ORDER NO. 91181

Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy	* * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND CASE NO. 9702

ORDER ON APPLICATION FOR A MULTI-YEAR RATE PLAN

Before: Frederick H. Hoover, Jr., Chair
Michael T. Richard, Commissioner
Kumar P. Barve, Commissioner
Bonnie A. Suchman, Commissioner

Issued: June 10, 2024

APPEARANCES

Kimberly A. Curry, Douglas E. Micheel, Matthew K. Segers and Taylor W. Beckham for Pepco Holdings, Inc.

Lloyd J. Spivak, Annette B. Garofalo, James Gregor, and Ruthie Herman for the Public Service Commission Staff

Jacob M. Ouslander, Michael Sammartino and Ryan Hsu for the Office of People's Counsel

Frann G. Francis, Excetral K. Caldwell and Katalin Peter for Apartment and Office Building Association of Metropolitan Washington

Michele Honick, Sondra S. McLemore, Steven Talson and David Shapiro for the Maryland Energy Administration

Lisa Brennan and Jim Ogorzalek for Montgomery County, Maryland

Barry A. Naum, Don C. A. Parker and Steven W. Lee, Spilman Thomas & Battle for Walmart

Susan Stevens Miller for Sierra Club

James K. McGee, Law Office of Robert R. Castro, and Rhonda L. Weaver for Prince George's County, Maryland

Kristi Singleton for U.S. General Services Administration (Washington)

Lee Ewing Keyes & Fox LLP for Chargepoint, Inc.

Interested Persons:

Joan White and Robin Dutta for Chesapeake Solar and Storage Association

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I. EXECUTIVE SUMMARY

Pepco is a regulated public service company that provides electric distribution service to Maryland customers in Montgomery County and Prince George's County. On May 16, 2023, the Company filed a second multi-year plan ("MYP") pursuant to Public Utilities Article ("PUA"), Annotated Code of Maryland, §§ 4-203, 4-204 and 7-505(c)(1).[1] In its Application, Pepco claimed cumulative electric revenue deficiencies of $117.2 million for the twelve months ending March 31, 2025, $160.5 million for the twelve months ending March 31, 2026, $193.2 million for the twelve months ending March 31, 2027, and $213.6 million for the proposed nine-month extension period ending December 31, 2027.

The Commission has reviewed the evidence and testimony presented, including the comments received at the public hearings, in reaching the decisions in this Order. Based on the record, the Commission has determined that a total revenue increase of $44,629,000, reflecting an adjusted rate base of $2,408,076,000, with an overall rate of return ("ROR") of 7.13%, based on a return on equity ("ROE") of 9.50%, is warranted. Also, as discussed in greater detail herein, the Commission grants the Company's MYP for Rate Year 1 (or MYP RY1) only. Consistent with this decision, the Commission approves a customer charge for only the first year, resulting in a $0.22 per month (or 2.68%) increase in the customer charge for the residential rate class for the rate year from April 1, 2024 through March 31, 2025.

This Order rejects Pepco's proposed three-year MYP and approves a revenue adjustment for one year only. In doing so, the Commission allows revenue recovery that approximates a 12-month historic test year, two partially forecasted bridge years, and–with adjustments–Rate Year 1 of the Company's proposed MYP. The following table presents the

[1] Application at 1. Pepco also described its application as the "Climate Ready Pathway MD."

Company's original requested cumulative revenue requirement and the Commission's authorized revenue requirement based on the Order herein.

	Year 1	Year 2	Year 3	Year 3 Extension	Total
Pepco Requested	$ 117.2	$ 43.3	$ 32.7	$ 20.4	$ 213.6
Commission Authorized	$ 44.6	$ -	$ -	$ -	$ 44.6

The Commission is mindful that consideration of this case was deferred by Pepco—by agreement with Staff and other parties. However, all parties were on notice that any MYP proposal would be subject to the "lessons learned" proceedings for the pilot MYP, as specified by the Commission as part of its adoption of alternative forms of ratemaking in Case No. 9618. Deferral of Pepco's MYP request in no way altered or otherwise affected this determination. This decision approves just and reasonable rates for Pepco, while the Commission awaits an evaluation of the pilot MYP through its lessons-learned proceedings.

Despite the Company's apparent assumption that MYPs are the new norm, the Commission has been clear that such a determination would be made only after conclusion of the lessons-learned proceedings. Because the Commission has not made any final determinations regarding the appropriate approach to ratemaking, it would be inappropriate to make such determinations in this proceeding. It would have been prudent for the Company to include in its filing a proposal based on an historic test year. Unfortunately, the record lacks the necessary information to base rates on an historic test year. Nevertheless, the Commission finds that there is sufficient testimony in the record to allow revenue recovery that approximates a 12-month historic test year, two partially forecasted bridge years, and–with adjustments–Pepco's forecast for Rate Year 1 of the Company's proposed MYP. The Commission expects rigorous scrutiny from parties when Pepco's costs are reviewed for prudency in the future, especially when cost variances are high.

II. BACKGROUND

The Application was submitted by Pepco on May 16, 2023 under terms of Order No. 89482 ("the MYP Pilot Order") in Case No. 9618.[2] The Application[3] was submitted pursuant to the filing requirements approved by the Commission in the MYP Pilot Order[4] and supported by the Direct Testimonies and Exhibits of Pepco witnesses: Elizabeth M.D. O'Donnell (Pepco Ex. 4), Robert T. Leming (Pepco Ex. 16), Laura N. Tomney (Pepco Ex. 29), Ned W. Allis (Pepco Ex. 27), Adrien M. McKenzie (Pepco Ex. 14), Lance C. Schafer (Pepco Ex. 36), Peter R. Blazunas (Pepco Ex. 38), John T. Coursey (Pepco Ex. 31), Phillip S. Barnett (Pepco Ex. 6), Amber C. Young (Pepco Ex. 12), Willa J. Hightower (Pepco Ex. 10), Ryan M. Hledik (Pepco Ex. 24), and David S. Schatz,[5] the Supplemental Direct Testimony of Pepco witness Leming (Pepco Ex. 17), as well as the Errata to the Direct Testimony of Pepco witnesses Hledik (Pepco Ex. 25) and Donohoo-Vallett (Pepco Ex. 21) and a confidential update to Schedule ACY2[6].[7]

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[2] Order No. 89482, *In the Matter of Alternative Rate Plans or Methodologies to Establish New Base Rates for an Electric Company or a Gas Company*, Case No. 9618 (Feb. 4, 2020) ("Order No. 89482" or "MYP Pilot Order").

[3] Although Pepco filed its Application in accordance with the procedures for alternative ratemaking set forth in the MYP Pilot Order, Pepco does not purport to be the pilot utility.

[4] The MYP Pilot Order (Order No. 89482 at 3) required the pilot utility to meet several minimum requirements in its plan, including that it: (i) contain all of the filing requirements found in the PC51 Implementation Report, (ii) allow up to three future rate-effective years with an agreement to "stay out" for that period, (iii) contain specific criteria for any "off-ramp" process (i.e., extraordinary circumstances outside the utility's control that would warrant the Commission's intervention to modify or terminate the MYP), (iv) track the accuracy of the utility's forecast, (v) have an annual informational filing which the Commission may use as the basis for mid-cycle MYP adjustments. and (vi) contain adequate reporting requirements.

[5] Pepco filed a Notice of Witness Substitution, designating Pearl Donohoo-Vallett, Senior Manager, Strategic Planning at the Company, as the substitute witness for David S. Schatz on all aspects of witness Schatz's testimony except Section VI and Schedule (DSS)-4 (which pertain to Pepco's Smart Inverter Pilot), for which Taiwo O. Alo, Director of Distribution Planning, Smart Grid, and Innovation will serve as the substitute witness for witness Schatz. Maillog No. 305731 (October 20, 2023). Furthermore, on February 29, 2024, after the Commission granted OPC's Motion to Strike Pepco's proposed Climate Solutions Program (but for the Smart Inverter Pilot Program), Pepco filed the Revised Direct Testimony of David S. Schatz (Pepco Ex. 21) which removed references to the stricken programs. Maillog No. 307917.

[6] Maillog No. 306250 (November 20, 2023).

[7] Pepco also waived the confidentiality of Schedule JTC-1 that was initially submitted with the Company's Application. Maillog No. 306596 (December 11, 2023).

Through Order No. 90634, issued on May 17, 2023, the Commission docketed Pepco's Application as Case No. 9702, scheduled a prehearing conference for June 7, 2023, and, pursuant to the Public Utilities Article ("PUA"), *Annotated Code of Maryland*, § 4-204, suspended Pepco's proposed new rates for an initial period of 270 days from May 16, 2023.[8]

On June 2, 2023, Staff filed a Request for Postponement, asking the Commission to initiate a dialogue at the prehearing conference with the goal of determining whether, and under what conditions, Pepco might agree to delay the litigation of its Application.[9] Pepco filed its Response to Staff's request on June 6, 2023, expressing concerns about the impact of a delay on Company and customer interests.[10] The Apartment and Office Buildings Association ("AOBA") and the Maryland Energy Administration ("MEA") filed letters in support of Staff's request.[11]

In accordance with Order No. 90634, Pepco published a Notice of the Commission's Pre-Hearing Conference in the Washington Post (Montgomery County and Prince George's County editions) on May 25 and June 1, 2023, as well as on Pepco's home page, X (formerly known as Twitter), and Facebook. All notices contained the time, date, location, and purpose of the Pre-Hearing Conference (Pepco Ex. 1).

The prehearing conference in this matter was conducted on June 7, 2023, at which time the Commission granted the Petitions to Intervene of Maryland Energy Administration ("MEA,") AOBA, the U.S. General Services Administration ("GSA"), Walmart, Inc. ("Walmart"), Montgomery County, Maryland ("Montgomery County"), Prince George's

[8] Maillog No. 302993.
[9] Maillog No. 303315.
[10] Maillog No. 303371.
[11] Maillog No's. 303365 and 303472, respectively. Prince George's County, Maryland also expressed its support for Staff's Request at the June 7, 2023 Prehearing Conference.

County, Maryland ("Prince George's"), and the Sierra Club.[12] Discussions were held regarding Staff's Request for Postponement, with the Parties concluding that additional time to confer would be helpful in order to reach an agreement on a reasonable accommodation in response to Staff's request.

On July 21, 2023, Pepco filed a Joint Motion for Approval of Agreement of Non-unanimous Stipulation and Settlement.[13] On July 26, 2023, the Commission issued a hearing notice for August 2, 2023, at which time the proposed settlement was considered. Also on July 26, 2023, AOBA filed comments on the Joint Motion, largely supporting the settlement, but seeking greater clarification of the Revenue Deferral Mechanism ("RDM") Rider.[14] Non-unanimous issues with the Settlement Agreement were discussed at the August 2, 2023 hearing, and on August 4, 2023, on behalf of all Parties, Pepco filed the Updated Agreement of Unanimous Stipulation and Settlement (the "Settlement Agreement").[15]

On August 7, 2023, the Commission granted the Joint Motion and approved the Settlement Agreement, thereby establishing a new procedural schedule that, among other things, implemented a 90-day suspension in response to Staff's Request for Postponement and set April 1, 2024 as the beginning date of the rate-effective period for the rates authorized under the Final Order in this proceeding.[16] The approved Settlement Agreement also allowed Pepco to establish a regulatory asset to defer collection of the authorized rates,

[12] On June 9, 2023, Chargepoint, Inc. ("Chargepoint") filed a motion to intervene out of time. No party objected. Therefore, Chargepoint's motion to intervene is hereby granted.
[13] Maillog No. 304214.
[14] Maillog No. 304265, AOBA Comments (July 26, 2023).
[15] Maillog No. 304445 (August 4, 2023).
[16] Maillog No. 304466, Order No. 90729 (August 7, 2023).

and for the Deferred Revenue Mechanism and Offsetting Credit to be in effect from April 1, 2024 through June 30, 2024.[17]

On November 28, 2023, the Office of People's Counsel ("OPC") filed a Motion to Strike Pepco's proposed Climate Solutions Programs, claiming that consideration of the programs would require the Commission to make policy determinations about electrification in a proceeding not designed for such decision-making, that two of the subprograms within the proposed Climate Solutions Programs would be more appropriately considered in other active Commission dockets, and that the Commission previously granted a similar motion filed by OPC in Case No. 9692.[18] Staff and MEA filed comments in support of OPC's Motion.[19] Pepco filed an Opposition to OPC's Motion, to which OPC filed a Reply.[20] On March 4, 2024, the Commission granted OPC's Motion to Strike Pepco's proposed Climate Solutions Programs, with the exception of the Smart Inverter Pilot Program.[21]

On December 15, 2023, Walmart filed the Direct Testimony of Lisa V. Perry,[22] MEA filed the Direct Testimony of MEA Director Paul G. Pinsky (MEA Ex. 1), AOBA filed the Direct Testimony of Bruce Oliver[23] and Timothy Oliver (AOBA Ex. 14), Staff filed the Direct Testimony and Exhibits of Lytangia Bunch (Staff Ex. 29), Christopher Lo (Staff Ex. 25), Anson Justi (Staff Ex. 13), Erik Delgado (Staff Ex. 3), David Hoppock (Staff Ex. 6 and 7), Drew McAuliffe (Staff Ex. 23), James Garren (Staff Ex. 11), DeAndre Wilson (Staff Ex.

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[17] Order No. 90729 also approved a true-up mechanism to take effect upon the issuance of the Commission's Final Order in this proceeding and directed Pepco to establish a rider for the deferred revenue mechanism and offsetting credit from April 1, 2024 to June 30, 2024 and for the true-up mechanism from August 17, 2024 to March 31, 2025.

[18] Maillog No. 306343, Order No. 90755, *Baltimore Gas and Electric Company's Application for an Electric and Gas Multi-Year Plan* (Order Granting OPC Motion to Strike).

[19] Maillog No. 306473 (December 4, 2023) and Maillog No. 306495 (December 5, 2023), respectively.

[20] Maillog No. 306913 (December 28, 2023) and Maillog No. 307164 (January 17, 2024), respectively.

[21] Maillog No. 307964, Order No. 91048 (March 4, 2024).

[22] Maillog No. 307082, Walmart filed an Errata to the Direct Testimony of Lisa V. Perry on January 12, 2024. (Walmart Ex. 1).

[23] On February 27, 2024, AOBA filed an Errata to the Direct Testimony of Bruce Oliver (AOBA Ex. 9).

27), Roger Austin (Staff Ex. 21), Felix Patterson (Staff Ex. 15), and Mark Rielly (Staff Ex. 17),[24] and OPC filed the Direct Testimony of Paul J. Alvarez and Dennis Stephens (OPC Ex. 32), David J. Effron (OPC Ex. 38), J. Randall Woolridge, Ph.D. (OPC Ex. 27), David J. Garren (OPC Ex. 23), Ron Nelson (OPC Ex. 35), Eric Borden, Courtney Lane (OPC Ex. 25), and Kenji Takahashi (OPC Ex. 30). On December 19, 2023, the Solar Energy Industries Association ("SEIA") and Chesapeake Solar and Storage Association ("CHESSA") filed Joint Comments in support of Pepco's Smart Inverter Pilot Program.[25]

On January 26, 2024, OPC filed the Rebuttal Testimony of Ron Nelson (OPC Ex. 36) and Dr. J. Randall Woolridge (OPC Ex. 28), AOBA filed the Rebuttal Testimony of Bruce Oliver (AOBA Ex. 12), and Staff filed the Rebuttal Testimony of Erik Delgado (Staff Ex. 4) and David Hoppock (Staff Ex. 8). Pepco filed the Rebuttal Testimony of Elizabeth M.D. O'Donnell (Pepco Ex. 5), Robert T. Leming, Laura N. Tomney (Pepco Ex. 30), Ned W. Allis (Pepco Ex. 28), Adrien M. McKenzie (Pepco Ex. 15), Lance C. Schafer (Pepco Ex. 37), Peter R. Blazunas (Pepco Ex. 39), John T. Coursey (Pepco Ex. 32), Phillip S. Barnett,[26] Amber C. Young (Pepco Ex. 13), Willa J. Hightower (Pepco Ex. 11), Ryan M. Hledik (Pepco Ex. 26), Pearl Donohoo-Vallett (Pepco Ex. 22), and Taiwo O. Alo (Pepco Ex. 23). On February 14, 2024, Pepco filed an Errata to the Rebuttal Testimony of Robert T. Leming (Pepco Ex. 18).

On February 20, 2024, the Commission issued a Notice of Public Comment Hearings to be held on March 5 and 26, 2024.[27] The Notice was also published by Pepco in

[24] On January 26, 2024, Staff filed the Supplemental Direct Testimony of Mark Rielly (Staff Ex. 20).
[25] Maillog No. 306761.
[26] On March 5, 2024, Pepco filed the revised Rebuttal Testimony of Phillip S. Barnett (Pepco Ex. 7).
[27] Maillog No. 307722.

newspapers of general circulation in Pepco's service territory on February 29 and March 1, 2024.[28]

On February 23, 2024, AOBA filed the Surrebuttal Testimony of Bruce Oliver (AOBA Ex. 13), Pepco filed the Surrebuttal Testimony of Robert T. Leming (Pepco Ex. 19) and John T. Coursey (Pepco Ex. 33), MEA filed the Surrebuttal Testimony of MEA Director Paul G. Pinsky (MEA Ex. 2), OPC filed the Surrebuttal Testimony of Paul J. Alvarez and Dennis Stephens (OPC Ex. 33), David J. Effron (OPC Ex. 39), David J. Garren, Courtney Lane (OPC Ex. 26), Ron Nelson (OPC Ex. 24 and 37), and Dr. J. Randall Woolridge (OPC Ex. 29), and Staff filed the Surrebuttal Testimony of Lytangia Bunch (Staff Ex. 30), Christopher Lo (Staff Ex. 26), Anson Justi (Staff Ex. 14), Erik Delgado (Staff Ex. 5), David Hoppock (Staff Ex. 10), Drew McAuliffe (Staff Ex. 24), James Garren (Staff Ex. 12), DeAndre Wilson (Staff Ex. 28), Roger Austin (Staff Ex. 22), Felix Patterson (Staff Ex. 16), and Mark Rielly (Staff Ex. 18).[29] On February 27, 2024 OPC filed the Surrebuttal Testimony of Kenji Takahashi (OPC Ex. 31).

On February 29, 2024, Pepco filed a Substitution of Testimony, noting that its witness Elizabeth M.D. O'Donnell would be unable to testify at the hearings to begin on March 7, 2024, therefore designating Phillip S. Barnett, Willa J. Hightower, and Robert T. Leming as substitute witnesses adopting Pepco witness O'Donnell's testimony.[30]

On March 5, 2024, Staff filed a Comparison Chart showing the final positions of Pepco, Staff, OPC, and AOBA based on testimonies filed.[31]

[28] Maillog No. 308031 (March 5, 2024).
[29] Maillog No. 307987. Staff filed corrected exhibits to Mark Rielly's Surrebuttal testimony (March 4, 2024).
[30] Maillog No. 307900.
[31] Maillog No. 308032.

