

ORDER NO. 90035

In the Matter of the Review of Delmarva
Power & Light Company Standard Offer
Service Administrative Charge

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BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND

CASE NO. 9226

In the Matter of the Review of the Potomac
Electric Power Company Standard Offer
Service Administrative Charge

CASE NO. 9232

Issue Date: January 7, 2022

ORDER ON APPEALS

Before: Jason M. Stanek, Chairman
Michael T. Richard, Commissioner
Anthony J. O'Donnell, Commissioner
Odogwu Obi Linton, Commissioner

I. BACKGROUND

1. This case is on appeal to the Commission by the Maryland Office of People’s Counsel (“OPC”) and Commission Staff (“Staff”) from the Third Proposed Order¹ of the Public Utility Law Judge (“PULJ”) in this case, involving Delmarva Power and Light Company’s (“Delmarva”) request to increase its Standard Offer Service (“SOS”)-related Cash Working Capital (“CWC”) revenue requirements, and Potomac Electric Power Company’s (“Pepco”) request for review of its overall SOS Administrative Charge.² Delmarva and Pepco are collectively referred to herein as “the Companies.”³

2. While the matter was pending before the PULJ Division, the Commission issued Order No. 87891 in Case No. 9221 addressing Baltimore Gas and Electric Company’s (“BGE”) request for recovery of SOS-related CWC revenue requirements.⁴ The Commission’s decisions in the *BGE Order* (and in its *Order on Requests for Rehearing and Clarification*, Order No. 87994) were applied by the PULJ in these cases--while at the same time OPC sought judicial review of Order No. 87891 in the Circuit Court for Baltimore City and subsequently the Maryland Court of Special Appeals. The Circuit Court affirmed the *BGE Order* in August 2017, and the Order was upheld in the

¹ The Third Proposed Order is referred to herein as “Proposed Order III”.

² *In the Matter of the Review of Delmarva Power & Light Company and Potomac Electric Power Company's Standard Offer Service Administrative Charge*, Case Nos. 9226 and 9232, Third Proposed Order of Public Utility Law Judge, September 6, 2017 (“Proposed Order III”). (Case No. 9226 was initiated to consider Delmarva and Pepco’s joint request to increase the Companies’ SOS-related cash working capital revenue requirements. (Case No. 9232 was initiated by the Commission in response to OPC’s Motion to Expand the Scope of Case No. 9226 to include a full examination of all components of the Companies’ Administrative Charge rates.)

³ These cases were not consolidated by the Commission; however, they were consolidated by the PULJ for the purposes of evidentiary hearings.

⁴ *In the Matter of a Request by Baltimore Gas and Electric Company for Recovery of Standard Offer Service-Related Cash Working Capital Revenue Requirement*, Case No. 9221, Order No. 89891 (Nov. 17, 2016) (“the *BGE Order*”). An *Order on Request for Rehearing and Clarification* (Order No. 87994) was issued by the Commission on January 24, 2017.

Maryland Court of Special Appeals in an unpublished decision issued by the Court on July 27, 2020.

A. The BGE Order

3. The Commission issued Order No. 87891 on November 17, 2016, adjudicating appeals from the Second Proposed Order of the PULJ Division pertaining to a request by BGE for recovery of its SOS-related CWC revenue requirement. There, the Commission concluded that the utility 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 set forth therein.

4. Except for the Return, the Commission directed that an adjustment, or true up, of actual costs shall occur every four months to set the Administrative Charge, and that an adjustment of the Return shall occur annually. The Commission directed further that the utility (BGE) shall not collect the Return component of the Residential Administrative Charge until the end of 2016.⁵

5. With regard to CWC, the Commission found that BGE had presented credible evidence to demonstrate that it has utilized practices that minimize SOS costs in a responsible manner and found that BGE's calculation of the CWC revenue requirement (at that time 0.95 mills/kWh) for SOS using its most recently authorized rate of return (grossed up for taxes) is the *least cost possible consistent with sound utility management*

⁵ BGE Order at 25-26.

