adverse parties representing divergent interests in previous rate case proceedings. In this case, the Parties were able to achieve an uncontested settlement, likely the result of thoughtful negotiation and delicate compromise. Historically, a settlement that is submitted by parties who normally have adverse interests is an indication that the overall agreement reached is a reasonable one. In addition, the Parties submitted testimony in support of the Settlement. *See, e.g., In the Matter of the Application of Delmarva Power & Light Company for Adjustments to Its*

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<sup>42</sup> Settlement Testimony of Benjamin Baker, p. 11.

<sup>43</sup> Settlement Testimony of Benjamin Baker, p. 12.

<sup>44</sup> *See* Settlement Testimony of K.M. McGowan at p. 5.

<sup>45</sup> Tr., p. 23-24.

<sup>46</sup> Pepco Witness McGowan testified at the Settlement Hearing that no one in Pepco’s office could recall the last time Pepco had settled a rate case in Maryland. Tr., p. 10.

*Retail Rates for the Distribution of Electric Energy*, 2018 WL 864147 (Md.P.S.C.) *slip op.* (February 9, 2018).

Staff Witness Smith testified that “[t]he agreed upon revenue requirement decrease of \$15.0 million along with the one-time bill credit of \$9.7 million are in line with what would have been Staff’s litigated position. The noted additional Settlement Agreement revenue requirement related items and regulatory asset items are generally consistent with Staff’s positions and with the Commission’s prior decisions.<sup>47</sup> OPC Witness Effron similarly testified that “based on [his] review of the Company’s testimony, exhibits, supporting workpapers, and responses to data requests [he] believed a decrease of \$15,000,000 to the revenues produced by base distribution rates is a reasonable resolution of the revenue requirement issues in this case.”<sup>48</sup> He further testified that the TCJA regulatory liability accrued from January 1 until May 31, 2018<sup>49</sup> was properly quantified at \$9.7 million, and that the one-time bill credit to customers properly credits ratepayers for the income tax savings realized by the Company from the effective date of the TCJA until the rates established in the Settlement take effect.<sup>50</sup>

The Commission must carefully review *any* settlement (whether it is contested or unopposed, as in this case) to ensure that the outcome is in fact reasonable. *See* Re Delmarva Power and Light Company, Case No. 9249, Phases I&II, Order No. 84170, 102 Md. P.S.C. 236, 240 (2011). We have thoroughly reviewed this Settlement, and, based on the record before us, we approve it. The Company’s original request in its

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<sup>47</sup> Settlement Testimony of Jamie A. Smith, p. 5.

<sup>48</sup> Settlement Testimony of David J. Effron, p. 3.

<sup>49</sup> OPC Witness Effron has May 30, 2018 in his testimony; we believe from Staff Witness Smith’s testimony that the period of accrual runs through May 31, 2018.

<sup>50</sup> Settlement Testimony of David J. Effron, p. 3.

Application was for a base rate increase of \$41,439,000. The TCJA was signed into law on December 22, 2017, which included a significant reduction of the federal corporate income tax rate effective January 1, 2018. On January 12, 2018, the Commission issued Order No. 88530 which directed Maryland utilities whose rates are explicitly grossed up for taxes to file with the Commission on or before February 15, 2018, an explanation of when and how they expected to pass through the impacts of the TCJA to their customers.<sup>51</sup> In compliance with Order No. 88530, Pepco filed Supplemental Testimony demonstrating an approximate \$34 million reduction in revenue requirement as a result of the TCJA (the difference between its original request of \$41.4 million and supplemental filing request of \$10.7 million), offset by a requested proposal to use the dispersion method for pre-1981 cost of removal, resulting in a total revenue requirement reduction of \$30.7 million. When Pepco updated its filings in this case to actual information on March 8, 2018, its approximate \$10.7 million request was further reduced to \$3,252,000. Although much of the reduction in Pepco's request in this case is due to the impact of the TCJA, the change from a request for an increase of \$3.252 million to a revenue reduction of \$15.0 million is substantial. We find, based on the record in this case, that this reduction will result in just and reasonable rates,<sup>52</sup> and is consistent with the public interest.

We find the cost of equity remaining at 9.50 percent, the cost of equity authorized in Case No. 9443, to be reasonable. We find the additional revenue requirement related

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<sup>51</sup> *In the Matter of the Impact of the Federal Tax Cuts and Jobs Act of 2017 on Maryland Utility Rates*, Case No. 9473, Order No. 88530 (January 12, 2018).

<sup>52</sup> For all classes, there will be a decrease in regulated sales revenue. Although rates for some classes will actually increase slightly from current rates, rates will be lower relative to what they would have been absent the Settlement.

items and regulatory asset items contained in the Settlement reasonable as well. We also find the one-time bill credit to customers of \$9.7 million to be reasonable and in the public interest. From the record, we agree that this amount properly credits ratepayers for the TCJA regulatory liability that accrued from January 1 until May 31, 2018.<sup>53</sup>

We agree with the Parties' allocation of the base rate revenue requirement utilizing the four-step method described in the Settlement. This methodology is consistent with methods previously authorized by the Commission, and we note that it results in the UROR for all rate classes either remaining unchanged, because it is already close to 1.0, or moving closer to 1.0. Thus, the rate design of the Settlement complies with the principles of cost causation and gradually eliminates intra-class subsidization.

We agree with the Customer Charge remaining unchanged for all classes except TM-RT such that the base rate revenue reduction is reflected in the volumetric and demand rate components.<sup>54</sup> Although this may result in the Customer Charge representing a relatively larger proportion of total charges, we are approving the Settlement as a whole, and we find this result reasonable under the circumstances.

We note that our approval of this Settlement does not bind the Commission in any way to accept in the future the methodologies or analyses incorporated into individual provisions thereof, including without limitation changes to customers charges and/or the four-step revenue allocation.

At the Settlement Hearing, Pepco Witness McGowan testified that revised tariff sheets, attached to the Settlement, decreasing rates by \$15.0 million in accordance with

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<sup>53</sup> We note that if additional tax savings are identified by Pepco related to the TCJA, Pepco will make a filing with the Commission providing a proposal on how to return those savings to customers as soon as possible on a prospective basis.

<sup>54</sup> Settlement, p. 3-4.

the rate design and other elements of the Settlement, have been reviewed and approved by all Parties to the Settlement.<sup>55</sup>

**IT IS THEREFORE**, this 31<sup>st</sup> day of May, in the year Two Thousand and Eighteen, by the Public Service Commission of Maryland,

**ORDERED:** (1) That the Application of Potomac Electric Power Company filed on January 2, 2018, seeking to increase distribution rates for electric service by \$41,439,000 in its Maryland service territory, is hereby denied;

(2) That the *Joint Motion for Approval of Agreement of Stipulation and Settlement* (the “Settlement”) is approved;

(3) That the Company shall implement the one-time bill credit to customers as proposed in the Settlement to be posted to customer accounts within 60 days of this Order; and

(4) That the Company’s revised tariffs, attached to the Settlement, that decrease rates by \$15.0 million, for service rendered on and after June 1, 2018, are hereby accepted by the Commission.

W. Kevin Hughes

Michael T. Richard

Anthony J. O’Donnell

Odogwu Obi Linton

Mindy L. Herman

Commissioners

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<sup>55</sup> Tr., p. 11.