An evidentiary hearing was held on March 7, 8, 11, 12, 13, and 14, 2024. Responses to bench data requests propounded by the Commission at the evidentiary hearing were filed on March 12, 2024 by OPC and on March 13, March 29, and April 12, 2024 by Pepco.[32]

Post-hearing initial briefs, or letters in lieu thereof, were filed on April 8, 2024, by Walmart,[33] MEA,[34] GSA,[35] Pepco,[36] Montgomery County,[37] Staff,[38] OPC,[39] and AOBA.[40] Reply briefs were filed on April 22, 2024 by AOBA,[41] GSA,[42] Pepco,[43] OPC,[44] and Staff.[45]

III. DISCUSSION AND FINDINGS

A. Revenue Requirements and Adjustments

MYP2 versus More Traditional Ratemaking

In this proceeding, several parties—namely OPC, AOBA, and GSA—raised the issue of whether the Commission should reject Pepco's MYP2 application in its entirety, convert the case to a traditional historic test year, calculate the rates on a single forward test, or some combination thereof. OPC and AOBA questioned whether Pepco's current MYP2 was in the public interest, would yield just and reasonable rates, or contained sufficient evidence to support the forecasted budgets presented in Pepco's MYP Application. The parties' positions on this issue are described below.

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[32] Maillog Nos. 308201, 308218, 308581, and 308929 respectively.
[33] Maillog No. 308825 ("Walmart Initial Brief").
[34] Maillog No. 308828 ("MEA Letter in Lieu of Brief").
[35] Maillog Nos. 308829 and 308831 (collectively, "GSA Initial Brief").
[36] Maillog No. 308830 ("Pepco Initial Brief").
[37] Maillog No. 308833 ("Montgomery County Comments in Lieu of Brief").
[38] Maillog No. 308836 ("Staff Initial Brief").
[39] Maillog No. 308837 ("OPC Initial Brief").
[40] Maillog No. 308838 ("AOBA Initial Brief").
[41] Maillog No. 309105 ("AOBA Reply Brief").
[42] Maillog No. 309118 ("GSA Reply Brief").
[43] Maillog No. 309134 ("Pepco Reply Brief").
[44] Maillog No. 309145 ("OPC Reply Brief").
[45] Maillog No. 309148 ("Staff Reply Brief").

Pepco

Pepco argued that its second multi-year ratemaking plan ("MYP[46]") filed in this proceeding is in the public interest and will produce just and reasonable rates.[47] The Company further argues that its MYP2 "adheres to the Commission's framework and requirements for MYP applications established in Order No. 89482 and will continue to deliver on the very same customer and other benefits and goals that the Commission believed MYPs would produce when it approved the Company's first MYP three years ago." Specifically, Pepco claims that with an approved MYP2 it will continue to:

> (i) provide the Company's customers with predictable and stable electric distribution rates over the MYP period;
>
> (ii) provide greater transparency and accountability into the Company's forward-looking work plans by giving parties and the Commission the opportunity to weigh in on those plans before money is spent;
>
> (iii) provide greater stakeholder and Commission governance over the Company's actual spending levels through annual information filings that report on project level spending and variances to budgets during the course of the MYP period;
>
> (iv) provide Pepco with more predictable revenues over this period to make needed reliability and safety-related investments; and
>
> (v) advance Maryland's electrification goals through investments to make the distribution system more resilient and robust to handle an electrified future.

First, Pepco argues that "no party presented any evidence to refute the conclusion that the Company adhered to the framework and specific detailed requirements that the Commission adopted for MYP applications in Order No. 89482 as well as those filing requirements that were enhanced by the Commission's orders approving BGE's, Pepco's,

[46] The acronym "MYP" refers to the multi-year rate plan, as discussed and approved for a pilot in Commission Order No. 89482. Pepco refers to its multi-year rate plan as an "MYP." Other parties refer to it as an "MRP." For purposes of consistency and to avoid confusion, this Order will use a single term: MYP.
[47] Pepco Initial Brief at 1.

and Delmarva Power & Light Company's ("Delmarva Power") first MYP applications."[48] In connection with the Application, the Company stated that it filed literally thousands of pages of supporting information and data–the "Minimum Filing Requirements"–that provided parties and the Commission with a vast amount of information concerning the Company's planned capital investments and rate request.[49]

Second, the Company asserted that there are valuable customer benefits and protections that are only provided through the MYP framework, such as customers knowing what the Company will be allowed to charge for multiple years.[50] Pepco claims that this "stability and predictability mitigates the frustration often felt by customers under the traditional ratemaking model when utilities would file "pancaked" rate cases, i.e., filing a new rate case only months after the previous rate case was completed."[51]

Pepco also pointed out that in this MYP2, the Company proposed to accelerate the return of certain tax benefits to customers to address affordability and reduce impact. As proposed, "because the MYP structure provides the Company with predictable and steady revenue over a three-year, nine month period, with pre-established rates for that period, the Company can financially shoulder an acceleration of tax benefits that the Commission previously determined would take 20 years to return to customers."[52] In accordance with Pepco's MYP2, Pepco's customers would receive nearly $70 million in accelerated tax benefits, i.e., reduced rates, in the first two years of the MYP. Pepco stated that this level of accelerated tax benefits is not financially feasible without an MYP.[53]

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[48] *Id*. at 10.
[49] *Id*. at 10-11.
[50] *Id*. at 11.
[51] *Id*.
[52] *Id*. at 12.
[53] *Id*.

Pepco noted that with the MYP, customers have much greater protection and oversight of utility spend–before, during and after investments are made.[54] The Company argues that the MYP model provides the Commission and stakeholders multiple "bites at the apple."[55]

Third, Pepco argues that the Commission should heavily weigh Pepco's successful completion of its first MYP. From a financial standpoint, Pepco adhered closely to the budgets that the Commission approved in the Company's first MYP case.[56] Despite operating in a high inflation environment over the past several years, Pepco asserted that it managed its actual costs very close to the Commission's approved budgets.[57]

OPC

OPC requests that the Commission reject Pepco's second MYP because it is not in the public interest and cannot produce just and reasonable rates.[58] OPC argues that "[t]he excessive capital investments and commensurate rate increases Pepco proposed far outweigh the limited customer benefits of multi-year ratemaking."[59] OPC also argued–-among other things—that "Pepco cannot claim a due process right to immunize its MRP from being challenged, converted, or rejected merely by virtue of having filed one."[60] OPC noted further that the Commission's broad supervisory powers confer the authority to reject or convert Pepco's MYP.

[54] *Id*.
[55] *Id*.
[56] *Id*. at 13.
[57] *Id*.
[58] Alvarez-Stephens Direct at 8.
[59] *Id*.
[60] OPC Initial Brief at 10. OPC uses the acronym MRP in lieu of MYP interchangeably to refer to Pepco's multi-year rate plan.

OPC observed that the Commission implemented the multi-year ratemaking to support increased adoption of distributed energy resources (DER), electric vehicles (EV), and building electrification.[61] OPC pointed out that as the Commission explained in Order No. 89226, alternative forms of ratemaking—such as MYPs—"may be helpful, if carefully implemented, in facilitating the achievement of the State's ambitious goals regarding electrification, renewable development, pipeline replacement, development of new customer solutions, grid resiliency, and other state goals."[62] As highlighted by OPC, the Commission in Order No. 89226 identified certain potential benefits that warranted pursuing implementation of multi-year rate plans: "shortening the cost recovery period, providing more predictable revenues for utilities and more predictable rates for customers" and "decreasing administrative burdens on regulators."[63] Additionally, in Order No. 89226 the Commission identified several perceived drawbacks to standard ratemaking it hoped to address through MYPs, including "a failure to equitably distribute risk, limited capabilities to monitor costs, limited ability to achieve policy outcomes and potential restrictions on utility innovation, and arguably regulatory lag, which can impede the utilities' ability to earn their authorized ROR."[64]

OPC witnesses Alvarez-Stephens argued that the multi-year rate making construct "has fared abysmally for customers and extremely well for utilities, and has significantly increased litigation and administrative burdens for Staff, OPC, and other stakeholders."[65] Alvarez-Stephens surmised that "[w]ith multi-year ratemaking, the utilities win and

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[61] Alvarez-Stephens Direct at 14.
[62] *Id*. at 15, *citing* Order No. 89226, *In the Matter of Alternative Rate Plans or Methodologies to Establish New Base Rates for an Electric Company or a Gas Company,* Case No. 9618. slip op. at 52-53 (Aug. 19, 2019).
[63] Alvarez-Stephens Direct at 15.
[64] *Id*.
[65] *Id*.

customers lose."[66] OPC argued that MYPs have led to no appreciable improvements in the ability to achieve state policy objectives, nor in the ability to cost-effectively meet reliability standards, relative to standard ratemaking and other regulatory processes available to the Commission.[67]

Alvarez-Stephens argued that MYPs have certain unintended consequences such as practically eliminating cost disallowance risk, reducing utility capital spending governance, exacerbating information asymmetry and introducing moral hazard into MYP development.[68] The MYP construct entails Commission review and approval of utility forecasted capital investment plans, which witnesses Alvarez-Stephens contend can frustrate regulators' ability to identify and remove costs of imprudent investments from customer rates.[69] Alvarez-Stephens argued that "[i]n practice, authorizing an MRP based on investment after reviewing a utility's proposed capital investments–and their associated costs–amounts to pre-approval of that level of spending" and this pre-approval combined with the massive size of these investments–frustrates regulators' ability to exercise their rights to disallow costs.[70]

Alvarez-Stephens asserted that the loss of cost disallowance risk resulting from advance approval of cost recovery for capital investments biases the outcome of MYP ratemaking to favor private shareholder economic interests over the broader public interest.[71] "In short, this fundamental shift undermines the regulator's ability to ensure utility rates align with the public interest."[72] Further, cost disallowance risk would mitigate the effects of information asymmetry; however, under the MYP construct, intervenors that relied on cost

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[66] *Id*.
[67] *Id*.
[68] *Id*.
[69] *Id*. at 28-29.
[70] *Id*.
[71] *Id*. at 29.
[72] *Id*.

disallowance risk to encourage utility capital spending governance can no longer do so.[73] Also, under the MYP construct, intervenors are reviewing multiple years of proposed (or forecasted) spending in a compressed procedural schedule, which has the effect of shifting the prudence burden from utilities to stakeholders.[74] Contrasting standard ratemaking with MYPs, Alvarez-Stephens argued that under standard ratemaking, utilities bear the burden of proving that their capital spending was prudent in a rate case; whereas, with MYPs, stakeholders must now demonstrate the imprudence of the utility's proposed MYP capital plans.

Alvarez-Stephens asserted that MYPs can lead to excessive capital spending, which creates a moral hazard because "a utility has nothing to lose–and everything to gain–by proposing expenditures in an MYP that would be too risky to pursue under the standard ratemaking construct."[75] Moral hazard suggests that "there is little consequence to proposing capital spending in an MYP that might be cost ineffective, premature, or unsupported."[76] Alvarez-Stephens argued that Pepco's MYP2 is an example of a utility taking advantage of the MYP construct to propose capital spending larger than it would be under standard ratemaking in three ways.[77] First, they argued that the Company is proposing investments that are not cost effective. To support this contention, witness Alvarez-Stephens look to many of the system performance investments, i.e., prospective substation equipment replacement, Benning Road 69kV substation rebuild or 69kV line rebuilds, proposed by the Company in this MYP2, which they argued are unlikely to deliver reliability improvements

[73] *Id*.
[74] *Id*. at 30.
[75] *Id*. at 31.
[76] *Id*.
[77] *Id*. at 37.

of sufficient value to justify their costs.[78] Second, witnesses Alvarez-Stephens point out that Pepco's MYP2 is larger than it would be under standard ratemaking because it proposes investments in grid readiness, i.e. capacity expansion projects like National Harbor Substation/Livingston Road Energy Storage and Downtown Resupply Investment Program, that are unnecessarily early.[79] Finally, witnesses Alvarez-Stephens argued that certain capital spending forecasts proposed in Pepco's MYP2 exceed historical trends, i.e., underground cable replacement, priority feeder improvements, new customer connections, without quantifiable evidence to support such increases.[80]

Given the problems with the multi-year ratemaking construct generally and with Pepco's MYP2 specifically, witnesses Alvarez-Stephens recommend the Commission reject Pepco's MYP2 in its entirety.[81] They contend that Pepco's MYP2 "illustrates the pitfall of multi-year ratemaking" and that the Company has not carried its burden of proof to justify the high level of spending it seeks to recover through customer rates.[82] Instead, witnesses Alvarez-Stephens found that the multi-year ratemaking concept shifts the burden from the utilities to stakeholders, who simply have "insufficient opportunity to learn the specifics of any utility's distribution system – including the system's capabilities, constraints, technologies, designs, forecast, operations, idiosyncrasies, and proposed investment programs and initiatives – in an 18-week MYP discovery period."[83] Alvarez-Stephens argued that such burdensome discovery process and burden shifting to stakeholders, "biases the outcome of an MYP proceeding in favor of unnecessarily high rates to the benefit of utility

[78] *Id*.
[79] *Id*.
[80] *Id*.
[81] *Id*. at 90.
[82] *Id*. at 91.
[83] *Id*. at 30.

shareholders and the detriment of utility customers."[84] Alvarez-Stephens contend that a ratemaking construct with such inherent bias is not in the public interest and therefore should be rejected by the Commission.[85]

In support of the recommendation of witnesses Alvarez-Stephens to reject Pepco's MYP2, OPC witness Effron presented an alternative approach for calculating Pepco's revenue requirement in this proceeding. In his direct testimony, OPC witness Effron describes his alternative approach to calculate a revenue adjustment to serve as a compromise between the historic test year and the future or forecasted MYP test year approach.[86] OPC witness Effron's proposed rate base is calculated on Exhibit DJE-1, Schedule B, and the operating income is calculated on Exhibit DJE-1, Schedule C.[87] In his surrebuttal, witness Effron further described his compromise or off-ramp approach as follows:

> My calculation of the revenue deficiency reflects plant as of March 31, 2024 net of accumulated depreciation and accumulated deferred income taxes, with the other elements of the revenue requirement based on values for the twelve months ending March 31, 2025. The intent of this approach is to create a test year to serve as an "off-ramp" from the MRP pilot back to standard ratemaking. In this regard, the proposed test year for the off-ramp can be viewed as a compromise between the type of test year used in the MRP and the type of test year used prior to the MRP pilot.[88] (italics added)

Witness Effron conceded that his approach "differs from the traditional test year employed in Maryland base distribution rate cases (historic test year adjusted for known and measurable changes) or the test year(s) used in the context of multi-year rate plans (future test years with fully projected values). However, the use of the net plant as of March 31,

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[84] *Id*. at 91.
[85] *Id*.
[86] Effron Direct at 5.
[87] *Id*.
[88] Effron Surrebuttal at 2.

2024 can be viewed as a proxy for a historic test year net plant balances with pro forma adjustments for post-test year safety and reliability- plant. The use of adjusted operating income for the twelve months ending March 31, 2025 can be seen as a proxy for the historic test year operating income adjusted for known and measurable changes."[89]

Witness Effron also noted that although the Company did not advance the alternative approach that he recommends in support of witnesses Alvarez-Stephens, the Company "has the sources and calculations supporting [his] "off-ramp" revenue requirement, and they certainly have the resources to "defend" against this proposal."[90] He stated that the Company did not challenge his presentation directly or offer any adjustments or alternatives to it. He also observed that the Company "has presented no argument that [his] off-ramp test year is erroneous or unreasonable if the Commission does decide that the MRP pilot should be terminated."[91] Alternatively, if the Commission decides to allow Pepco to continue with its MYP2 and reject Alvarez-Stephens' recommendation to discontinue Pepco's MYP, witness Effron also developed incremental revenue requirements for the Company's proposed MYP2.[92]

Alvarez-Stephens also recommended that if the Commission decides to approve Pepco's MYP2, then the Commission should consider certain improvements to the MYP construct, including eliminate the opportunity to recover overspending through the reconciliation process,[93] completing the Lessons Learned review of MYPs in Maryland,[94] increasing stakeholder participation in the MYP capital plan development through the use of

[89] *Id*. at 3.
[90] *Id*. at 4.
[91] *Id*.
[92] Effron Direct at 6-22.
[93] Alvarez-Stephens Direct at 92.
[94] *Id*. at 93.

the NARUC-NASEO Task Force Jade Cohort roadmap,[95] and requiring utilities to support capital spending with risk-informed benefit costs analysis.[96]

AOBA

In its Initial Brief, AOBA recommends that the Commission reject Pepco's proposed MYP2 in this proceeding "as the record clearly portrays a filing that is devoid of necessary support for the forecasted budgets that are central to approving rates for future rate years."[97] AOBA argues that Pepco's presentations in this proceeding fail to provide a sound foundation for setting rates for multiple future years. Thus, AOBA encourages the Commission to either (i) reject the Company's entire Application or (ii) establish rates for Pepco on the basis that is "more closely tied to the Company's historical expenditures."[98]

AOBA witness Bruce Oliver argued that Pepco's first MYP approved by the Commission in Case No. 9655 "has not served the interest of Pepco's Maryland ratepayers" and that the Company's request for MYP2 in this proceeding "further amplifies the shortcomings of Pepco's first MYP and should be rejected."[99] Witness Oliver recommended that the Commission "should act to establish rates based on costs for a single historical test year adjusted for known and measurable changes."[100] However, to the extent that Pepco is permitted to rely upon forecasted data to support its revenue requirement, AOBA argues that "provision must be made for more detailed and rigorous after-the-fact assessment of the reasonableness and prudence of the Company's actual expenditures."[101]

[95] *Id*. at 94.
[96] *Id*. at 94-95.
[97] AOBA Initial Brief at 3.
[98] *Id*.
[99] B. Oliver Direct at 5.
[100] *Id*. at 5 and 64.
[101] *Id*. at 5.

Witness Oliver argued that Pepco's initial MYP raises concerns regarding the MYP ratemaking construct and Pepco's request for implementation of a second MYP. To support his claim that Pepco's MYP forecasting was problematic, witness Oliver pointed out the variance between Pepco's budgeted and actual costs reflected in Pepco's Annual Informational Filing ("AIF") for 2022.[102] Witness Oliver observed that "the Company had a projected 2022 capital budget for its Maryland service territory of $308,658,000 and actual capital expenditures of $329,114,000. Thus, in aggregate, Pepco overspent the capital budget it presented for ratemaking purposes in Case No. 9655 by approximately $20.5 million or 6.6%."[103] Witness Oliver explained that a closer "examination of the details of that filing finds that Pepco had $183.3 million of budgeted costs for projects for which it actually spent only $30.1 million. That means—he argued—"nearly half of [the Company's] overall budget was not spent as forecasted."[104] Therefore, witness Oliver argued that "these substantial deviations from budgeted expenditures greatly diminish the confidence [the] Commission can place on Pepco's budgets based on forecasted expenditures."[105] He observed this places a larger burden on the Commission to assess the prudence of the Company's changes to the budgeted costs.[106] Witness Oliver argued that without requiring Pepco to demonstrate reasonable conformance with its estimated costs by project and activity level, then "Pepco's forecasted budgets become little more than large "pools of funds" that management can spend without concerns regarding substantive regulatory challenges and cost disallowance."[107]

[102] *Id*. at 14.
[103] *Id*.
[104] *Id*.
[105] *Id*.
[106] *Id*. at 14-15.
[107] *Id*. at 16.