practices, thereby accepting both the utility’s methodology for calculating its SOS-related CWC revenue requirement and the resulting CWC component charge itself.⁶

6. With regard to the Return component, the Commission adopted the Return component proposed by OPC and Staff, noting that “reasonable return” under PUA § 7-510 means a return on capital investment.⁷ The Commission noted further that:

The goal of regulatory oversight as provided by PUA § 7-510 is to achieve a competitive environment of companies that have similar risks. 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. ... Absent [] argument regarding the different standards of return applicable to this case, we also are not convinced that the return proposed by BGE [which used the Return on Sale Methodology] is proper.⁸

7. In Order No. 87994, addressing requests for rehearing and clarification of the *BGE Order*, the Commission rejected OPC’s and Staff’s assertion that -- applying Staff’s methodology for calculating the utility’s SOS-Return component and including the Return component as part of the SOS Administrative Charge [along with the CWC component, based on the utility’s most recently authorized rate of return (grossed up for taxes)] -- resulted in double recovery of the Return component. Based on the methods that it accepted and the resulting Administrative Charge that these methods produced, the Commission concluded that the utility was not over-earning on SOS.⁹

8. The Maryland Court of Special Appeals affirmed the Commission’s *BGE Order* (and the *Order on Requests for Rehearing and Clarification*) in an unpublished opinion

⁶ *Id.* at 17-18.

⁷ *Id.* at 20.

⁸ *Id.* at 20-21. PUA § 7-510(c)(ii)(2) provides that “[o]n 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.”

⁹ *Order on Requests for Rehearing and Clarification* at 2.

issued by the Court on July 27, 2020.¹⁰ The Court held “[w]e find no reversible error in the Commission’s decision to allow 0.93 mills/kWh as the Return component, even though OPC’s proposal was premised upon allowing a lesser amount for the CWC component.”¹¹

B. Third Proposed Order

9. On September 6, 2017, then-Chief PULJ Terry J. Romine issued Proposed Order III in Case Nos. 9226 and 9232. Proposed Order III directed that the Companies may recover through an Administrative Charge for Residential and Non-Residential Standard Offer Service (“SOS”): (i) actual SOS-related Incremental Costs; (ii) actual SOS-related Uncollectible Costs; (iii) a Return; and (iv) an Administrative Adjustment, with the initial rate for each component set in the proposed order.

10. Proposed Order III also directed that the Companies may recover a SOS-related CWC revenue requirement, calculated using the companies’ pre-tax weighted average cost of capital (“WACC”) based on the Companies’ most recent base rate case, and provided for an Administrative Adjustment, for which no specific amount was calculated. The PULJ further directed that except for the Return component, an adjustment (or true up) of actual costs in the Administrative Charge shall occur at least three times per year, an adjustment of the Return component shall occur annually.

¹⁰ *Maryland Office of People’s Counsel v. Maryland Public Service Commission*, Sep. Term, 2017, No. 1366.

¹¹ *Id.* at 28. The Court also concluded that it was in the Commission’s discretion and expertise to reject the recommendation of OPC that the utility (BGE) be required to use short-term debt to meet all of its cash flow needs. *Id.* at 30.

C. OPC and Staff Appeals

11. OPC and Staff appeal Proposed Order III. OPC appeals the PULJ's application of the Commission's decisions in the *BGE Order* and Order No. 87994 (the *Order on Requests for Rehearing and Clarification*) in Case No. 9221 pertaining to the CWC component applicable to the utilities' Administrative Charge. OPC argues that the PULJ erred in permitting the Companies to retain a CWC component (calculated at each utility's authorized rate of return on its SOS-related CWC asset) and a Return component (based on—what OPC argues—is “the same SOS-related CWC asset”) both as part of the Administrative Charge.

12. In its appeal Staff requests that the Commission clarify that Staff, OPC and other parties may seek review of the Companies' SOS returns at “anytime,” including during a base rate case, and that during a base rate case the parties may conduct discovery regarding SOS returns and propose revenue requirement adjustments--if warranted.