In addition to Pepco's tendency to develop bad forecast, witness Oliver argued that the Company's use of two bridge years in its MYP2 proposal serves to further erode the strength of ties between Pepco's reported actual historic costs and the projected costs on which the Company seeks to use in the development of revenue requirements and rates for future periods.[108] Witness Oliver asserted that "[i]f the Company requires a two year lag between its historic test year and the start of a proposed MYP, the Commission should recognize that parties reviewing such an MYP application will also need more time to evaluate the Company's proposals."[109] Witness Oliver also argued that the use of a second bridge year is indicative of the complexity of MYP filings. He pointed out that bridge year 1 represents the twelve months ended March 31, 2023 and fully completed before the Company's rate application in this proceeding was filed, but the Company did not update its presentation or show its actual results for that period, nor has it updated its forecasts of budgeted costs to reflect the influence of its actual expenditures for the twelve months ended March 31, 2023.[110] Witness Oliver observed that this results in Pepco's reliance on historical actual cost data to support its revenue increase request that is substantially out-of-date and will be even more so when applied to Pepco's proposed Rate Years 3 and the Rate Year 3 extension.[111]

Staff

Unlike OPC and AOBA, Staff did not initially offer an opinion on whether the Commission should reject Pepco's MYP2 and revert it back to a traditional rate case.[112] Instead, Staff remained agnostic on the question of whether to allow MYPs and stated that it

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[108] *Id*. at 18.
[109] *Id*.
[110] *Id*. at 19.
[111] *Id*.
[112] Staff Initial Brief at 48.

had not reached the point where it could unequivocally say that the MYPs are not working as intended and a historical test year model was clearly superior.[113] Staff acknowledged that the Commission in Order No. 89226 saw certain potential benefits in MYPs.

Nonetheless, Staff indicated that it "does not believe that use of MYPs has substantially reduced the administrative burdens of rate cases, and the predictability of rate increases does not make them any more palatable when they are as large as those the MYP utilities have sought in recent years."[114] However, Staff acknowledges that MYPs have given Staff and other parties more opportunities to review utility capital expenditures at different stages in their planning and implementation processes.

Additionally, Staff pointed out that the Commission does have the authority to reject Pepco's proposed MYP and substitute a one-time rate increase, so long as it is clear that the Commission is acting based on the record in this proceeding.[115] Staff further advised that "[s]uch a decision should be clearly limited to Pepco and the current MYP proposal, without precluding Pepco or other electric and gas utilities from applying for an MYP in the future. This would eliminate the hazard of making a broad policy determination in a proceeding where many of the interested stakeholders are not represented."[116] Staff recommended that a decision about whether to stop allowing MYPs and revert fully to historic test year rate cases should be made in a generic proceeding similar to the proceeding that the Commission initiated to establish a multi-year ratemaking process.[117]

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[113] *Id*.
[114] *Id*.
[115] *Id*. at 49.
[116] *Id*.
[117] *Id*.

In its reply brief, Staff noted that it had further considered the issue of what the Commission can do if it is not persuaded to allow Pepco a second MYP.[118] In that instance, Staff recommends that the Commission grant Pepco a one-time rate increase equal to Staff's Year 1 MYP recommendation of $41,487,000. That increase is based on a forecast year and should be in effect until at least March 31, 2025, after which Pepco should be required to submit a reconciliation filing to reconcile forecast and actual expenditures for the year ending March 31, 2025.[119] Staff further opined that Pepco could also file a new rate case at the time of its choosing, so long as the new rates would not go into effect any earlier than April 1, 2025. A prudency review could occur during either the reconciliation or the new rate case"[120]

In response to Pepco's claims that its MYP2–as proposed–will achieve the perceived benefits enumerated in Order No. 89482, Staff stated that it is "less certain that allowing Pepco's continued operations under a second MYP will provide the benefits the Commission thought MYPs would produce."[121] Regarding rate stability, Staff argued that the annual increases Pepco seeks in MYP2 cannot reasonably be considered any more stable than those that would result from rate cases adjudicated under a historical test year framework.[122] Likewise, concerning transparency into Pepco's capital spending, Staff found that the information Pepco presented in its filing regarding its planned capital expenditures provided little detail or depth.[123] Regarding Pepco's argument that its MYP2 advances State goals like electrification, Staff questioned whether an MYP was even necessary to do so.[124]

[118] Staff Reply Brief at 18.
[119] *Id*. at 18-19.
[120] *Id*. at 19.
[121] *Id*. at 25.
[122] *Id*. at 26.
[123] *Id*.
[124] *Id*. at 27.

GSA

In its initial brief, GSA argued that the Commission should reject Pepco's proposed MYP2 and implement a single rate increase using a single future historical test year.[125] GSA points out that in Order No. 89482, the Commission made clear that it may exercise its authority to reject or modify a proposed MYP if it finds that an application is not consistent with the public good, or that the MYP is not in the public interest at the time it is filed.[126]

GSA indicated that it would support a return to traditional ratemaking but understands that the record in this case may not support such a decision. However, GSA argued that "if the Commission concludes that a base rate increase for Pepco is warranted, the Commission should approve a single year rate increase based on a forward test year."[127] (italics added) GSA further asserted that "there is evidence on the record with Pepco's RY1 as a basis with the adjustments recommended by Staff, AOBA and OPC for the Commission to order a single rate increase."[128] GSA acknowledged that "[a] rate increase based on a single forward test year would itself be an alternative form of ratemaking and would be a reasonable middle ground between the traditional historic test year approach and the MYP requested by Pepco in this proceeding."[129] GSA also recommended that "[i]f the Commission does allow Pepco to institute a second MYP, the Commission should similarly condition that approval on the outcome of the lessons learned proceeding and any regulations that may come from that proceeding and put Pepco on notice that the Commission may invoke the off-ramp provision."[130] In its reply brief, GSA argued that Pepco's reliance on the notion that MYPs

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[125] GSA Initial Brief at 15.
[126] *Id*. at 15 (citing Order No. 89482 at 13).
[127] *Id*. at 15-16.
[128] *Id*. at 16.
[129] *Id*.
[130] *Id*.

allow stakeholders “multiple bites at the apple” is overstated.[131] GSA points out that Pepco acknowledges that its “MYP work plans … are not static; rather, the Company will continuously review and adjust its work plans over the course of the term of the MYP to respond to system needs as well as to the needs of the State’s public policy initiatives.”[132] GSA surmised that the MYP may provide transparency into Pepco’s capital and work plans at the time the MYP is filed, but because these plans can be altered at any time at the discretion of Pepco, this transparency provides little value.[133] Therefore, GSA concluded that “Pepco has not demonstrated … that the MYP structure provides any greater transparency into Pepco’s capital planning than traditional ratemaking.”[134]

MEA

In his Surrebuttal, MEA Director Pinsky stated that although MEA did not explicitly seek disallowance of Pepco’s MYP2, MEA supports the Commission’s efforts–in this case or a future proceeding–to explore whether Maryland should continue with this type of alternative ratemaking at all especially to the extent that multi-year rate plans do not promote transparency or alleviate administrative burdens, and ultimately burden ratepayers with unnecessary up-front costs.[135] Director Pinsky noted that Pepco witness O’Donnell stated that the “Company would … actively participate in a general proceeding…to consider the statewide evaluation of MYPs.”[136] Further, Director Pinsky stated that if the Commission decides on a future proceeding to examine the multi-year construct, MEA also would

[131] GSA Reply Brief at 6.
[132] *Id*. at 7.
[133] *Id*.
[134] *Id*.
[135] Pinsky Surrebuttal at 3.
[136] *Id*. (citing O’Donnell Rebuttal at 20:15-18).

strongly encourage renewed Commission inquiry into performance-based ratemaking and performance-incentive mechanisms ("PIMs").[137]

Montgomery County

In its comments, Montgomery County noted that it had previously supported the general concept of multi-year rate plans and continues to see value in longer term planning, however, it recognizes that a number of parties have raised concerns about the present application.[138] Regardless of any decisions the Commission may make regarding the proposed MYP in this proceeding, Montgomery County encourages the Commission to convene broader discussions outside the context of this proceeding to invite all interested stakeholders to discuss lessons learned and the merits and appropriate use of multi-year rate plans as well as other forms of alternative rate making such as performance incentive mechanisms moving forward.[139]

Commission Decision

The Commission's statutory responsibility governing its rate setting authority is that it set "just and reasonable" rates pursuant to PUA §§ 4-101, 4-102 and 4-201. For a rate to be just and reasonable, the rate: (1) cannot violate any provision of the PUA, (2) must "fully consider and be consistent with the public good," and (3) "result in an operating income … that yields, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a reasonable return on the fair value of the public service company's property used and useful in providing service to the public."[140] The Commission also may

[137] Pinsky Surrebuttal at 3.
[138] Comments of Montgomery County, Maryland In Lieu of an Initial Brief ("Montgomery County Comments") at 5-6.
[139] *Id*. at 6.
[140] PUA § 4-101.

adopt alternative forms of regulation, including MYPs, "if the Commission finds, after notice and hearing, that the alternative form of regulation: (1) protects consumers, (2) ensures the quality, availability, and reliability of regulated electric services, and (3) is in the interest of the public, including shareholders of the electric company."[141]

"No statute or law requires the Commission to use any particular rate setting method."[142] This is because, under the "just and reasonable" standard, "it is the result reached not the method employed which is controlling."[143] As the U.S. Supreme Court explains, rate-making bodies are not bound "to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[144] The Commission's sole obligation in this proceeding is "to determine what rates the utility should be allowed to charge in future years to cover prudent expenses and earn a reasonable profit."[145]

As discussed above, several parties questioned generally the continued use of the MYP construct and specifically whether Pepco's MYP2 application should be approved and offered recommendations that the Commission set rates in this case using a different form of alternative form of ratemaking under its rate setting authority. Pepco argued that its MYP2 is just and reasonable and should be approved because it claims that it continues to achieve the perceived benefits of an MYP that the Commission discussed in Order No. 89226.

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[141] PUA § 7-505(c)(2).
[142] OPC Initial Brief at 18 (citing *Off. of People's Couns. v Maryland Pub. Serv. Comm'n*, 355 Md. 1,24 (1999) ("[PUA § 4-102] merely requires the Commission to set "just and reasonable" rates; it does not prescribe the specific criteria to be used for the determination, and evaluation, of justness and reasonableness of those rates")).
[143] *Id*. at 18 (citing *Fed. Power Comm'n v Hope Natural Gas Co.*, 320 U.S. 591, at 603 (1944) (emphasis added; *see also*, *Fed. Power Comm'n v. Natural Gas Pipeline Co. of Am.*, 315 U.S. 575 (1942)).
[144] *Natural Gas Pipeline Co. of Am*., 315 U.S. at 586.
[145] OPC Initial Brief (citing *Off of People's Couns. v. Maryland Pub. Serv. Comm'n*, 355 Md. 1, 8 (1999) (citation omitted)).

Pepco argued that many of the positions or recommendations–especially those argued by OPC–are identical to the recommendations suggested in Baltimore Gas and Electric Company's ("BGE") most recent MYP case that the Commission ruled upon in December 2023.[146] Pepco noted that the Commission rejected OPC's arguments in BGE's MYP2 rate case as discussed in Order No. 90948. Pepco, therefore, argued that "there is no basis to rule any differently or to treat Pepco's MYP any differently in this case and it would be arbitrary to do so."[147] The Commission finds there is one fundamental difference between BGE's MYP and Pepco's MYP–that is, BGE is the Pilot utility. In Order No. 89482, the Commission stated its intentions to design the MYP for **one** utility and BGE promptly filed a letter volunteering to serve as the Pilot utility. In the Commission's Order Establishing a Multi-Year Rate Plan, Order No. 89482, the Commission observed that the purpose of the Pilot is to "gain additional experience and lessons learned regarding MRP filings…"[148] The Commission—as discussed by many stakeholders in this case—has not completed its lessons-learned process with the pilot utility, BGE, and many intervenors have argued that the Commission must complete this process before moving forward with another MYP that does not have the benefit from the learnings. According to these parties, ratepayers could be harmed by approving annual base rates for a utility for three years into the future without considering those lessons.

The Commission finds that, just because Pepco filed a second MYP and adhered to the MYP filing requirements set forth in Order No. 89482, it does not mean that the resulting rates from Pepco's MYP2 application are just and reasonable, nor does it mean that the

[146] *See* Order No. 90948, *Application of Baltimore Gas and Electric Company for an Electric and Gas Multi-Year Plan,* Case No. 9692 (Dec. 14, 2023).
[147] Pepco Initial Brief at 10.
[148] Order No. 89482 at 13.

Commission may only approve Pepco's proposed MYP2-based rate.[149] Not only would a decision such as this be premature, but it would also ignore the chorus of intervenors requesting that the Commission look at other alternative forms of ratemaking in this specific case with the non-Pilot utility. In Order No. 89482, the Commission stated that it "may exercise its statutory authority to reject or modify a proposed [MYP] if it finds that the application is not "consistent with the public good" or the [MYP] "is not in the public interest at the time it is filed."[150]

Here, the Commission adopts an approach that combines OPC's off-ramp adjustment to rate base with adjustments to Pepco's forecasted data for the Company's MYP2 Rate Year 1 only. The Commission finds that the resulting revenue requirement is just and reasonable and also works within the MYP construct, which allows for the annual reconciliation process and continues to promote the argued benefits attributed to MYPs.

During the hearing, Pepco witness Leming conceded that OPC witness Effron's off-ramp adjustment approach, while not one advanced by the Company, is supported by the record evidence in this case. Specifically, witness Leming stated the following when questioned on cross examination by OPC's counsel, Mr. Ouslander:

> MR. OUSLANDER Question: "Do you agree with Mr. Effron that the record[] in this case is sufficient to support his alternative rate structure?"[151]
>
> MR. LEMING Answer: "I believe he has used information that is in the record to develop his proposal. I think I noted some of my reasons why I do not support it and I'm advocating against it, but I think he has certainly developed it based on information provided in the record in that manner."[152]

Witness Leming also testified that, if the Commission approved a revenue requirement using a forecasted test year just for MYP2 Rate Year 1 instead of approving all

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[149] OPC Initial Brief at 7. *See also* Staff Reply Brief at 25.
[150] Order No. 89482 at 13.
[151] Hearing Transcript, Vol. 6, 1228: 12-20 and 1229:15-22 (March 14, 2024).
[152] *Id*.

three years, it would still promote the required transparency, rate predictability, and safety and reliability–all of which Pepco has claimed are benefits of its MYP2.[153]

During the hearing, Pepco witness Leming agreed that all of these benefits–albeit to a lesser degree–would still be present if the Commission approved a revenue requirement with a forecasted test year for just MYP2 Rate Year 1.[154] Moreover, Pepco in its initial brief acknowledged that, while the Company prefers that the Commission approve its requested three-year, nine month MYP,

> ... the Commission has the flexibility to approve a forward-looking plan of shorter duration with the understanding that any reduction in the years approved also lessens the customer benefits of rate stability, predictability and transparency, lessens the Commission benefits of lower administrative burdens, lessens the benefits to the Company of predictable revenues to support its investment plans, and lessens a stable revenue stream for diverse suppliers and those suppliers' ability to locate resources to support the utility's future work plans.[155]

As suggested by OPC, "if the revenue requirement proves to be insufficient, nothing precludes Pepco from filing a subsequent application for an adjustment to base rates."[156] In fact, under the MYP construct, the Company will need to file its next rate case before the end of the rate effective period, which is March 31, 2025 or the end of MYP2 Rate Year 1, and the new rates will not go into effect any earlier than April 1, 2025. The form of the Company's next rate case can be any of its choosing, so long as its application is accompanied by the requisite information needed to calculate a historic test year.

The Commission finds that the approach we have taken will yield a just and reasonable rate, until further learnings can be had, including a fuller determination of

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153 Hearing Transcript, Vol. 6, 1241:5- 23 and 1242:1-9 (March 14, 2024).
154 *Id*.
155 Pepco Initial Brief at 13.
156 OPC Initial Brief at 20.

whether the purported customer benefits are being achieved.[157] As part of these lessons learned, consideration should be given to the appropriateness of permitting projected rates given the uncertainty in investment created by changing technology that enables decarbonization and more efficient operations of the grid that could make obsolete previously reviewed investment decisions.

The Commission notes the recommendations of Staff and other stakeholders calling for a general proceeding, open to all, as the appropriate venue to consider a statewide evaluation of MYPs, including potential modifications or terminations. That proceeding will be taking place in the lessons-learned proceedings for the pilot MYP. The remainder of this Order considers Pepco's MYP2 rate request based on the approach described above.

The approach being used for this specific case does not negate or override the off-ramp provisions contained in Order No. 89482, which would warrant the Commission's intervention to modify or terminate the MYP.[158] In that order, the Commission held that the off-ramp provision was a necessary counterbalance to the Public Utilities Article's three year stay-out provision, and that the off-ramp would become applicable in the event of extraordinary circumstances that call into question whether the existing rates are just and reasonable.

B. Contested Operating Income Adjustments

1. Employee Headcount

OPC

In his direct testimony, OPC witness Effron testified that Pepco's forecasted increase in employee levels over the MYP2 is not supported by the Company's data request responses

[157] Order No. 90948 at 10. The Commission noted that it would not be appropriate to terminate MYPs in the confine of a particular utility's rate case.
[158] Order No. 89482 at 3.

to OPC. Witness Effron stated that the Company provided a forecast level of 1,434 Pepco employees over the term of the MYP2 in response to OPC Data Request 2-19.[159] However, that forecast is higher than recent actual employee levels, which showed the Pepco employee complement in recent months in the range of 1,330 to 1,340 employees.[160] Mr. Effron noted that the Company explained the difference between its forecasted increase and its actual levels is due to the fact that actual headcounts are "lower than budgeted FTE [full time equivalent] headcount due primarily to attrition and longer than expected recruiting timelines"[161] and that "actual FTE count is expected to get back to the projected count as recruiting initiatives are held to bring in new candidates."[162]

Further, Mr. Effron testified that there is no evidence showing an increase in the number of Pepco employees over the course of 2023 and there is no trend showing an increasing Pepco employee complement in 2023 compared to earlier years.[163] Mr. Effron calculated that "the average number of employees for the third quarter of 2023 was 1,338,"[164] which he testified is 96 fewer employees than the forecast. Mr. Effron therefore recommended that the Commission reduce the Company's forecasted employee level for MYP2 by 96 employees. Witness Effron noted that "[r]educing the Company's forecasted employee complement by 96 employees results in decreases to Maryland jurisdictional operation and maintenance expense of $3,167,000, $3,319,000, $3,420,000, and $3,477,000 for MRP2-RY1, MRP2 RY2, MRP2 RY3, and MRP2 RY3E respectively."[165]

[159] Effron Direct at 11.
[160] *Id*.
[161] *Id*.
[162] *Id*.
[163] *Id*. at 11-12.
[164] *Id*. at 12.
[165] *Id*.

On Surrebuttal, Mr. Effron stated that he does not dispute that the Company intends to fill the open positions and has plans to do so.[166] However, in response to OPC Data Request 49-4, the Company updated its employee complement through 12/31/2023, which showed that the employee count as of 12/31/2023 was 1,338, the number Mr. Effron used in calculating his proposed adjustment to labor expense.[167]

<u>Pepco</u>

In his Rebuttal Testimony, Pepco witness Barnett indicated that based on the Q3 2023 actual headcount data provided to OPC, the Company's lower than expected headcount of 96 FTEs included: "74 Operational positions, 16 Customer positions, and 6 Non-Operational positions."[168] Company witness Young testified that the 74 Operational positions projected below Year 1 of the MYP staffing levels are primarily driven by "fifty (50) open positions within Electric Operations and sixteen (16) open positions within Transmission and Substation (T&S). The eight remaining Operational positions below the projected staffing level are within various other responsibility areas."[169] Witness Young claimed that the primary cause of the variance from Q3 2023 average headcount to Year 1 of the MYP is due to "hiring delays in obtaining qualified candidates to fill various openings, retirements, and normal attrition."[170] She further stated that the job vacancies involved "system operations, engineering, overhead and substation construction and maintenance personnel that are essential in ensuring the successful and safe completion of both capital and O&M [operations and maintenance] projects."[171]

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[166] Efron Surrebuttal at 11.
[167] *Id*. at 8-9.
[168] Barnett Rebuttal at 3.
[169] Young Rebuttal at 62.
[170] *Id*. at 63.
[171] *Id*.

Witness Young argued that the "[p]otential consequences for removing the positions … are that it would limit the responsibility areas within Operations from adequately fulfilling activities …" and would contribute to the continued increase in contracting costs in order to provide responsibilities critical to safe and reliable service.[172] She also claimed that OPC witness Effron's recommendation to reduce headcount would only add challenges to meeting customer expectations and needs as well as negatively impacting the Company's ability to address critical aspects of monitoring, and maintaining and Pepco's electric distribution system.[173]

Additionally, Company witness Hightower explained that the variance of the 16 Customer Operations positions that are lower than Year 1 of the MYP is due to "normal attrition and hiring practices specific to Customer Care Center."[174] She explained that a new Call Center Representative is first hired as temporary workers (temps) in classes and then moved to permanent classification based on their performance.[175] She stated that in 2023, there were three new classes and as of December 2023, there were 27 temporary workers who the Company will evaluate for permanent employment during 2024.[176] Witness Hightower further explained that if the call center temps meet performance expectations after 12-18 months, they are converted to full time employees–as open positions become available, and approximately 71% of the call center temps are offered full time employment. She argued that while there are fewer FTEs than budgeted, several temps are expected to be hired during the MYP period.[177]

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[172] *Id*.
[173] *Id*. at 62.
[174] Hightower Rebuttal at 2.
[175] *Id*.
[176] *Id*.
[177] *Id*.

Commission Decision

The Commission finds that Pepco has not provided sufficient evidence to show that its forecasted employee headcount will take place over the course of the MYP2. As pointed out by OPC witness Effron, Pepco's response to data requests do not show any increase in the number of Pepco employees over the course of 2023 and filing requirements suggest there is no trend of an increasing Pepco employee headcount as compared to earlier years.[178] While the Commission continues to believe, as it did in Case No. 9655,[179] that Pepco intends to fill its open positions, the evidence does not show that the forecasted increase will take place during the MYP2 at the level projected by Pepco. Therefore, the Commission accepts OPC's adjustment and reduces Pepco's forecasted employee levels to 1,338–which is its actual employee level as of December 31, 2023. As discussed earlier, using forecasted data, the Commission has adopted an approach that limits Pepco's cost recovery in this MYP 2 to Rate Year 1. Consequently, the Commission finds that Pepco's operations and maintenance expenses for MYP Rate Year 1 should be reduced by $2,296,000.[180] If the Company is able to overcome current impediments to hiring and retaining qualified employees, Pepco may request cost recovery of additional employees in future proceedings.

2. Outside Services

OPC

In his direct testimony, OPC witness Effron testified that Pepco seeks increased costs specific to FERC Account 923, which includes fees for services provided by outside

[178] Effron Direct at 12.
[179] *See* Order No. 89868, *Potomac Electric Power Company's Application for an Electric Multi-Year Plan,* Case No. 9655, slip op. at 108 (Jun 28, 2021).
[180] Effron Surrebuttal at Exhibit DJE-6, Schedule C.

professionals such as accountants, attorneys and engineers.[181] Witness Effron noted that costs charged to Account 923 by Pepco also include IT, financial and support services, including such services provided by Pepco Holding Incorporated Service Company (PHISCO) and Exelon Business Services Company (BSC) affiliate organizations of Pepco.[182]

Witness Effron pointed out that Pepco's MYP2 forecast shows that the Company's actual and forecasted expenses charged to Account 923 vary from the historical test year through the proposed MYP2 Rate Year 3 extensions from 2022 to 2027 show year-over-year increases at a rate between 3% to 5% per year, except for "an extraordinary increase of 20.5% between the $62 million in Bridge Year 1 (i.e. the twelve months ending 3/31/2023) and the $75 million in Bridge Year 2 (i.e. the twelve months ending 3/31/2024).[183] To explain the large increase, Pepco stated in OPC Data Request 2-14 that "Higher outside services from the 12ME March 2023 to the 12ME March 2024 are primarily driven by wage increases, higher pension, increased vehicle and facilities costs, corporate property and casualty insurance premiums and higher IT costs."[184] Witness Effron argued that Pepco's explanation describes routine expenses that could be expected to result in increases similar to the 3% to 5% range. "The factors cited by the Company do not adequately explain the 20% increase in expenses forecasted to take place during the twelve months ending March 31, 2024."[185]

Additionally, OPC pointed out that Pepco's outside services expense of $78,862,000 forecasted in MYP2 RY1 represents an increase of 33% over the expenses from the historical test year and an increase of 27% over the expense of the MYP2 Bridge Year 1. Witness

[181] Effron Direct at 13.
[182] *Id*.
[183] OPC Initial Brief at 40-41.
[184] Effron Direct at 14.
[185] *Id*.

Effron argued that the Bridge Year 2, which is fully forecasted, is not consistent with the Company's recent actual experience.[186] Therefore, he recommended that the Commission "escalate the actual Historic Test Year outside service expense by 5% per year to project the annual outside services expense for the MRP2."[187] Witness Effron stated that his adjustments would result in reductions to Maryland jurisdictional operations and maintenance expenses of $10,185,000 for MYP2 RY1, $9,096,000 for MYP2 RY2, and $8,311,000 for MYP2 RY3 and MYP2 RY3E.[188]

Pepco Rebuttal

Pepco witness Barnett disagreed with OPC's recommendation and offered an explanation of the drivers for the 20% increase -or approximately $13 million-increase in Outside Services account for the twelve-months ending March 31, 2023 (Bridge Year 1) to the twelve months ending March 31, 2024 (Bridge Year 2). In his Rebuttal, witness Barnett provided a summary of the IT and other costs he indicated that are driving the increase in Outside Services costs.[189] Witness Barnett argued that because he provided a list of projects and associated cost increases as an explanation, that should address OPC's concern. He also noted that the Company "manages its spend at the total O&M level and strives to keep the increase in overall O&M below the rate of inflation."[190] Witness Barnett indicated that Pepco's Maryland distribution O&M compound annual growth rate for the twelve months ending March 31, 2022 to–the period ending–March 31, 2027 was at 2.5%[191] and therefore suggested this rate of increase reflected in Pepco's budgeted O&M is indicative of a

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[186] *Id*.
[187] *Id*. at 15.
[188] *Id*. at 16.
[189] Barnett Rebuttal at 6-7.
[190] *Id*. at 7.
[191] *Id*.

reasonable forecast.[192] He also highlighted that Staff witness Patterson found that "An analysis of the commitment proposed by Pepco for O&M costs during the course of the plan does not show significant increases or decreases in spending."[193] Mr. Barnett offered that another way to assess the reasonableness of O&M increases is through an overall year over year analysis.[194] He testified that "[e]ven with the increase in [costs related to] Outside Services account between Bridge Year 1 and Bridge Year 2 of 20%, the overall increase in Pepco MD distribution O&M YOY increase between Bridge Year 1 and Bridge Year 2 is only 3.8%."[195] Mr. Barnett further testified that the impact of both OPC's employee headcount disallowance and the Outside Services disallowance would reduce year over year O&M growth between March 31, 2023 (Bridge Year 1) and March 31, 2024 (Bridge Year 2) to (0.4%) compared to the forecasted 3.8% currently filed in Pepco's MYP2, "which is a material reduction in O&M expense and is not reasonable, particularly in this higher than normal inflationary environment."[196]

<u>OPC Surrebuttal</u>

OPC witness Effron acknowledged that Pepco provided additional details to explain the forecasted increases in Outside Services; however, he argued that "there is no evidence that the forecasted increases are actually taking place."[197] He noted that the Company is already well into Bridge Year 2, but OPC witness Barnett "does not provide any data that would establish that the outside services expenses are increasing at anything near that [20%]

[192] *Id*.
[193] *Id*.
[194] *Id*.
[195] *Id*. at 8.
[196] *Id*. at 9.
[197] Effron Surrebuttal at 9.

rate. In fact, the available evidence indicates the opposite."[198] Mr. Effron highlighted the Company's updated response to OPC Data Request 3-8, which compared the Company's actuals to budgeted outside services expenses for the six months ending September 30, 2023, which showed that the actual expenses realized were $57,370,000 was $10,897,000, or 16%, below the forecasted expense of $68,267,000 included by Pepco.

<u>Pepco Rejoinder</u>

On live rejoinder, Pepco witness Barnett introduced Pepco Exhibits 8 and 9 to offer further explanation about the variance between budget to actual expenses and to provide an alternative to OPC witness Effron's approach.[199] Specifically, Mr. Barnett argued that Exhibit 8 showed updated FERC Account 923 preliminary results through December 2023 and that costs budgeted on FERC Account 923-Outside Services- were actually paid out of non-FERC 923 Accounts. As an alternative to OPC's recommendation, Mr. Barnett recommended that the Commission consider making an annualized adjustment of $1.6 million to total O&M as an alternative to the $9-$10 million annual reduction that Mr. Effron proposed to Outside Services as discussed in Exhibit 9.[200] Mr. Barnett made clear on live rejoinder that the Company was not recommending the alternative approach, but instead has a strong preference to address differences between actual and budgeted costs in required reconciliations that will occur throughout the MYP.

No other intervenor offered recommendations or commented on OPC's proposed recommendation or Pepco's alternative recommendation.

[198] *Id*. at 10
[199] Hearing Transcript Vol. 1, 25:18–33:22 (March 7, 2024).
[200] Hearing Transcript Vol. 1, 31:20–33:22 (March 7, 2024).

Commission Decision

While Pepco offered some testimony to account for the forecasted 20.5% increase between Bridge Year 1 and Bridge Year 2, the Commission is concerned that such a significant increase has the effect of unnecessarily raising costs in Bridge Year 2. This increase would thus raise the costs upon which the MYP2 effective period rates are calculated. Since Bridge Year 2 is a fully forecasted test year, the Commission finds that OPC's adjustment that provides for an annualized increase of five percent in Outside Services is more reasonable and consistent with the need for developing reasonable rates. In fact, Pepco's argument about managing its total O&M levels highlights additional difficulties with MYPs. There is a balance to consider at both the macro and micro level of the forecasts, but the Company has the burden to justify all of its spending and the foundation upon which the projections are based, including at the individual account level. This treatment is no different than an historic base rate case, where the Company has the burden to justify the prudency of all of its spend and parties are looking at individual issues. Using forecasted data, the Commission finds that Pepco's operations and maintenance expenses for MYP2 Rate Year 1 should be reduced by $7,382,000.[201]

3. Major Event Day Storm Expense

Pepco

In his direct testimony, Pepco witness Leming testified that the Company "is requesting that it be allowed to establish a regulatory asset for actual expenses associated with storms that result in a major event day (MED), as defined by COMAR

[201] Effron Surrebuttal at Exhibit DJE-6, Schedule C.

20.50.01.03.B(29), that are incurred in the future, with recovery over a five-year period."[202] He argued that with this approach, customers would avoid the volatility of these expenses and pay for a more smooth and normalized level of expense each year. Mr. Leming testified that the Company's request for regulatory treatment of major storm costs is supported by Pepco witness Young's direct testimony. Ms. Young testified that "Pepco's storm restoration expenses nearly doubled in 2021, relative to what the Company incurred in 2019 and 2020."[203] She noted that since the Company began tracking MEDs[204] in 2020 for reliability reporting purposes, it has observed a steady increase in storms that have resulted in MEDs, consistent with the cost trends.[205] Witness Young testified that the storms the Company has experienced in recent years that have resulted in MEDs have directly resulted in the increases in the Company's storm restoration expenses.

Staff

Staff witness Patterson opposed Pepco's proposal to defer non-major storm restoration costs into a regulatory asset to be recovered over five years.[206] Mr. Patterson testified that costs deferred into a regulatory asset are generally costs that are unusual in nature, non-recurring or extraordinary.[207] He argued that non-major storms "are a regular occurrence, occurring on an annual basis" and do not warrant being deferred into a regulatory

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[202] Leming Direct at 24-25.
[203] Young Direct at 70.
[204] As defined in COMAR 20.50.01.03.B(29), a Major Event Day (MED) is a day determined using the Institute of Electrical and Electronics Engineers (IEEE) method for determining excludable data for calculation of reliability indices under IEEE Std 1366TM 2003. According to IEEE, MEDs are days where the system operational and/or design limits are exceeded. *Id*. at 70.
[205] Young Direct at 70.
[206] Patterson Direct at 20.
[207] *Id*.

asset.[208] Therefore, Mr. Patterson argued that restoration costs for non-major storms should be included in O&M expenses based on a normalized amount.[209]

Pepco Rebuttal

In his Rebuttal, Pepco witness Leming argued that Staff mischaracterizes the Company's proposal as for "non-major storms" but does not address that the Company is seeking only to defer storm costs that result in MEDs as defined by COMAR 20.50.01.03.B(29).[210] He contended that the very definition of MEDs is a stark contrast to Staff witness Patterson's description of these events as regular occurrences.[211] Mr. Leming further argued that based on the definition of MEDs, the related costs would meet the criteria of being unusual in nature, extraordinary and be considered for regulatory asset treatment as explained by Mr. Patterson.[212] Mr. Leming also noted that Pepco's proposal is different from the request that BGE included in Case No. 9692. Specifically, BGE requested that all O&M costs incurred from non-major outage events be given regulatory asset treatment and be amortized and recovered over a five-year period,[213] whereas Pepco is requesting that only those storm costs that result in MEDs be given regulatory asset treatment.[214]

Commission Decision

As the Commission is only establishing rates for a single projected year in this proceeding, the Commission does not believe it is necessary to establish a regulatory asset for MEDs. Pepco here is seeking to extend regulatory asset treatment to costs of non-major storms that result in MEDs. To the extent that there are MEDs with significant restoration

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[208] *Id*.
[209] *Id*.
[210] Leming Rebuttal at 23.
[211] *Id*. at 24.
[212] *Id*.
[213] *Id*.
[214] *Id*.

costs in the future, the Company is free to petition for regulatory asset treatment based on the merits at that time. Therefore, the Commission accepts Staff's adjustment. The Company's rebuttal emphasizes that MEDs are "events that are so far away from normal performance that they are known as outliers."[215]

The Commission finds troubling certain arguments presented by both parties related to the data. Pepco witness Young appears to present only four years of data to justify a trend, while Staff witness Patterson does not address what appears to be a large increase in MED restoration costs in 2022. As Pepco bears the burden of proof with respect to cost recovery and the Commission is establishing rates for a single forecasted year, the Commission denies regulatory asset treatment of MEDs and accepts Staff's adjustment. To the extent that there are MEDs with significant restoration costs, those may be examined in future proceedings.

4. Street Lighting Regulatory Asset

Staff

In his supplemental direct testimony, Staff witness Rielly described a pending issue in Case No. 9706 that would impact a capital project budgeted in the present proceeding.[216] Specifically, Mr. Rielly described the formal complaint of Alfred Carr regarding Maryland streetlight service. Mr. Rielly noted that Mr. Carr's petition stated that: "(1) Pepco billing for streetlight service was inaccurate, due to billing not reflecting new and upgraded lighting, (2) that Pepco's streetlight bills are difficult for customers to understand, (3) Pepco's streetlight outage reporting system contains inaccuracies, and (4) Pepco is providing insufficient

[215] *Id*. at 23.
[216] Rielly Supplemental Direct at 2, referencing Case No. 9706, *Formal Complaint of Alfred C. Carr, Jr. v. Potomac Electric Power Company*.

streetlight maintenance service."[217] Staff witness Rielly testified that in the current proceeding, Case No. 9702, the Company included a capital project to automate and improve the asset management and billing process for Pepco MD streetlights in Project 87526. In that project, Pepco budgeted $660,000 in 2023 and $1,410,000 in 2024 for Pepco Streetlights capital.[218]

Witness Rielly testified that Staff recommends that the Commission "require Pepco to place all costs related to resolving streetlight billing errors, including automating the connections between Pepco's streetlight inventory database and its billing system database in a regulatory asset for tracking, and not allow the recovery of the regulatory asset until the Commission rules on the recovery of these costs in a rate case."[219] He noted in his surrebuttal testimony that Staff removed Project 87526 costs from rate base and adjusted depreciation expense.[220] Staff also proposed to remove any other known costs.[221]

Pepco

In his Surrebuttal, Pepco witness Leming testified that the Company filed testimony in Case No. 9706 agreeing with Staff's recommendation to place all costs associated with resolving streetlight billing errors into a regulatory asset.[222] Therefore, Pepco removed the costs associated with Project 87526 from the MYP2 and will defer them into a regulatory asset as they are incurred.[223] Witness Leming pointed out that Schedule (RTL-SR)-1 reflects the changes in rate base, operating income and revenue requirement impacts for removing

[217] *Id*. at 2 (citing *Complaint of Al Carr Against Potomac Electric Power Co.* ("Complaint"), Case 9706, October 21, 2022, Maillog No. 242773.).
[218] Rielly Supplemental Direct at 2.
[219] *Id*. at 3.
[220] *Id*.
[221] *Id*.
[222] Leming Surrebuttal at 2.
[223] *Id*.