II. DISCUSSION

A. CWC and Return Components

1. OPC

13. OPC accepts that the SOS rates adopted by the Commission must be “just and reasonable,” but argues that rates adopted in Proposed Order III are not—arguing that the PULJ erred in allowing the Companies to earn a second return on their SOS-related CWC asset, as part of the Return component, in addition to a return already embedded within the CWC revenue requirement.¹² OPC argues that the utilities' Incremental Cost, Uncollectible Cost, and CWC components of the Administrative Charge, with true-ups,

¹² OPC Memorandum on Appeal at 5.

alone allow the Companies to recover the “just and reasonable” rate for providing SOS,¹³ and further argues that the *BGE Order*—which also included the Return component in the make-up of the utilities’ SOS Administrative Charge—should not be applied to these proceedings.¹⁴

14. OPC argues that “if the utility asset is compensated at its ROR [*i.e.*, rate of return], then any additional return based on that same asset produces an above-market return.”¹⁵

15. OPC suggests that the PULJ’s allowance of both a CWC component and a Return component in the calculation of the utilities’ SOS Administrative Charge derives from “confusion” stemming from the Commission’s preference for separately stating Return and CWC components,¹⁶ and that in accounting for this apparent confusion, in the proceedings underlying the Commission’s orders, OPC and Staff recommended that the Return component be “set at the difference between the CWC Compensation Revenue Requirement calculated at the most recent ROR and the CWC Revenue Requirement calculated using a short-term interest rate.”¹⁷ Using this formula—OPC argues—would have satisfied OPC’s and Staff’s position that the total of the CWC Revenue Requirement and the Return component would equal the CWC Revenue Requirement calculated at the most recent ROR.¹⁸

16. Arguing that the “only utility property used to provide SOS is CWC,” OPC insists that the maximum reasonable compensation for the use of that asset is the CWC Revenue

¹³ *Id.* at 7.

¹⁴ *Id.*

¹⁵ *Id.* at 8.

¹⁶ *Id.* at 9.

¹⁷ *Id.*

¹⁸ *Id.*

Requirement calculated at the ROR.¹⁹ OPC emphasizes that the “cost” of the utility’s capital and the “return” on that capital are the same,²⁰ arguing that because there is no other asset involved in providing SOS on which the Companies can earn a return, the CWC component and the return (combined) must be limited to the revenue requirement on the SOS-related CWC—calculated at the utilities’ rate of return.²¹

17. In order to resolve what OPC describes as the Commission’s “confusion” in requiring both a CWC component and a Return component for purposes of calculating the SOS Administrative Charge, OPC recommended three alternatives: (i) calculating the CWC revenue requirement by multiplying the CWC asset times the pre-tax authorized rate of return, and setting the separate Return component at zero; (ii) setting the CWC revenue requirement at zero, and calculating the separate Return component by multiplying the SOS rate base times the pre-tax overall cost of capital; or (iii) calculating the Return component as the CWC asset at the utility’s return on equity.²² According to OPC, any of these alternatives would allow the utilities to earn their pre-tax overall rate of return as determined in their last rate case.²³

2. The Companies

18. The Companies argue that the PULJ properly determined that the Companies’ authorized rates of return is the appropriate return to use when calculating the utilities’ SOS CWC revenue requirement, and insist that the Companies must also be granted a separate utility return associated with providing SOS.²⁴ They note that Proposed Order

¹⁹ *Id.* at 10.

²⁰ *Id.*

²¹ *Id.* at 12-13.

²² *Id.* at 13-14.

²³ *Id.* at 15.

²⁴ Delmarva and Pepco Reply Memorandum at 2.