Project 87526 from Pepco's MYP2. Mr. Leming testified that the revenue requirement impacts are an \$89,000 reduction in Rate Year 1, a \$627,000 reduction in Rate Year 2, a \$573,000 reduction in Rate Year 3, and a \$518,000 reduction in Rate Year 3E.[224] Witness Leming testified that there are no other known costs that will impact Case No. 9702; however, there are a few known costs that will impact Pepco's MYP 1 in Case No. 9655. Mr. Leming pointed out that Staff DR 93-1 shows that to date Pepco has incurred \$108,060 of operations and maintenance expense to initiate Phase 0 IT assessment work in preparation for Project 87526 in the twelve months ending March 31, 2024, a period that represents Rate Year 3 of Pepco's current MYP, Case No. 9655.[225]

Mr. Leming further noted that the Company agrees that upon approval of the proposed regulatory asset in Case No. 9706, that it would defer these costs into the regulatory asset so that they are not included in the final reconciliation and prudency review in Case No. 9655, Pepco's MYP1.[226] Similarly, the Company responded that, to date, it has incurred \$631,557 in Rate Year 3 of Case No. 9655 to complete field survey work. The Company noted that it would agree to record these costs as a regulatory asset and not seek recovery through the final reconciliation and prudency review.[227]

Commission Decision

Based on the record, the Commission accepts Staff's recommendation, and directs the Company to establish a regulatory asset for Pepco's Streetlight project. The Commission also accepts Pepco's recommendation to place the Pepco Streetlighting-related known costs from Rate Year 3 of Case No. 9655 into a regulatory asset, so that the propriety of those costs can

[224] *Id*.
[225] *Id*. at 2-3.
[226] *Id*. at 3.
[227] *Id*.

be properly evaluated in the future. The Commission's decision is consistent with the Public Utility Law Judge's Order issued on April 22, 2024 in Case No. 9706, which authorized Pepco to create a regulatory asset for its Billing Alignment IT costs only, directed that the regulatory asset would not earn a return and determined that the Billing Alignment IT costs will be subject to a prudency review in Pepco's next rate base.[228]

5. Revenue Offsets

Pepco

Pepco witness Leming testified that the Company "recognizes that the requested annual increases over the requested MYP period represent significant amounts for customers." He noted that for Year 1 of the MYP, this is a result of several factors including:

> (1) increased RY1 rate base and operating costs relative to RY3 of the first MYP which represents $42 million of the RY1 increase;
>
> (2) increases in cost of capital which represents $20 million of the RY1 increase;
>
> (3) increases in depreciation rates which represents $17 million of the RY1 increase; and
>
> (4) inflationary pressures that will result in earnings attrition during the bridge period, relative to what was included in revenues in Case No. 9655, which represents $31 million of the RY1 increase.[229]

Mr. Leming testified that in order to smooth the rate increases over the three-year MYP period, Pepco proposes to lessen impacts through the use of certain accelerated tax benefits in Rate Year 1 and Rate Year 2 in the MYP2.[230] The accelerated benefits stem from a reduction in the Federal corporate income tax rate. Specifically, Pepco's MYP2 "includes

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[228] Order No. 91162, *Formal Complaint of Alfred C. Carr, Jr. v. Potomac Electric Company*, Case No. 9706 slip op. at 26-31 (May 23. 2024) (Order of Approving Agreement Unanimous Stipulation and Settlement Agreement).
[229] Leming Direct at 7.
[230] *Id*.

acceleration of tax benefits attributable to the amortization of the Tax Cuts and Jobs Act (TCJA) unprotected non-property excess deferred regulatory liabilities, similar to the accelerated tax benefits that reduced bill impacts in in Case No. 9655."[231] Witness Leming explained that the "TCJA tax benefits associated with unprotected non-property relate to the annual amortization of the regulatory liability arising from changes in Pepco's accumulated deferred income tax (ADIT) balances that were approved by the Commission in Order No. 88719."[232]

Witness Leming stated that "Pepco is proposing to accelerate 50%, or $42.9 million, of the remaining $85.8 million of tax benefits to customers in MYP RY1. In order to smooth the resulting RY2 and RY3 increase, the Company is accelerating an additional $26.7 million in RY2."[233] He argued that this proposal will help reduce, but not fully mitigate, the initial MYP rate increases when rates become effective.[234] Mr. Leming stated that the Company "acknowledges that the proposed revenue increases would be considerable to customers if fully approved, particularly in RY1. Therefore, Pepco is proposing that $42.9 million of tax benefits be accelerated for customers in RY1 and $26.7 million be accelerated in RY2.

Staff

Staff witness Patterson agreed with the concept of accelerating the tax benefits as offsets to traditionally calculated revenue requirements but recommended a different amount than the level proposed by Pepco.[235] Staff recommended that the "revenue offsets proposed by Pepco in its MYP for years 1 and 2 be applied to MYP Rate Year 1 in the amount of

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[231] *Id*. at 15.
[232] *Id*., 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*, Case No. 9472, slip op. (May 31, 2018).
[233] Leming Direct at 15.
[234] *Id*.
[235] Patteson Direct at 21.

$42,772,000 and to MYP Rate Year 2 in the amount of $26,552,000."[236] Mr. Patterson testified that "[t]his would benefit ratepayers more by bringing the year 1 and year 2 rates down and being more stable."[237]On Surrebuttal, Staff revised their proposed revenue offsets to $42,000,000 and $27,324,000 for MYP Rate Year 1 and 2 respectively.[238]

<u>OPC</u>

OPC witness Effron testified that Pepco's revenue deficiency prior to the accelerated amortization of tax benefits is significantly greater in Rate Year 1 than in Rate Years 2, 3 and the extended year 3.[239] Similarly, he noted that OPC's calculated incremental revenue deficiencies prior to the accelerated amortization were also significantly greater during the MYP2 rate effective period.[240] Therefore, Mr. Effron agreed that it is reasonable to accelerate use of the tax benefits to mitigate the magnitude of the rate increases in Rate Years 1 and 2 and to smooth the increases over the term of the MYP2.[241]

Mr. Effron noted that the Company's acceleration of tax benefits is not unreasonable given the significant revenue requirement calculated by the Company. He further observed that the Company's calculated revenue requirement is based on Pepco's request for a 10.50% return on equity (ROE) in the present case and, that to the extent the Commission reduces the ROE, the incremental MYP2 Rate Year 1 revenue requirement will need to be reduced accordingly, which will in turn reduce the pool of the accelerated tax benefits available to smooth the impact of rate increases over the term of the MYP2.[242]

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236 *Id*.
237 *Id*.
238 Patterson Surrebuttal at Exhibit FP-1.
239 Effron Direct at 17.
240 *Id*.
241 *Id*.
242 *Id*. at 18.

Mr. Effron cautioned that:

> "by accelerating the amortization of regulatory liabilities for excess deferred income taxes, customers in future years will have to pay higher rates to make up for the benefits conferred in rate years 1 and 2. The Company's accelerated recognition of tax benefits reduces the revenue requirements in rate years 1 and 2 combined by approximately $70 million. This amount represents greater revenue requirements that will have to be recovered from customers in the years after March 31, 2026, with a return, than would be the case in the absence of the acceleration. To the extent that the accelerated recognition of tax benefits in rate years 1 and 2 can be pared back, the tax benefits available to customers in the years after March 31, 2026 will be greater."[243]

Nonetheless, he proposed to accelerate the recovery of tax benefits, albeit much less than the level proposed by Pepco. Mr. Effron recommended a revenue offset of $6,000,000 to Rate Year 1 and a revenue offset of $9,600,000 to Rate Year 2.

<u>AOBA</u>

AOBA witness Bruce Oliver opposed the Company's proposal to use Rider ERR Revenue Offsets in MYP2. Mr. Oliver argued that the Company's use of these offsets is "simply a strategic move by Pepco and the Company's Regulatory Strategy personnel to hide the full rate impact of the Company's aggressive capital spending plans by effectively shifting revenue requirements to years beyond the period of Pepco's proposed MYP in this proceeding."[244] He noted that the only justification offered by the Company to the use of revenue offsets was provided when Pepco witness Blazunas stated that it reflects the Company's "recognition of on-going economic uncertainty."[245] But, Oliver argued that Blazanus' reference to "on-going economic uncertainty" has no foundation and should be

[243] *Id*. at 19.
[244] B. Oliver Direct at 35.
[245] *Id*.

given zero weight, and further contended that varying degrees of "economic uncertainty" are always present in a free market economy.[246]

In its initial brief, AOBA offered several reasons why the Commission should reject Pepco's use of revenue offsets in this proceeding. First, AOBA argued that the condition upon which the Company relied to justify the use of offsets–namely, the global Covid-19 pandemic–was no longer present. AOBA argued that Maryland boasts an economy with one of the lowest unemployment rates in the U.S. and therefore, the economic assistance rationale used to support the use of revenue offsets in Pepco's MYP1 no longer applies. Second, AOBA argued against the revenue offsets because it shifts the revenue requirements between current and future Pepco ratepayers and advantages current ratepayers at the expense of future customers.[247]

AOBA argued that although the Commission permitted revenue offsets to respond to the economic conditions created by the pandemic, continuing such practices in this proceeding "to improve the palatability of Pepco's large revenue increase request in this proceeding is inconsistent with long-standing established ratemaking principles."[248] Third, AOBA argued that "if 'smoothing' the impacts of the Company's revenue increase request across MYP rate years is necessary to maintain affordable rates, Pepco should achieve that objective through the management of its expenditures during the MYP, not taking rate credits from future ratepayers."[249] Last, AOBA argued that a more appropriate resolution to making

[246] *Id*.
[247] AOBA Initial Brief at 34.
[248] *Id*. at 34-35.
[249] *Id*. at 35.

Pepco's requested revenue increase in this MYP affordable is for the Commission to reduce the magnitude of the revenue increase it approves for Pepco.[250]

Commission Decision

The Commission has determined that a just and reasonable rate in this case limits Pepco's cost recovery in this MYP2 to Rate Year 1, using forecasted data, and reduces the revenue requirement increase by accepting the adjustment recommended in OPC's "off ramp" proposal for MYP2 Rate Year 1. The Commission declines to incorporate any further revenue offsets for Rate Year 1. The Commission finds that this approach provides for the mitigation that the proposed stable rate plan would yield as suggested by Staff, does not burden future ratepayers with higher rates as cautioned by OPC and AOBA, and recognizes that the economic conditions that drove and justified the use of accelerated tax benefits in Pepco's MYP1 have improved. The Commission also finds the resulting revenue requirement does not warrant a revenue offset at this time. Additionally, by disallowing revenue offsets in this proceeding, the Commission finds that there will be no revenue impacts from accelerated tax benefits for MYP2 to be considered in subsequent reconciliation filings related to MYP2. By declining to use offsets in the current revenue requirement, the Commission does not forestall Pepco's request to use accelerated tax benefits in the future should conditions and circumstances arise that warrant such an approach.

6. Late Payment Revenue

OPC

OPC witness Effron testified that Pepco's late payment revenue for this MYP2 is forecasted based on the three-year average from 2020 through 2022 and is calculated to be

250 *Id*.

$1,478,999 for each year of the MYP2. Mr. Effron pointed out that this calculation is not reasonable because it was reflective of abnormal conditions resulting from the COVID-19 pandemic when late payment fees had been suspended. He stated that "with late payment fees being charged again, late payment revenues increased to $2,171,000 in the 12 months ending March 31, 2022, and $3,315,000 in the twelve months ending March 31, 2023."[251]

Mr. Effron recommended that the forecast of late payment revenues should be modified to reflect the average of the actual late payment revenues in the twelve months ending March 31, 2022, and the twelve months ending March 31, 2023.[252] He also argued that since the late payments are based on the Company's billings, the forecasted late payment revenues should be based on the ratio of late payment revenues to retail sales for this period.[253] He calculated that for the twelve months ending March 31, 2022, and the twelve months ending March 31, 2023, the ratio of late payment revenues to retail sales was 0.38%.[254] Applying this factor to the forecasted retail sales for the years of the MYP2, Mr. Effron calculated late payment revenues of approximately $2.9 million per year (Exhibit DJE-2, Schedule C-1). These late payment revenues exceed the Company's forecast of late payment revenues by $1,449,000, $1,452,000, $1,455,000, and $1,457,000 for rate years 1, 2, 3, and the extended third year, respectively.

Pepco

In his Rebuttal, Pepco witness Leming testified that he found OPC witness Effron's proposed modification to be a reasonable approach to forecasting late payment revenues in this proceeding given the effect that the COVID-19 pandemic had on late payment revenues

[251] Effron Direct at 9-10.
[252] *Id*. at 10.
[253] *Id*.
[254] Effron Direct at 10.

during the period leveraged in the Company's initial projections.[255] Mr. Leming stated that he included ratemaking adjustment (RMA) 27 in Schedule (RTL-R)-1 to adopt OPC witness Effron's position and reflect its impact to the Company's proposed revenue requirement.[256]

Commission Decision

The Commission accepts the consensus approach reached by OPC and Pepco regarding the appropriate forecasting method to be used. Using forecasted data, the Commission finds that Pepco's costs for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

7. Financial Reporting Consistency

Staff

Staff witness Rielly testified that in both Case No. 9655 (Pepco's first MYP) and the current proceeding, the Company reported capital projects on a calendar year basis (12/31) rather than a fiscal year basis (3/31) used in the MYP Rate Years 1, 2 and 3.[257] Mr. Rielly recommended that the Commission direct the Company to implement financial reporting in this MYP2 so that Pepco reports capital project amounts, both budgeted and actual, on a fiscal year basis (3/31) not later than the beginning of MYP Rate Year 2 (4/1/2025).[258]

Pepco

In his Rebuttal, Pepco witness Barnett explained that Pepco manages the business on a calendar year basis for both O&M and Capital expenditures, and therefore, financial reporting is not available on a fiscal year basis.[259] Fiscal year reporting would take additional

[255] Leming Rebuttal at 4.
[256] *Id*.
[257] Rielly Direct at 10.
[258] *Id*.
[259] Barnett Rebuttal at 29.

time and resources for the Company to prepare and determine the variances, as the project managers are not managing projects on a fiscal year basis.[260] Mr. Barnett pointed out that Company witness Leming proposed that the MYP Rate Year 3E period will help transition the fiscal period to a calendar period which would mitigate the challenges related to fiscal year reporting.[261] Witness Barnett offered that if the Commission does not accept the extension period MYP Rate Year 3E, the Company proposes that the issue of fiscal year versus calendar year reporting be addressed in a lessons learned session where different parties can provide feedback.[262]

<u>Commission Decision</u>

The Commission accepts Staff witness Rielly's argument that Pepco elected to file its Case No. 9655 using a 12-month period ending March 31, and has had since 2021 to change its reporting and forecasting of individual capital projects.[263] In Case No. 9655, the Commission made clear that it found Pepco's forecasting for its capital projects unsupported, and the Company's budget-to-spending history included variances and fluctuations that did not provide the confidence needed to approve all the revenue requests.[264] It is unacceptable that the data used to justify the Company's request and its previous spend is not presented in a consistent manner. The Commission finds that it is Pepco's responsibility to ensure that the Commission and other parties are able to appropriately evaluate the reasonableness of Pepco's revenue requirement request through comparisons of actual and variances on similar reporting bases in the current MYP2 and any future rate case, whether MYP or traditional.

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[260] *Id*. at 29-30.
[261] *Id*. at 30.
[262] *Id*. at 31.
[263] Rielly Surrebuttal at 5.
[264] *Id*. (citing Order No. 89868, *Potomac Electric Power Company's Application for an Electric Multi-Year Plan*, Case No. 9655.) (June 28, 2021)

C. Contested Capital Programs and Projects

1. <u>OPC Proposed "Off-Ramp" Adjustment</u>

<u>OPC</u>

OPC witness Effron proposed an alternative approach for calculating Pepco's revenue requirement that approximates a test year of the type that would be used under standard ratemaking.[265] As explained in brief: "Mr. Effron calculated his non-[MYP] revenue requirement using Pepco's "plant as of March 31, 2024–net of accumulated depreciation and accumulated deferred income taxes–along with other elements of the revenue requirement based on values for the twelve months ending March 31, 2025."[266] In his Direct Testimony, he testified that his alternative approach for calculating a revenue requirement serves "a compromise" between the historic test years and the future or forecasted MYP test year approach.[267]

In its Initial Brief, OPC stated that "Mr. Effron's recommendation effectively stands-in for the rate base and operating income adjustments that would have been set under standard ratemaking."[268] Further, OPC argued that "Mr. Effron's approach to exclude plant additions after March 31, 2024, is reasonable because plant additions after that date would not yet be in service (or necessarily be used and useful) during the rate effective period."[269] OPC contended that this approach represented a reasonable net plant in service for Pepco as of March 31, 2024 that can be viewed as a "proxy" for historical test year net plant balances "with proforma adjustments for post-test year safety and reliability plant."[270] To calculate

[265] OPC Initial Brief at 57.
[266] *Id*.
[267] Effron Direct at 5.
[268] OPC Initial Brief at 57.
[269] *Id*.
[270] *Id*. at 57-58.

Pepco's non-MYP operating income using the alternative approach, "Mr. Effron adjusted expenses to eliminate the depreciation expense and property taxes on the plant additions after March 31, 2024 and adjusted the income tax expense to reflect the reduction to the interest deduction associated with rate base adjustments."[271]

Pepco Rebuttal

Pepco witness Leming claimed that OPC's alternative approach was "arbitrary at best" and argued that Mr. Effron's proposal sets rates based on a test year proposal that the Company did not advance and is unable to defend.[272] Witness Leming also argued that the Company has the burden of proof in a rate case and it has not prepared a traditional test year rate case that it can defend as just and reasonable in this proceeding and OPC does not have the authority to file a rate case on behalf of the utility which is akin to what they have done.[273]

OPC Surrebuttal

OPC witness Effron pointed out that the test years used by the Commission prior to MYPs could just as easily be described as "arbitrary" for authorizing post-test year safety and reliability plant in rate base without recognizing other post-test year changes in rate base.[274] He explained that there is nothing magical about the formulation previously used to set Pepco's rates under standard ratemaking.[275] "However, this is the formulation that the Commission in its judgment determined to be reasonable, and that's what was used."[276]

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[271] *Id*. at 58.
[272] Leming Rebuttal at 18-19.
[273] *Id*. at 19.
[274] OPC Initial Brief at 58.
[275] Effron Surrebuttal at 3.
[276] *Id*.

Mr. Effron testified that although Pepco did not advance the alternative approach, it is not clear what the Company is unable to defend.[277] He pointed out that "[t]he Company has the sources and calculations supporting [the] "off-ramp" revenue requirement, and they certainly have the resources to "defend" against this proposal."[278] Mr. Effron testified that even with the opportunity available to defend against the alternative approach the Company has not challenged the proposal directly or offered any adjustments or alternatives. More strikingly, Effron argued that "the Company has presented no argument that [the] off-ramp test year is erroneous or unreasonable…"[279]

Live Rejoinder

During the hearing, Pepco witness Leming conceded that OPC witness Effron's off-ramp adjustment approach, while not one advanced by the Company, is supported by the record evidence in this case. Specifically, witness Leming stated the following when questioned on cross examination by OPC's counsel, Mr. Ouslander:

> MR. OUSLANDER Question: "Do you agree with Mr. Effron that the record[] in this case is sufficient to support his alternative rate structure?"[280]
>
> MR. LEMING Answer: "I believe he has used information that is in the record to develop his proposal. I think I noted some of my reasons why I do not support it and I'm advocating against it, but I think he has certainly developed it based on information provided in the record in that manner."[281]

Mr. Leming further noted during cross-examination that he agreed with Mr. Effron that in order to calculate a historic test year additional information would be needed in the record; nonetheless, the record would support a Commission decision to use either Pepco's proposal for an MYP2 with a nine-month extension or Mr. Effron's alternative approach.

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[277] *Id*. at 4.
[278] *Id*.
[279] *Id*.
[280] Hearing Transcript, Vol. 6, 1228: 12-20 and 1229:15-22 (March 14, 2024).
[281] *Id*.

Specifically, witness Leming stated the following when questioned on cross examination by OPC's counsel, Mr. Ouslander:

> MR. OUSLANDER Question: "You and Mr. Effron both agree that additional information and time would be needed for an historic test year calculation in this case but that the record currently supports a Commission decision to use either Pepco's 45 month multi-year rate plan or Mr. Effron's alternative?"[282]
>
> MR. LEMING Answer: "Yes, I do."[283]

Commission Decision

As discussed above, the Commission's statutory responsibility when setting rates that are "just and reasonable" is laid out in PUA §§§ 4-101, 4-102 and 4-201. The Maryland Supreme Court has held that "No statute or law requires the Commission to use any particular rate setting method. This is because, under the "just and reasonable" standard, "it is the result reached not the method employed which is controlling."[284]

Here, and as discussed in more detail in Section III.A. above, the Commission elects to exercise its authority and use an approach that combines OPC's off-ramp adjustment to rate base with Pepco's requested MYP2 Rate Year 1 only. The Commission finds that the resulting revenue requirement will be just and reasonable and offers a compromise that works within the MYP construct, until we have concluded the lessons-learned proceedings. Pepco offered no defense against, or adjustments/alternatives to, Mr. Effron's alternative approach. Moreover, during the hearing, Pepco witness Leming conceded that OPC witness Effron's off-ramp adjustment approach, while not one advanced by the Company, is supported by the record evidence in this case.[285] Witness Leming also affirmed on cross examination that "the record currently supports a Commission decision to use either Pepco's

[282] *Id*.
[283] *Id*.
[284] *Office of People's Counsel v. Maryland Public Serv Comm'n*, 355 Md 1, 24 (1999).
[285] Hearing Transcript, Vol. 6, 1228:12-20 and 1229:15-22 (March 14, 2024).

45 month multi-year rate plan or Mr. Effron's alternative."[286] Witness Leming also testified that, if the Commission approved a revenue requirement using a forecasted test year just for multi-year rate year one instead of approving all three years, it would still promote transparency, rate predictability and safety and reliability–all of which Pepco has claimed are benefits of its MYP2.[287] And during the hearing, Witness Leming agreed that all these benefits–albeit to a lesser degree–would still be present if the Commission approved a revenue requirement with a forecasted test year for just MYP2 Rate Year 1.

The Commission, as acknowledged by the Company in its Initial Brief, "has the flexibility to approve a forward-looking plan of shorter duration" than Pepco's MYP2 proposal.[288] Therefore, the Commission has determined that is in the public interest to limit Pepco's cost recovery in this MYP2 to Rate Year 1 and reduce the revenue requirement increase by accepting OPC's off-ramp proposal for MYP2 Rate Year 1, and that this approach will yield a rate that is just and reasonable.

As previously discussed, because of the material concerns raised by parties as to the benefits of the MYP, that Commission is justified in approving the utilization of the off-ramp adjustment until the lessons-learned proceedings from the pilot MYPs is concluded. The Company is reminded that, had it also included in its proposal a revenue requirement based on an historic test year, the Commission could have accepted that proposal without the need for an off-ramp adjustment, thereby allowing the Commission to fully consider the appropriateness of the MYP approach through the lessons-learned proceedings. Unfortunately, the parties agreed the record was insufficient to convert the MYP to a traditional base rate case. The OPC off-ramp adjustment approach of setting net-plant in

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[286] *Id*.
[287] Hearing Transcript, Vol. 6, 1241:5-23 and 1242:1-9 (March 14, 2024).
[288] Pepco Initial Brief at 13.

service at the end of March 2024 while permitting an additional year of O&M projections at the end of March 2025 will still provide the Company with some of the benefits it claims it gains from the MYP structure.

2. 69kV Feeder Rebuild Program

Pepco

Pepco witness Young testified that the Company is seeking approval for three 69kV feeder hardening projects originating at Norbeck, Ritchie, and Palmer's Corner within MYP2.[289] Ms. Young stated that these projects were initiated to replace aging infrastructure of overhead circuits, mitigate outage risk by supporting increased storm resiliency while also combating against complications such as off right-of-way vegetation overgrowth.[290] The specific feeders slated for improvement under MYP2 include Projects 69079 (Norbeck), 69001 (Ritchie), and 69025 (Palmer's Corner).[291] Ms. Young noted that the 69kV feeder hardening program arose out of Case No. 9240 with the intent to harden three 69kV feeder substation supply feeders into each 69kV/13kV station to support greater storm resiliency.[292]

Witness Young then delineated the project work for each of the three feeders. She testified that the Ritchie feeder rebuild is projected to include approximately 10 total circuit miles with a total of 325 poles replaced. She noted that design for the project will be completed in 2025, with construction projected to commence the following year in 2026 and estimated to be in-service by 2027.[293] She also stated that the Palmer's Corner feeder rebuild is on track with the same design, construction, and in-service timeline as the Ritchie feeder

[289] Young Direct at 45.
[290] *Id*.
[291] *Id*.
[292] *Id*.
[293] *Id*.

rebuild, with proposed project work to include five (5) total circuit miles that will see the replacement of 125 poles.[294] Last, witness Young noted that the Norbeck feeder rebuild is estimated to begin design in 2026, with construction and a current in-service date that is outside of this current MYP planning cycle and PHI's long range planning window. The project work for the Norbeck feeder will include 14 total circuit miles and require replacement of approximately 400 poles. The Norbeck project is estimated to be in service in 2030 in the preliminary schedule.[295]

Witness Young argued that the hardening projects for 69kV feeders are beneficial to Maryland customers because "the loss of these 69kV feeders would create a long-term outage duration scenario for all customers served downstream from the substation."[296] She discussed how the Company completed a comprehensive review of 40 of the 69kV circuits in 2014 and identified thirteen (13) circuits that required work to address reliability issues. She remarked that the Company sought approval for work on all 13 69kV priority feeders in its first MYP, Case No. 9655, but the Commission denied recovery because the program was not cost-effective.[297] Witness Young explained that the Company is proposing hardening for the three 69kV feeders because it views these projects as imperative to mitigating risks posed by long term outages resulting from increasing weather events. Ms. Young testified that since 2016, the three feeders being proposed collectively experienced 74 interruptions and in this MYP2 Pepco commits to maintain the highest reliability metrics.[298]

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[294] *Id*. at 46.
[295] *Id*.
[296] *Id*.
[297] *Id*. at 47.
[298] *Id*. at 48-49.

Staff

Staff witness Austin testified that Pepco's 69kV Feeder Rebuild Program was developed to meet the Company's goal of having at least one hardened 69 kV feeder supply to every distribution substation in case of a large-scale storm event.[299] Mr. Austin noted that the current cost estimate of the Ritchie rebuild is $41 million with a variance of ±50 percent; the current cost estimate of the Palmer's Corner rebuild is $32 million with a variance of ±25 percent; and the current cost estimate of the Norbeck rebuild is $47.6 million with a variance of ±25 percent.[300] He testified that the combined cost estimate of these three rebuilds is $120.6 million with variances that could increase costs up to $161 million.[301]

Staff witness Austin explained that a guiding principle in evaluating reliability investments is that the cost of improvements should not exceed the value of the economic loss to customers that the system improvement is intended to prevent.[302] Mr. Austin further noted that he used the Department of Energy's (DOE) Interruption Cost Estimator ("ICE") tool to determine the cost to customers for sustained interruptions caused by outages on the three 69 kV feeders for which the Company is seeking funds to rebuild in MYP2.[303]

Based on witness Austin's examination, the DOE ICE calculator showed that the total cost of an interruption of service to customers served by the Ritchie 69kV feeder (69001) is approximately $5 million, the total cost of an interruption to service for customers served by the Palmer's Corner 69kV feeder (69025) is approximately $1.9 million, and the total cost of an interruption to service for customers served by the Norbeck 69kV feeder (69079) is approximately $6.8 million. Mr. Austin concluded that based on the ICE calculator, "the cost

[299] Austin Direct at 39.
[300] *Id*. at 40.
[301] *Id*.
[302] *Id*. at 46.
[303] *Id*.

of rebuilding these three feeders far outweighs the cost of interruptions caused by these feeders.[304] Therefore, witness Austin argued that just as in Case Nos. 9602 and 9655, "Pepco had not then and still has not now provided any evidence that: (1) its 69 kV Feeder Rebuild Program provides any notable impact on normal "blue sky" reliability and (2) the Company has not performed an avoided outage cost benefit analysis for this program the way BGE did for its proposed Reliability Investment Plan in its second MYP application."[305] Mr. Austin contended that the evidence that the Company supplied during discovery in this MYP2 showed the cost of rebuilding the feeders far outweighs the cost of interruptions caused by each of the three 69kV feeders and that none of the outages in the previous seven years on two of the three feeders resulted in interruptions. Mr. Austin recommended that the Commission disallow Pepco's request for the 69kV Feeder Rebuild Program because the rebuilds will "add little in terms of blue sky reliability to the electric distribution system and disputable resiliency benefits."[306] However, Staff witness Austin recommended, as he did in BGE's second MYP, that the Commission "establish an administrative docket to consider at the very least the implementation of resiliency standards and objectives, metrics by which to measure the effectiveness of resiliency investments, resiliency reporting requirements and penalties for failure to meet any agreed upon resiliency standards and objectives."[307]

OPC

OPC witnesses Alvarez-Stephens testified that Pepco is requesting to spend $56 million rebuilding 69kV circuits that have experienced the most frequent equipment outages

[304] *Id*. at 48.
[305] *Id*.
[306] *Id*. at 49.
[307] *Id*.

since 2016.[308] They noted that the Company cited 74 equipment total outages since 2016 on three 69kV circuits and proposed to rebuild those circuits in the MYP2 period.[309] Alvarez-Stephens discussed that during discovery, Pepco reported that only one of the 74 69kV circuit outages since 2016 resulted in a sustained service interruption greater than five minutes to customers. In fact, the single interruption amounted to 7.8 minutes for 1,009 customers.[310] Alvarez-Stephens argued that "[t]here is simply no way that the avoidance of a single service interruption of 7.8 minutes over 7 years justifies a capital spending program that will cost Maryland customers a minimum of $56.8 million."[311]

Alvarez-Stephens testified that the Company failed to conduct benefits and costs analysis for alternatives to rebuilding the 69kV circuits.[312] They also noted that one of the 69kV rebuild projects included in the MYP2 had not been reviewed by Company management and that the Company has spent $3.1 million in recent years hardening the circuits Pepco proposed to rebuild.[313] Alvarez-Stephens commented that the Company indicated that the 69kV circuits proposed for rebuilding serve some Energy Justice Dashboard communities, but OPC countered that almost every 69kV circuit serves both Energy Justice and disadvantaged communities.[314] Alvarez-Stephens recommended that the Commission disallow the Company's request for the 69kV Feeder Rebuild Program until Pepco can quantify the reliability improvement benefits and costs of all available alternatives

[308] Alvarez-Stephens Direct at 59.
[309] *Id*.
[310] *Id*. at 60.
[311] *Id*.
[312] *Id*. at 61.
[313] *Id*.
[314] *Id*.

and can show that the alternative proposed for MYP cost recovery is the most cost-effective.[315]

Pepco Rebuttal

Pepco witness Young argued that Staff witness Austin's cost-benefit analysis does not factor in large storm events that can cause failures on the existing Pepco 69kV overhead systems.[316] She noted that significant failures on the Pepco 69kV circuits due to major storms last occurred from 2010 to 2012. Witness Young stated that Pepco performed an analysis using examples of major storm events from that time period to calculate the additional avoided costs. Using the 2010 to 2012 major storm event data, witness Young used the ICE calculator to estimate interruption costs and compared that to the estimated circuit rebuild project costs for the three 69kV circuits.[317] According to the Company's analysis, there would only need to be at most two major storm events to achieve the societal benefits to justify the estimated 69kV rebuild projects.[318]

Regarding OPC's alternative approaches, Ms. Young disagreed with OPC's suggestion of rebuilding only one (1) 69kV circuit per grid planning cycle and claimed that would not be viable as it would take over 30 years to complete the rebuild plan.[319] She also argued that OPC's proposal to replace wood poles with steel towers one at a time is not viable because the 69kV circuits on the existing poles were not built to withstand the effects of damaging weather storm events.[320]

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[315] *Id*. at 62.
[316] Young Rebuttal at 31.
[317] *Id*. at 32-33.
[318] *Id*.
[319] *Id*. at 34.
[320] *Id*.

Commission Decision

In Order No. 89868, in Case No. 9655 (Pepco's first MYP), the Commission advised the Company that at the end of the MYP period, "Pepco should be prepared to thoroughly demonstrate the prudence of its decisions whether to proceed, or not, with the 69kV rebuild program … ."[321] Here the Company requests to continue the 69kV rebuild program on three circuits that have experienced the most frequent equipment outages since 2016. However, as pointed out by Staff and OPC, the Company provided limited analysis on alternatives to the 69kV rebuild program and did not perform detailed benefit-cost analysis of the various options. Ms. Young even admits that the Company "has not performed an extensive and detailed benefit-cost analysis report," although she did note that the Company evaluated rebuilding the 69kV circuits as underground lines and looked at a no-build alternative. [322]

The Commission finds that Pepco still has not demonstrated how the cost of its 69kV Rebuild Feeder Program adds value in terms of blue-sky reliability and continues to fail to provide detailed benefit-cost analysis of its 69kV Rebuild Feeder Program and various alternatives. The Commission recognizes that the Company based its benefit-cost analysis on major storm data from 2010 to 2012 but, as Staff points out in Surrebuttal, the Company's analysis is more supportive of resiliency planning than reliability improvements.[323] Witness Young even admitted in her Rebuttal testimony that "these 69kV rebuild projects are being proposed for purposes of improving resiliency."[324] To the extent there are costs that impact the revenue requirement period approved by the Commission, the Commission accepts Staff and OPC's recommendation to disallow the Company's revenue increase request associated

[321] Order No. 89868 at 86.
[322] Young Rebuttal at 33.
[323] Austin Surrebuttal at 9.
[324] Young Rebuttal at 36.

with the 69kV Feeder Rebuild Program. It is noted there are no revenue requirement impacts associated with this program, as no proposed project was projected to go into service during the authorized rate effective period.[325] Similar to Case No. 9655, should the Company choose to continue to pursue the 69kV Feeder Rebuild and seek cost recovery at the time it is in service, Pepco should be prepared to thoroughly demonstrate the prudence of its decisions to proceed with the 69kV rebuild program.

Additionally, the Commission accepts Staff recommendation to initiate a workgroup[326] to consider the implementation of resiliency standards and objectives, metrics by which to measure the effectiveness of resiliency investments, resiliency reporting requirements and the penalties for failure to meet the agreed upon resiliency standards.[327] As discussed earlier, because forecasted data is being used, the Commission will limit Pepco's cost recovery in this MYP 2 to Rate Year 1, and the Commission finds that Pepco's costs for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

3. <u>13kV Underbuild Projects (Projects 70099 and 70100)</u>

<u>Pepco</u>

Pepco witness Young testified that the 13kV Underbuild projects were necessitated by the 69KV Rebuild projects.[328] She explained that "[w]hen a pole with a 69kV circuit on it is replaced and has collocated 13kV circuits and equipment, the 13kV circuits and equipment

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[325] Leming Rebuttal at (RTL-R)-3 and Rielly Surrebuttal Exhibit MR-3.
[326] On March 25, 2024, the Commission issued a notice directing Technical Staff to convene a workgroup–within Case No. 9353–to consider "the implementation of resiliency standards and objectives, metrics by which to measure the effectiveness of resiliency investments, resiliency reporting requirements, and penalties for failure to meet any agreed upon resiliency standards or objectives" for all resiliency-related matters before the Commission. (Maillog No. 308426)
[327] Young Rebuttal at 10.
[328] *Id*. at 36.

must also be replaced onto the newly installed pole. Leaving the 13kV circuits and equipment on the existing poles would create an undesirable situation where the existing wood pole would be left directly next to the newly installed wood or steel pole."[329] In witness Young's hearing testimony, she acknowledged that if the Commission declined to approve the Company's 69kV Feeder Rebuild Program, then the 13kV Underbuild projects would not be necessary.[330]

<u>Staff</u>

Staff witness Lo testified that Pepco proposed two 13kV Underbuild Projects to include: 1) 70099 - 13 kV Underbuild Work for 69001 Rebuild, and 2) 70100 – 13 kV Underbuild Work for 69025 Rebuild. He noted that Pepco described these projects as consisting of replacing existing wood poles as part of the 69kV rebuild because they are near end of life.[331] He further indicated that "[t]here are approximately 500 poles identified to be replaced or transferred on these projects" which are connected to the Ritchie and Palmers Corner circuits.[332] Staff witness Lo contended that Pepco was unable to provide any quantitative reliability benefits that further justify the necessity of the 13kV projects. He noted that the Company acknowledged that the 13kV underbuilds collocated on the Ritchie and Palmer's Corner poles will have minimum benefits when the construction is completed as these projects are not intended to address reliability on the 13kV underbuild lines.[333] Therefore, Mr. Lo recommended that the Commission disallow all funds associated with the two Underbuild Projects.[334]

329 *Id*.
330 Hearing Transcript Vol. 1, 296:3–11 (March 7, 2024).
331 Lo Direct at 12.
332 *Id*.
333 *Id*.
334 *Id*.

Commission Decision

As discussed earlier, the Commission accepts Staff and OPC's recommendation to disallow the 69kV Feeder Rebuild Projects. Therefore, as noted by Pepco witness Young and in the Company's initial brief,[335] the 13kV Underbuild Project works in tandem with the 69kV Feeder Rebuild Projects and would not be necessary if the 69kV Feeder Rebuild Project is rejected. Therefore, the Commission accepts Staff's recommendation to disallow all costs associated with the 13kV Underbuild Projects in the MYP2. As demonstrated in Staff witness Rielly's surrebuttal exhibit MR-3a, there is no plant in service (PIS) to impact the revenue requirement in Rate Year 1. The Commission also notes that, should Pepco move forward with these programs, they will bear the burden of demonstrating the prudency and sufficiency of costs related to these projects.