III in this case is consistent with the Commission’s decisions in the *BGE Order*, and argue that it is also consistent with the *Public Utilities Article*, and Commission precedent.²⁵ Rather than advancing other arguments, the Companies assert that OPC’s appeal attempts to relitigate the Commission’s decisions in Case No. 9221, again propounding that the Companies’ SOS-related CWC revenue requirements reflect “the lowest cost possible consistent with sound utility management practices.”²⁶

19. In response to OPC’s assertion that the CWC revenue requirement—as implemented in Proposed Order III—produce compound returns on the utilities’ SOS rate, the Companies note that the Commission has consistently determined that CWC represents a cost to the utilities, observing that the Commission reiterated in the *BGE Order* that “CWC Revenue Requirement is a cost that BGE and other utilities incur when providing SOS service, ... and [as] stated in Order No. 86881, CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS.”²⁷ The Companies also note that their witness (Mr. McGowan) explained how “CWC does not generate a return but in fact is a cost incurred by the Companies as part of the SOS procurement process.”²⁸

20. Additionally, the Companies refute OPC’s assertion that the Administrative Charge, utilizing the CWC component rate and the Return component rate adopted in Proposed Order III, would allow the Companies a pre-tax return of 19.36 percent for Delmarva and 21.25 percent for Pepco, respectively. Pointing to their post-hearing reply

²⁵ *Id.* at 3-4.

²⁶ *Id.* at 4, citing Proposed Order III at 18-19.

²⁷ Delmarva and Pepco Reply Memorandum at 5, citing BGE Order at 14 and Order No. 86881 at 19-20.

²⁸ Delmarva and Pepco Reply Memorandum at 5.

brief, the Companies argue that OPC’s calculations conflate the rate of return used to calculate the CWC component with the Return component.²⁹

21. Finally, the Companies submit that the PULJ properly rejected OPC’s alternatives for calculating the CWC revenue requirement component and the Return component, arguing that OPC’s alternatives one and two contravene State law and Commission precedent—by denying the utilities a return on the provision of SOS service as required under PUA § 7-510(c)(3)(ii)(2), and arguing that OPC’s third alternative is flawed.

Commission Decision

22. The crux of OPC’s argument focuses on whether the PULJ in Proposed Order III permits a double return by allowing the Companies’ SOS Administrative Charge to include both a CWC component and a separate Return component. OPC argues that because CWC is the only type of investment utilities make in providing SOS, the CWC return satisfies the reasonable return requirement of PUA§ 7-510(c)(3)(iii)(2).³⁰ However, the Commission finds—as did the PULJ—that the utilities, like competitive suppliers, have to finance all or a portion of their cash working capital to procure and provide the supply commodity and must be able to recover the cost of financing their SOS cash working capital through the SOS market price similar to the manner in which the competitive suppliers include the cost of financing in setting their customer rates.³¹ To that end, the Commission agrees with the PULJ finding that requiring the Companies to segment the cash management process of its various services including SOS “may

²⁹ *Id.* at 6.

³⁰ *See* OPC Memorandum on Appeal at 5.

³¹ *See* Proposed Order III at 18.

increase costs not only to the SOS ratepayers, but also to distribution ratepayers.”³² The PULJ found that the weighted average cost of capital (“WACC”) authorized by the Commission in the Companies’ most recent base rate case is the least cost financing of the SOS cash working capital using the best utility management practice.³³ She therefore directed that the Companies’ CWC Cost component be calculated by applying the pre-tax WACC authorized in each Company’s most recent rate case to its SOS CWC asset.³⁴

23. The Commission affirms the PULJ’s decision and rationale and agrees that parsing the source of financing or directing a specific financing source to be used to finance the SOS CWC would increase—unnecessarily—the SOS costs to be recovered from SOS customers.³⁵ Additionally, the Commission finds the PUA§ 7-510(c)(3)(iii)(2) provides that the Companies are permitted to earn a return on the provision of SOS. Specifically, PUA § 7-510(c)(3)(iii)(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. (Emphasis added.)

24. In Proposed Order III, the PULJ noted that the Return component is designed to compensate the Companies for their potential risk associated with the provision of the SOS product whereas the CWC Cost component allows the Companies to recover the costs to finance the SOS cash working capital using its cash management.³⁶ The PULJ found that these two components were separate and independent from one another and

³² *Id.*

³³ *Id.* at 18-19.

³⁴ *Id.* at 20.