4. National Harbor Substation and Livingston Road Battery Energy Storage System (BESS)

OPC

OPC witnesses Alvarez-Stephens testified that the National Harbor Substation Project was one of two examples of premature spending to expand distribution grid capacity in Pepco's MYP2.[336] Alvarez-Stephens testified that Pepco's MYP2 includes $49.3 million to begin construction of a new substation, called National Harbor, to replace the Livingston Road substation that currently serves the area.[337] They noted that the Company had first proposed the National Harbor substation in MYP1, but the Commission removed the program from the former MYP, citing a lack of load growth.[338] Alvarez-Stephens indicated

[335] Pepco Initial Brief at 33.
[336] Alvarez-Stephens Direct at 62.
[337] *Id*. at 63.
[338] *Id*.

that "Pepco's current load forecast for the circuits served by the Livingston Road substation indicates almost zero load growth is expected and that the circuits' existing capacity (76.5 MVA) is more than adequate for the foreseeable future."[339] Alvarez-Stephens recommended that the Commission disallow the entire $49.3 million for the National Harbor Substation forecasted in Pepco's MYP2.[340] Additionally, they argued that "[u]nless and until load forecasts—backed by construction commitments from qualified developers regarding specific new facilities, loads, and dates, or forecasts showing DER [distributed energy resources], EV [electric vehicle], and building electrification driven load growth—indicate the capacity of the equipment will be exceeded within three years (to allow for substation design and equipment procurement), the Commission should continue rejecting Pepco's requests to replace the Livingston Road substation."[341]

Staff

In his Direct testimony, Staff witness Wilson recommended disallowing Pepco's Capacity Expansion–Distribution Projects Nos. 72727, 72730, and 72731.[342] He noted that these projects are proposed to address a forecasted 1% overload at Livingston Road Substation, which the Company has stated will no longer occur within the 10-year investment window, and because the in-service date for the National Harbor Sponsor Group has been pushed out beyond the 10-year investment plan window.[343] Staff witness Lo testified that he supported the recommendation of Staff witness Wilson for disallowance of the National Harbor Substation Projects Nos. 72727, 72730, and 72731.[344]

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[339] *Id*.
[340] *Id*. at 64.
[341] *Id*.
[342] Wilson Direct at 15.
[343] *Id*.
[344] Lo Direct at 7.

Pepco Rebuttal

In her Rebuttal testimony, Pepco witness Young discussed the purpose of each project and clarified that they are separate projects. She testified that the Livingston Road BESS project was initiated for two reasons: (1) to pilot the installation of a BESS within the Pepco Maryland territory, and (2) to address an overload condition at Livingston Road substation; the BESS would defer the need for a new substation.[345] She also stated that the National Harbor substation project is the permanent solution to relieve the overload condition at Livingston Road substation.[346] She also noted that the in-service date for National Harbor substation is currently scheduled for 2029, which is outside the MYP2 period, so she claimed that any expenditure on this project would not affect customer rates during the MYP2.

Regarding the BESS project, Ms. Young testified that the Company accepted Staff's recommendation to remove $3.1 million in project costs from Pepco's Rate Year 1 and Rate Year 2 reconciliations for Pepco's MYP1. Staff witness Austin argued that there were deficiencies in contractor progress monitoring and project management causing $3.1 million in project costs incurred through 2022 to be imprudent.[347] Witness Young testified that Pepco witness Leming removed these expenses from rate base in this MYP2 filing.[348]

Regarding the National Harbor Substation Projects, the Company identified three projects: "(1) 72727: National Harbor Substation - Distribution feeders, (2) 72730: National Harbor Substation – New 69/13kV Distribution Substation, and (3) 72731: National Harbor Substation – Supply Feeders.[349] In Staff DR 34-1, Pepco described the purpose of each project. Specifically, the purpose of Project No. 72730 is to construct a new 69 kV/13.8 kV

[345] Young Rebuttal at 56.
[346] *Id*.
[347] *Id*. at 58.
[348] *Id*. at 61.
[349] Lo Direct at 7.

National Harbor Substation, which is anticipated to go into service in June 2029. The purpose of Project No. 72727 is to construct 13.8 kV distribution feeders out of National Harbor Substation, and the purpose of Project No. 72731 is to construct 69 kV feeders to supply the new National Harbor Substation.[350] The Company explained that a significant load growth at National Harbor is associated with future development projects that could range from 30 MVA [megavolt-ampere] to 60 MVA and that the projects are necessary to mitigate impacts to reliability from overloading the Livingston Road Substation, as well as to support future development in the National Harbor area.[351]

Pepco witness Young conceded that the Company's recent load forecast does indicate a lack of growth in the National Harbor area, but indicated that Pepco plans to "continue to monitor new load application in the area and look to reassess the need for the project upon approval of the next 10-year forecast."[352] She noted that the Company proposes addressing variances to proposed spending plans during the annual reconciliation process.[353] Ms. Young stated that Staff's proposed reduction of expenditures related to National Harbor has no impact on the Company's proposed revenue requirement since the project was not forecasted to go into service during the MYP.[354]

Commission Decision

For the Livingston Road BESS project, the Commission accepts removal of the costs from the case. As the Company has represented, there is no impact to the revenue requirement period under consideration by the National Harbor Substation projects, and so the Commission offers no guidance at this time.

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[350] *Id*.
[351] *Id*.
[352] Young Rebuttal at 61.
[353] *Id*.
[354] *Id*.

5. EU Customer Flight Path Program

Pepco

In her direct testimony, Pepco witness Hightower described Project 79264: EU Customer Flight Path Program, as customer service projects which "focus on increasing self-service adoption by making it easier for residential and commercial customers to manage their energy needs online."[355] Ms. Hightower claimed that other benefits of the project include: helping to increase participation in energy assistance and energy efficiency programs contributing to the Company's goal of enhancing affordability; improving communications during power outages; aligning with customer expectations regarding digital self-service; enhancing the customer's online experience in areas such as billing and payments, managed account services, start, stop, and move; and improving access to online platform for current and future large commercial customers.[356]

In her rebuttal testimony, Ms. Hightower acknowledged that when the MYP was filed, the project was in the demand phase; however, it was subsequently approved by the PHI Board of Directors as of December 2023 and will begin execution in early 2024.[357] She testified that given that MYPs span multiple years, there are projects that are expected to start in the future years but before the next MYP and for these projects, the Company develops initial requirements, designs, and estimates of costs to determine if they should be included in the MYP.[358] Witness Hightower reiterated that the EU Customer Flight Path Program is focused on enhancing the way customers interact with customer facing digital tools and will

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[355] Bunch Direct at 11.
[356] Hightower Direct at 36.
[357] Hightower Rebuttal at 7-8.
[358] *Id*. at 8.

help maintain and improve the customer experience.[359] She discussed that customer survey data indicates that the Company's website and mobile app experiences need improvement to meet customer expectations and that the EU Customer Flight Path Program is the most cost-effective method for Pepco to achieve this.[360]

Ms. Hightower argued that there were several quantitative benefits to be gained from the EU Customer Flight Path Program. Specifically, she contended that the digital tools developed from the EU Customer Flight Path Program will significantly reduce the time and effort that customers need to complete common online tasks, such as making payments, enabling customers to enroll in payment arrangements with fewer steps, and reducing the Company's cost of supporting the customer.[361] She noted that since 2019, the number of calls handled by customer service representatives in Pepco Maryland has dropped from about 961,000 to 588,000 in 2023.[362] Ms. Hightower attributed that shift to increased use of the Company's digital tools and believes that will only continue to improve with the EU Customer Flight Path Program.[363] Ms. Hightower also noted that the project is being implemented at all Exelon utilities and was included in BGE's Case No. 9692.[364]

Staff

In her direct testimony, Staff witness Bunch stated that the Company had not performed a thorough analysis, had not explored alternatives, and had not performed a cost/benefit analysis.[365] Ms. Bunch noted that in response to Staff DR 21-6c, the Company indicated that it was currently in the demand phase of the project life cycle and had begun the

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[359] *Id*.
[360] *Id*. at 9-10.
[361] *Id*. at 10.
[362] *Id*.
[363] *Id*.
[364] *Id*. at 13.
[365] Bunch Direct at 14.

authorization phase.[366] Staff witness Bunch testified that even though the Company included the project as part of its MYP2 application, the project had not received internal review through the Company's project concurrence committee's authorization review.[367] Ms. Bunch recommended that the costs associated with the Customer Flight Program be disallowed since the project initially had not received internal approval at the Company. She argued that the Company needed to provide additional information that indicates that the projects have net benefits versus costs.[368]

In her Surrebuttal, Ms. Bunch acknowledged that in Company witness Hightower's Rebuttal she discussed alternatives to the Customer Flight Path Program and listed some program benefits. Nonetheless, she argued that Ms. Hightower did not provide the benefits in a quantified form, and therefore maintained her recommendation to disallow the costs associated with the Customer Flight Program in the MYP2.

Commission Decision

The Company asserted that the EU Customer Flight Path Program is the "most cost-effective method" for Pepco to achieve the improvements that it seeks to meet customer expectations. However, this assertion is not supported by quantitative data showing how this method compares with other alternatives that the Company investigated. The Commission recognizes that Ms. Hightower does provide some qualitative assessment of alternatives in her rebuttal testimony. Nonetheless, the Commission finds that the Company should be able to provide additional quantitative data showing how additional investment in the EU Customer Flight Path improves the customer experience. Such quantitative data may include,

[366] *Id*. at 15.
[367] *Id*.
[368] *Id*. at 17.

but is not limited to: increased utilization rates for online bill pay over time, utilization rates of customers making bill payment arrangements through online tools, tracking the number of customer sign ups in energy assistance and energy efficiency programs using online tools, and tracking better utilization of online tools by commercial customers. This is not an exhaustive list, but the Commission expects that the Company should be able to provide quantitative data supporting witness Hightower's claims of the benefits of additional investments in the EU Customer Flight Path Program.

While the Commission encourages the Company to continue its focus on improving the customer experience through ease-of-use of the Company's digital tools that help customers manage their energy needs in a more efficient manner, the Commission finds that the record lacks quantitative evidence supporting the need for additional investment in the IT systems' budget in the EU Customer Flight Path Program at this time. Therefore, the Commission accepts Staff's recommendation to disallow the EU Customer Flight Path Program in this MYP2. Using forecasted data, the Commission finds that Pepco's costs for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

6. Green Button Connect Program

Staff

Staff witness Bunch argued that the Company has not performed a thorough analysis for the Green Button Connect My Data Program, that it was in the demand phase of the IT Project Life Cycle, and that it is expected to go into authorization in early 2026.[369] Ms. Bunch recommended that the costs for the Green Button Connect My Data Program not be

[369] Hightower Rebuttal at 15.

included in the MYP2. In her Surrebuttal, Ms. Bunch stated that "[i]n response to Staff DR 86-8, the Company stated that the benefits of this program do not outweigh the costs, at this time."[370] Therefore, witness Bunch maintained her recommendation that the Commission disallow cost recovery of this program in MYP2.

Pepco Rebuttal

Pepco witness Hightower testified that the Green Button Connect My Data project builds upon a previous project "Green Button," that was implemented in response to a White House "call-to-action" for utilities to provide their customers an easy and secure way to access their energy usage information.[371] The program encouraged utilities to provide advanced metering infrastructure (AMI) interval usage data in a standardized digital format, which can easily and securely be shared by customers with third parties who could further assist customers with monitoring and managing their energy usage.[372] Ms. Hightower explained that the "connect my data" component being proposed in this MYP2 would allow customers to benefit from a variety of services that aim to help customers understand and manage their energy use in a more efficient way.[373] Witness Hightower testified that at the time of Pepco's MYP2 application, the project was in the demand phase of the IT life cycle and a comprehensive alternative solution had not been completed.[374] She stated that the "development and implementation of Green Button Connect My Data is contingent upon a DC Public Service Commission decision … ."[375]

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[370] Bunch Surrebuttal at 4.
[371] Hightower Rebuttal at 11.
[372] *Id*.
[373] *Id*.
[374] *Id*.
[375] *Id*. at 11-12.

Ms. Hightower indicated that one of the primary benefits of the Green Button Connect My Data Program will be to help customers who want to take advantage of available products that help them monitor their AMI meter usage in a cost-efficient way, by giving them the ability to share their AMI data with third-party companies who offer services such as smart thermostats, solar-panels, and energy consulting services.[376] She also noted that once implemented, the program would replace the manual download and data entry process with an automatic, reliable, and secure data sharing with third parties.[377] This could result in greater energy saving for customers, higher customer participation in energy efficiency products and tools, and participation in an industry standardized data sharing practice which can be used for existing and future "green" products in the market.[378]

Ms. Hightower disagreed with Staff witness Bunch's recommendation for disallowance and argued that the Green Button Connect My Data Program is following the Company internal vetting/approval process and that the Company has provided all available project presentations as part of the MYP2 proceeding and Staff has had an opportunity to view the materials now and in the future.[379]

Commission Decision

Since the project is not expected to go into the project authorization phase until early 2026, the Commission takes no action on this project. To the extent the Company seeks cost recovery of this project at a later date, Pepco should be prepared to defend the benefit and costs of pursuing the program, including how such upgrades make it easier for customers to use their data with non-utility services.

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[376] *Id*. at 12.
[377] *Id*.
[378] *Id*.
[379] *Id*. at 13-14.

7. Substation Equipment Replacement

Pepco

Pepco witness Young testified that projects that fall within the executive category of System Performance–Substation are designed to maintain and/or improve the reliability, safety and operation of the substation infrastructure.[380] Ms. Young stated that some of the projects in the MYP2 for which the Company seeks approval include Pepco's Fire Protection Replacement Projects.[381] She explained that these projects are intended to revitalize substations to ensure the safety of employees and customers while also safeguarding critical equipment at the substation-level in the event of a fire.[382] These projects are also implemented to meet certain design standards to make transformers less susceptible to fire in case of emergency.[383] Other types of projects under this category in the MYP2 include:

> Metzerott West Substation, Switchgear replacement project. Ms. Young explained that the switchgear, built in 1960, is aged and in deteriorated condition.[384] Due to its age and obsolescence, General Electric is no longer supporting maintenance and repair of this legacy equipment.[385] The relays have not been updated and the building has water intrusion issues. Complete replacement of the existing equipment and structures with a new building, new switchgear, and relaying and control equipment will both resolve the ongoing operational, maintenance, and reliability issues and consolidate the site equipment layout. The project has an estimated in-service date of December 2026.[386] Ms. Young indicated that there is no other alternative to replacement because the equipment is obsolete and replacement parts are not available. She cautioned that failure to replace this switchgear places the Company at increased risk of customer outages due to mis-operation of the equipment.[387]
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> Replace 2T Transformer at Bells Mill (Sub 121) project. Ms. Young testified that the "2T transformer relative saturation of water in the oil is high; in addition, the last oil sampling indicated that there was high acetylene gas present, therefore it is recommended that the Company replace the aging transformer and all related

[380] Young Direct at 50.
[381] *Id*.
[382] *Id*.
[383] *Id*.
[384] *Id*. at 53.
[385] *Id*.
[386] *Id*.
[387] *Id*.

equipment."[388] Ms. Young indicated that this project has an estimated in-service date of April 2027.

Replace 4T Transformer at Bells Mill (Sub 121) project. Ms. Young testified that "[t]he 4T transformer has been in service for 52 years and has exceeded its useful life as confirmed through oil sampling. The relative saturation of water in the oil is high; in addition the last oil sampling indicated that there was high acetylene gas present in the oil. This can result in thermal problems that can often develop into electrical fault and eventual failure."[389]

Staff

Staff witness Austin testified that the "projects under this category fall in the gray area between discretionary and non-discretionary."[390] He explained that these projects are mainly to address reliability problems brought about by aging infrastructure, the need or desire to improve physical security, the need or desire to reduce fire-related risk, and the need to comply with EPA regulations at the Company's substations."[391] Mr. Austin testified that for its reconciliation of Rate Year 1 and Rate Year 2, the major variance was largely due to the Company's efforts to build a spare transformer pool.[392] Staff found that these expenditures were not unreasonable given the recent supply chain issues related to power transformers.[393]

OPC

OPC witnesses Alvarez-Stephens testified that they identified 40 projects in Pepco's MYP2 that appear to involve prospective replacement of substation equipment. They pointed out that these projects are not a part of a distinct program identified in Pepco's proposed

[388] *Id*. at 53-54.
[389] *Id*. at 54.
[390] Austin Surrebuttal at 21.
[391] *Id*.
[392] *Id*.
[393] *Id*.

capital plan.[394] OPC defined prospective replacement of substation equipment as "the replacement of substation equipment that has passed functional and diagnostic tests."[395] The purpose of these tests is to proactively identify equipment at risk of failure, and to repair or replace equipment that fails such tests. Alvarez-Stephens take issue with the fact that "Pepco is replacing substation equipment that has passed functional and diagnostic tests, citing equipment age and 'expert opinion' regarding equipment condition" and failed to offer any analysis that the dollar value to customers of reliability improvements from prospective replacement exceeds the incremental costs of such replacement.[396]

Alvarez-Stephens stated that for Rate Year 1 and Rate Year 2 of Pepco's first MYP, the Company spent about $13.5 million and $20.1 million annually on such replacement. In its MYP2, Pepco proposed to expand this program by spending an average of $26.3 million annually from 2024-2027, which is nearly double the annual amount from 2021.[397] Alvarez-Stephens expressed concern that Pepco does not present prospective substation replacement as a significant capital spending program in its MYP2. They argued that if they had not done a careful review of Pepco's discovery responses, they would never have identified expenditures for prospective equipment replacements that amount to almost $28 million annually by 2027.[398]

Alvarez-Stephens testified that to support prospective equipment replacement, the Company often used qualitative statements characterizing the equipment as "reaching the end of its useful life" to serve as the rationale for equipment replacement.[399] OPC points out that

[394] Alvarez-Stephens Direct at 43.
[395] *Id*. at 44.
[396] *Id*.
[397] *Id*. at 44-45.
[398] *Id*. at 45.
[399] *Id*. at 46.

the term "'useful life' is not an operating concept used to justify equipment replacement; rather, it is an accounting concept used to determine equipment depreciation rates and depreciation expense."[400] Alvarez-Stephens argued that the proper way to determine whether prospective replacement is justified is by performing a cost-benefit analysis.[401]

In their direct testimony, OPC witnesses Alvarez-Stephens discussed a few key questions that would help determine the benefits of discretionary capital spending projects such as prospective equipment replacements. Those questions include: (1) What is the adverse event (in this case a service interruption) the investment intends to avoid? (2) What reduction in the likelihood of this adverse event will the investment deliver?; and (3) What is the consequence (in dollars) to customers of the adverse event if it were to occur?[402] Alvarez-Stephens conducted a cost-benefit analysis using the U.S. Department of Energy's online Interruption Cost Estimator ("ICE") tool. Alvarez-Stephens analysis shows that the cost to replace substation power equipment far exceeds the value of the reliability improvements such replacements would yield.[403] For example, they estimate the customer value of the reliability improvement from a power transformer replacement as being $134,292, but Pepco's average cost to replace the power transformer is $4 million.[404]

OPC argued that "Pepco has not shown that any of the equipment it plans to replace has failed diagnostic testing, nor has it shown how the customer value of such replacements justify the costs."[405] Therefore, OPC recommends that "recovery of all prospective substation equipment replacement spending in 2021 and 2022 be disallowed, and that all proposed

[400] *Id*.
[401] *Id*. at 48.
[402] *Id*. at 49.
[403] OPC Initial Brief at 30.
[404] *Id*.
[405] *Id*.

prospective replacement spending in Pepco's MRP 2 be eliminated."[406] Instead, OPC witnesses Alvarez-Stephens recommend Pepco continue its historical practice of repairing or replacing substation equipment that fails functional or diagnostic tests.[407]

Commission Decision

The Commission finds that Pepco's program to proactively replace substation equipment that is aging and susceptible to failure is reasonable. Pepco witness Young testified that "the Company's approach to asset replacement decisions is based on various factors which includes but is not limited to functional testing, visual inspections, operation history, subject matter expert's opinion, material lead time, outage coordination, customer impact and good engineering."[408] Ms. Young further explained that the Company has many aging assets that require complex planning for replacement and continuous proactive replacement of assets is required to maintain the level of system reliability to which Pepco customers are now accustomed.[409] She aptly argued that using OPC's "low-cost approach to replacing aging equipment would increase the risk of poorer safety and reliability performance and the risk of more frequent and longer duration of outages for customers" [410] and cited specific instances in her rebuttal testimony of how proactive replacement programs have benefited customers.[411] Another important point raised was that, during an emergent failure, "Pepco cannot competitively bid its engineering and construction contracts" to obtain best cost options, as the Company's primary emphasis at that time is maintaining a safe and

[406] Alvarez-Stephens Direct at 52.
[407] *Id*.
[408] Young Rebuttal at 19.
[409] *Id*.
[410] *Id*.
[411] *Id*. at 20.

reliable system with the least amount of customer impact.[412] That stated, OPC raises valid concerns that substation equipment can and does operate past its useful life.