³⁵ *See id.*

³⁶ *Id.* at 24.

represent two differing sources of recovery and revenue to the Companies.³⁷ She directed the Companies to calculate the Return component for all customer classes by applying the pre-tax WACC minus the short-term debt average rate to the SOS CWC.³⁸

25. The Commission affirms the PULJ’s finding and rationale noting that the statute clearly states recovery is permissible for verifiable and prudently incurred costs to procure the electricity for SOS customers **plus** a reasonable return. This finding is further supported by the Court of Special Appeals’ affirmance of the *BGE Order* in the *Maryland Office of People’s Counsel* decision.

26. In *Maryland Office of People’s Counsel*, the Court held that the statute “is clear that utilities are allowed a ‘reasonable return’ in addition to the recovery of SOS ‘costs.’”³⁹ The Court further explained that “CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS” and if a return is not included in the CWC revenue requirement then it must be included elsewhere.”⁴⁰

B. Review of SOS Returns in Base Rate Cases

1. Staff

27. Staff argues that pursuant to footnote 2 of Order No. 87994,⁴¹ the PULJ erred in denying its request for a ruling authorizing Staff, OPC and other parties to seek review of the Companies’ SOS returns at “anytime,” including during a future base rate case.⁴² Staff notes that in its request for clarification of the *BGE Order* it--like OPC--was

³⁷ *Id.*

³⁸ *See id.* at 27.

³⁹ *Maryland Office of People’s Counsel v. Maryland Public Service Commission*, Court of Special Appeals of Maryland, No. 1366, (Unreported Opinion) September Term, 2017, slip op. at 27 (Jul. 27, 2020) (“*Maryland Office of People’s Counsel*”).

⁴⁰ *Id.*

⁴¹ Case No. 9221, *Order on Requests for Rehearing and Clarification*.

⁴² Staff Memorandum on Appeal at 4.

concerned that the *BGE Order* could be read as granting the utility (BGE) “what amounts to a double return on the same capital asset [the utility’s SOS-related] cash working capital.”⁴³ Staff therefore argues that based on its reading of footnote 2 of the *Order on Requests for Rehearing and Clarification*, the Commission authorized Staff and other parties to review utilities SOS returns “and the potential for overearning in the context of a base rate case.”⁴⁴

28. Noting the Commission’s concern that adding SOS issues to rate cases might “add complexity” in such proceedings, Staff further argues that “the addition of a few more numbers to the calculation of the utility’s return, possibly resulting in an accounting adjustment, would not add any undue complexity to a rate case.”⁴⁵ Finally, Staff argues that reviewing utility SOS returns on a stand alone basis in SOS-related proceedings is not a simple task, in part because there is no real precedent or standard that applies to a stand alone SOS return.⁴⁶ However, Staff argues that if the utilities’ SOS returns can be reviewed and reset in the context of a base rate case, then the Companies’ overall authorized returns can serve *as a cap* and a clear demarcation of what constitutes a reasonable return.⁴⁷

⁴³ *Id.* at 2.

⁴⁴ *Id.* at 4. Staff states that footnote 2 of Order No. 87994 should be read as “indicating that the Commission has reconsidered its earlier opposition to the possibility of reviewing the SOS return in the context of a base rate proceeding.” *Id.* at 5.

⁴⁵ *Id.* at 6.

⁴⁶ *Id.*

⁴⁷ *Id.*

2. The Companies

29. The Companies argue that the PULJ properly determined that the Companies' SOS revenues should not be reviewed in base rate proceedings, arguing that there are different costs and customers when comparing the utilities' distribution business segment with the provisioning of SOS service.⁴⁸ The Companies also quoted from Commission Order No. 85797 (in the *Delmarva SOS case*), stating that: "... it would not be appropriate to consider SOS issues in the Companies' future rate cases ... [t]he Commission finds that adding additional complex SOS issues [in base rate cases] would not promote the thorough analysis required to address either distribution rates or SOS issues appropriately."⁴⁹ Additionally, the Companies argue that Staff's assertion that only minimal effort and "the addition of a few more numbers to the calculation of the utility's return ... would not add any undue complexity to a rate case" is a new argument, raised for the first time on appeal, without support in the record.⁵⁰

30. The Companies also argue that footnote 2 in Order No. 87994 is meant to be read in conjunction with the Commission's determination in Order No. 85797—holding that SOS issues should not be addressed in utility base rate proceedings—and the Cost of Service Study that the Commission directed the utility file in its next rate case was solely for purposes of producing evidence on what the appropriate Administrative Adjustment should be, if any.⁵¹ PUA § 3-102, the Companies argue, permit interested parties to file a complaint "at any time" challenging the Companies' SOS Administrative Charges

⁴⁸ Delmarva and Pepco Reply Memorandum at 11.

⁴⁹ *Id.*, quoting *In re Delmarva Power and Light Co.*, Order No. 85797, Case Nos. 9226 and 9232, slip op. at 33 (Aug. 21, 2013).

⁵⁰ Delmarva and Pepco Reply Memorandum at 12.

⁵¹ *Id.* at 12-13.

outside the context of a base rate case, which they can submit should the parties have concerns about the potential for utilities over-earning with regard to the utilities' provisioning of SOS.⁵²

3. OPC

31. In its reply memorandum, OPC argues that Staff's request for authorization to address over-recovery—by proposing an adjustment in the Companies' next base rate cases—would not suffice to address what it alleges to be over-earning based on “an excessive return” on the Companies' SOS-related CWC.⁵³ OPC also notes, as do the Companies, that the Commission has stated in previous orders that it does not want SOS costs and revenues litigated in base rate cases.⁵⁴ OPC posits that the only remedy, if the Companies are over-earning on providing SOS—due to what it alleges is a double return on CWC—is to adopt one of the three alternatives OPC proposed in its Memorandum on Appeal.

Commission Decision

32. The Commission finds that while the PULJ denied Staff's request to direct the Companies to file their SOS revenues in a base rate case, Proposed Order III does not preclude Staff and other parties from pursuing discovery regarding SOS returns and proposing such revenue adjustments as they consider warranted based on their review of SOS returns. Therefore, despite the Companies' protests, the Commission will allow Staff, OPC, and other parties to pursue discovery in base rate cases to determine whether utilities may be over earning with regard to SOS revenues.

⁵² *Id.* at 13-14.

⁵³ OPC Reply Memorandum at 3.

⁵⁴ *Id.*

III. CONCLUSION

33. Upon consideration of the appeals by OPC and Staff, the Commission denies OPC's appeal and grants Staff's request for clarification. Accordingly, Proposed Order III is hereby affirmed.

IT IS, THEREFORE, this 7th day of January, in the year Two Thousand Twenty-Two by the Public Service Commission of Maryland,

ORDERED: (1) That the Third Proposed Order of the Public Utility Law Judge in this matter is hereby affirmed. The Maryland Office of People's Counsel Appeal is denied;

(2) That the SOS Administrative Charges for Delmarva Power and Light Company and Potomac Electric Power Company, as stated in Proposed Order III, are adopted;

(3) That except for the Return component of each of the Companies' SOS Administrative Charge rates, an adjustment, or true up, of actual costs in the Administrative Charge shall occur every four months. An adjustment of the Return component shall occur annually;

(4) That consistent with the *BGE Order* and Proposed Order III (ordering paragraph 3) the SOS Administrative Adjustment for Delmarva and Pepco is set at zero mills/kWh and may be modified at a future time based upon each Company's cost of service study created at the Company's next rate case;

(5) That Delmarva and Pepco shall submit compliance filings within 30 days of this Order, for review by Staff and approval by the Commission, updating each

Company's SOS Administrative Charge by customer class consistent with the methodologies adopted herein; and

(6) That Staff's request for clarification that it, OPC, and other parties, may pursue discovery regarding utility SOS earnings in base rate proceedings is granted.

/s/ Jason M. Stanek _____

/s/ Michael T. Richard _____

/s/ Anthony J. O'Donnell _____

/s/ Odogwu Obi Linton _____

Commissioners⁵⁵

⁵⁵ Commissioner Mindy L. Herman did not take part in the Commission's deliberation and decision in this matter.