The Commission is also troubled by Pepco's discussion regarding benefit-cost analysis in relation to these types of projects.[413] Any investment made to the distribution system presumably is improving or maintaining reliability. The Commission expects the Company to put in place tighter reviews and justifications on prospective equipment slated for replacement that have passed functional and diagnostic testing and is currently operating reliably. Additional public forums for considering improvements to these types of programs include Case No. 9335 and the Commission's Distribution System Planning docket.

Finally, the Commission must balance the benefits of pursuing these types of programs against their cost to ratepayers. To effectuate this balance, the Commission will reduce the Company's budget for the proactively replaced substation equipment identified by OPC by capping the incremental spend plant placed into service in Bridge Year 2 and Rate Year 1 at Bridge Year 1 levels of $15,526,000 per year.[414] Using forecasted data, the Commission finds that Pepco's costs for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

8. 69kV Benning Substation

OPC

OPC witnesses Alvarez-Stephens point out that Pepco proposed to rebuild the Benning Road 69kV substation as part of its capital spending plan during MYP2.[415] Pepco forecasts $61.5 million in capital spending for the project in MYP2 with additional costs

[412] *Id*. at 26.
[413] *Id*. at 29-30.
[414] Leming Rebuttal at (RTL-R)-3 at 2 of 3.
[415] Alvarez-Stephens Direct at 52.

anticipated after 2027.[416] Alvarez-Stephens testified that the Benning Road 69kV Substation is a subtransmission[417] substation that distributes power to four distribution substations in the District of Columbia.[418] In the summer of 2019, one of these distribution substations (the Florida Street substation) went out causing service interruption for 50 minutes to 15,926 customers, and a service interruption of about 12 hours to an additional 5,537 customers.[419] "Through this project, Pepco proposes to replace the current Air Insulated Switchgear (AIS) ring bus configuration with a new Gas Insulated Substation breaker and a half configuration, and install new transformers and new control and relay systems."[420] Based on OPC witnesses Alvarez-Stephens' assessment, "the project will not come close to delivering reliability improvements commensurate with its costs."[421] They testified that "while reliability improvements to the District of Columbia appear almost non-existent relative to costs, reliability improvements to Maryland will be even smaller, because all the substations that will supposedly benefit from the project's alleged reliability improvements service the District of Columbia."[422] The cost of subtransmission project work is split between the company's Maryland and District of Columbia customers according to a peak-load contribution formula established in 1969."[423]

Alvarez-Stephens argued that Pepco's justifications for the rebuilding of this project were "woefully insufficient" and unsupported by the record.[424] They indicated that

[416] *Id*.
[417] *Id*. at 56 explaining that "The Benning 69kV substation is part of Pepco's subtransmission network. Generally, the subtransmission network consists of circuits between distribution substations, as well as the subtransmission voltage (34kV and 69kV) equipment in both distribution and transmission substations."
[418] Alvarez-Stephens Direct at 52.
[419] *Id*. at 52-53.
[420] OPC Initial Brief at 23.
[421] Alvarez-Stephens Direct at 54.
[422] *Id*. at 55-56.
[423] *Id*. at 56.
[424] *Id*. at 56-57.

"equipment in the Benning 69kV Substation had a net book value of $15.1 million at the end of 2022," which, if the substation is rebuilt, would require customers to pay depreciation expense in rates for the next two decades.[425] Alvarez-Stephens concluded that Pepco failed to justify the high cost of the Benning 69kV substation and therefore recommended that the project not be approved in the MYP2.[426]

Pepco

In Rebuttal, Pepco witness Young explained that the Benning 69kV Substation Rebuild project will replace the "aging Benning 69kV Substation Air Insulated Switchgear ring bus configured substation equipment with new configured Gas Insulated Switchgear and a Half (BAAH) including new 230/69kV, 224 MVA supply Transformers No. 18 and 19, and new control and relay systems."[427] She claimed that a single breaker failure or planned outage would break the ring and subject the system to loss of one or two supplies to one to three distribution substations for a subsequent outage.[428] Ms. Young asserted that the proposed project is a significantly more robust configuration.[429] She also stated that the existing configuration could result in the loss of service for approximately 73,000 customers.[430]

Responding to OPC witnesses Alvarez-Stephens' critique that the project would be more beneficial for D.C. residents, Ms. Young countered by explaining that "subtransmission facilities benefit customers across jurisdictions throughout Pepco's service territory, regardless of the geographic location of those facilities. She also argued that rebuilding the

[425] *Id*. at 57-58.
[426] *Id*. at 58.
[427] Young Rebuttal at 44.
[428] *Id*. at 45.
[429] *Id*.
[430] *Id*. at 46.

Benning 69kV Substation will benefit customers by "removing a concerning liability and providing operational flexibility."[431] Ms. Young also noted that "[a]lthough many of the pieces of the equipment attached to this bus was [sic] upgraded through the years, the bus itself with its obsolete cap and pin design has not been upgraded and poses additional reliability risks."[432]

Commission Decision

The Commission accepts OPC's recommendation to remove the budgeted cost to rebuild the Benning 69kV Substation. Given the lack of more quantitative evidence to support the project cost and witness Young's acknowledgement during the hearing[433] that there is no information in the record to substantiate the qualitative statement that the substation equipment is "aging and needs to be replaced," the Commission finds that the Company should prepare additional quantitative analysis to support such a large investment of $61.5 million over the MYP2 period. Using forecasted data, the Commission finds that Pepco's costs for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

9. 69kV Underground Getaway Replacement

Pepco

Pepco proposed a 69kV UG Getaway replacement program to replace the underground residential distribution (URD) 69kV Getaway cables that are operating in a high stress environment, due to being tied to 69kV overhead lines.[434] Pepco noted that the underground sections of 69kV cable are on average nearly 40 years old and have reached the

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[431] *Id*.
[432] *Id*. at 48.
[433] Hearing Transcript Volume 1, 240:21-23 to 241:1-7 (March 7, 2024).
[434] Lo Direct at 15.

end of their anticipated life.[435] Pepco witness Young testified that the "high level rough cost estimate for the replacement of each getaway is between $1.5 million and $3.8 million (on average $2.5 million per getaway).[436]

Staff

Staff witness Lo expressed concern about the significant increase in spending after 2024 forecasted by the Company. Mr. Lo testified that the forecasted expenditure will increase fourfold after 2024 (see table below).

Table 1 – 69kV UG Getaway Replacement Program Expenditures (in thousands)

2023	**2024**	**2025**	**2026**	**2027**
$851	$832	$4,105	$4,378	$4,367

Mr. Lo stated that he is troubled by the significant increase in budgets beyond 2024 and the number of 69kV getaway cable failures; however, the contribution of 69kV cable failures to the Transmission Line Interruption Rate (TLIR) for the past five years do not justify the project.[437] Mr. Lo stated that he recognizes that the infrastructure for this program is aging and will require continual investment. Based on the data provided by the Company, Staff witness Lo recommended that the Company maintain the budget levels for 2024-2027 at the 2023 level and identify the most at risk assets that need replacing for each year.[438] Therefore, Mr. Lo recommended that the Commission disallow $3.254 million for 2025, $3.527 million for 2026, and $3.516 million for 2027.

[435] Pepco Initial Brief at 37.
[436] Young Rebuttal at 44.
[437] Lo Direct at 15.
[438] *Id*.

Table 2 – Staff Suggested Budgets and Recommended Disallowances (in thousands)

	2024	**2025**	**2026**	**2027**
69kV UG Getaway Budget	$832	$4,105	$4,378	$4,367
Staff Suggested Budget	$851	$851	$851	$851
Recommended Disallowance	0	$3,254	$3,527	$3,516

Pepco Rebuttal

Pepco witness Young argued that "[l]imiting the budget to $800,000 would mean that each getaway would need to be constructed in multiple years which would be extremely inefficient and impractical."[439] She testified that there are currently 44 getaways included in the replacement program and to complete the program in a reasonable time frame, Pepco will need to replace multiple getaways each year.[440] Ms. Young argued that maintaining Pepco's proposed current budget level for replacing 2 to 4 getaways each year, it will take 15 years to complete the program.[441] Using Staff's approach, Ms. Young estimated it would take over 120 years to complete the program, which would create undue risks to system reliability and undermine the benefits of the program.[442]

Staff Surrebuttal

Staff witness Lo testified that he recognized that 69kV Underground Getaway Replacement Program is an aging infrastructure project that will require continual

[439] Young Rebuttal at 44.
[440] *Id*.
[441] *Id*.
[442] *Id*.

investments; however, he remained concerned about the increased budgets beyond 2024 and the low number of 69kV cable failures.[443] He noted that the Company emphasizes that failures in the 69kV UG getaways have been the major factor in the TLIR. He noted that the Company's response to an OPC data request showed "[t]he average number of 69kV cable failures annually over the past five years was two and the number of cable failures that directly contributed to the TLIR was only 0.012 between 2018-2022."[444] He argued that "[t]he contribution of 69kV cable failures to the TLIR do not justify the development of this project and the cost associated with the replacement program."[445] Witness Lo stated that he maintained his position regarding the 69kV UG Getaway Replacement Program and recommended that the Company maintain the budget levels for 2024-2027 at the 2023 level and identify the most at-risk assets that need replacing for each year.[446]

Commission Decision

The Commission accepts Staff's recommendation to hold Pepco to the 2023 budget level and directs the Company to identify the most at-risk assets that need replacing. Using forecasted data, the Commission finds that Pepco's revenue requirement for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

10. Priority Feeder Improvement

Pepco

In response to OPC-DR 6-67, the Company indicated that it will need "to invest more on Priority Feeder[447] programs to ensure that all identified deficiencies and system

[443] Lo Surrebuttal at 3.
[444] *Id*.
[445] *Id*.
[446] *Id*.
[447] "The Priority Feeder Program addresses the COMAR 20.50.12.03 requirement of remediating the poorest performing feeders in Pepco Maryland's service territory. [sic] An annual review of the feeders in Maryland is

deteriorations for the worst performing feeders are addressed."[448] Company witness Young explained that this increase "is needed to make certain that the Company can continuously provide reliable and resilient service to the customers." The Company also noted that the current level of budget and spending for Priority Feeders are becoming challenging to make significant improvements to worst performing feeders … ."[449] Witness Young maintained that this increased level of funding will benefit customers because the current level of budget for the Priority Feeder program does not allow the Company to execute full improvement scopes identified by engineering each year and some of the improvement executions are deferred to the future years.[450] Ms. Young argued that "increased level of investment for this program will ensure that necessary improvement scopes identified are executed without reduced scope and deferrals which will benefit customers on these feeders from experiencing more frequent and longer duration outages."[451]

<u>OPC</u>

OPC witnesses Alvarez-Stephens testified that Pepco plans to triple its spending on priority feeder improvement in 2027.[452] The increase proposed amounts to more than triple the average spending (actual or forecast 2021-2026, which is $3.8 million).[453] Alvarez-Stephens testified that the Company claims the significant increase is due to aging infrastructure making it harder to complete priority feeder improvements at current funding

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conducted by Pepco to select feeders with a SAIFI value and SAIDI value greater than 250% or greater than the system SAIFI and SAIDI where the number of feeders selected each year will vary based on entire system performance." Young Rebuttal at 40-41.

[448] *Id*. at 41.

[449] *Id*.

[450] *Id*.

[451] *Id*.

[452] Alvarez-Stephens Direct at 75; OPC Initial Brief at 33.

[453] Alvarez-Stephens Direct at 75.

levels, but they argued the Company provides no support for tripling the budget in 2027.[454] Therefore, Alvarez-Stephens recommended that "the 2027 Priority Feeder Improvement forecast be reduced by $8.4 million in 2027, thus bringing it into alignment with Pepco's actual and forecasted spending for 2021–2026."[455] OPC also requested that the Company provide an estimate of the reliability improvements the Company expects to secure from its proposed spending increases.[456]

Commission Decision

The Commission finds that the Company has not provided sufficient evidence and quantitative analysis to justify a tripling of the planned expenditure for the Priority Feeder Improvement Program. Since the Commission's decision in this case limits Pepco's cost recovery in this MYP 2 to Rate Year 1, there is no revenue impact from accepting or rejecting the tripling of the budget in 2027. If Pepco chooses to pursue this type of incremental increase in the future, it should be prepared to provide an estimate of the reliability improvements the Company expects to secure from its proposed spending increases on the Priority Feeder Program.

11. Underground Cable Replacement

OPC

OPC witnesses Alvarez-Stephens evaluated the Company's planned underground cable replacement for 2025-2027 (Project 70898). Data showed that the Company's capital spending forecast for planned underground cable replacement will be five times higher by

[454] *Id*.
[455] *Id*.
[456] Alvarez-Stephens Surrebuttal at 59.

2027 than underground cable replacement spending in 2021 and 2022.[457] Alvarez-Stephens noted that "when asked to support this increase in discovery, Pepco stated 'individual URD cable project locations are identified closer to the year of execution' and 'corrective maintenance actions often identify long term investment needs for the system.'"[458] But the Company did not provide quantitative analysis supporting why underground cables have to be replaced at such significant rates.[459] Alvarez-Stephens also testified that the Company had not conducted a benefit-cost analysis. They argued absent such analysis, Pepco's 500% increase is unsupported.[460] Therefore, Alvarez-Stephens recommended that Pepco's MYP2 capital spending forecast be reduced to the average (actual or forecast) spending for 2021–2024, which is $4.05 million annually.[461]

Further, Alvarez-Stephens recommended that the Commission continue to reject increases in Pepco's planned underground cable replacement spending until the Company provides analyses identifying the optimum annual mileage replacement rate as supported by quantified analyses.[462]

Staff

Staff witness Lo evaluated the program and recommended allowing the program with monitoring of the expenditures above budget.[463]

Pepco Rebuttal

Pepco witness Young testified that the Company's Underground Cable Replacement Program is an aging cable replacement program based mostly on the number of failures

[457] Alvarez-Stephens Direct at 73.
[458] *Id*.
[459] *Id*.
[460] *Id*. at 74.
[461] *Id*.
[462] *Id*.
[463] Lo Direct at 14.

experienced and the age of cable.[464] She stated that multiple cable failures is an indication of aging condition that requires replacement in order to reduce customers experiencing multiple long duration outages."[465] Witness Young testified that the Company is proposing to increase investment for this program as many Maryland residential developments are over 30 years old and have started to build a backlog of replacement candidates.[466] She also indicated that more than 61% of underground cable identified for replacement is over 30 years old.[467] Ms. Young argued that the primary benefits from proactive underground cable replacement program investments will be reduction of customers experiencing repeat and long duration outages due to aging cable failures. Customers will also see the side benefit of planned and organized construction activity which includes lane and road closures in the neighborhood as the emergency repair and replacement work due to cable failure will be reduced.[468]

Responding to OPC's critiques of the Company's planned increase in underground cable replacement, witness Young argued that OPC witnesses Alvarez-Stephens do not provide or recommend any specific quantifiable analysis for this program.[469] Ms. Young further stated that since the replacement decision is based on actual cable failures, the Company does not use any quantifiable analysis.[470]

<u>Commission Decision</u>

The Commission accepts OPC's recommendation to reduce forecasted spending of Underground Cable Replacement Program to the average spending for 2021-2024 in MYP2.

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[464] Young Rebuttal at 37.
[465] *Id*.
[466] *Id*.
[467] *Id*., *See also* Pepco Initial Brief at 34.
[468] Young Rebuttal at 38.
[469] *Id*. at 39.
[470] *Id*.

Using forecasted data, the Commission finds that Pepco's rate base expenses for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

12. Emergency Underground Cable Replacement

OPC

OPC witnesses Alvarez-Stephens highlighted that the Emergency Underground Cable Replacement Program, unlike the Cable Replacement Program, addresses underground cable that must be completed immediately.[471] Alvarez-Stephens testified that the Company spent an average of $12.3 million annually from 2021-2023 (2023 forecasted), and it forecasts spending $17.3 million on average annually during MYP2 on emergency underground cable replacement.[472] They questioned the 40% increase and testified that Pepco's discovery responses indicated that "... the cost to complete URD cable faults has increased significantly from 2018 to 2022."[473] Alvarez-Stephens also observed that Pepco provided actual spending data for 2018 to 2022 which indicated an 18 percent growth rate over 5 years, for a compound average growth rate of just 3.5 percent per year.[474] Alvarez-Stephens argued that Pepco should use the historical growth rate of 18% over five years versus a 40% increase over four years which is unnecessary and unreasonable.[475] Alvarez-Stephens recommended that the Commission reduce Pepco's MYP2 capital spending budget for emergency underground cable replacement to the $12.3 million annual average for 2021–2023.[476]

[471] Alvarez-Stephens Direct at 78.
[472] *Id*. at 78-79.
[473] *Id*. at 79.
[474] *Id*.
[475] *Id*.
[476] *Id*. at 80.

Pepco

In her Rebuttal, Pepco witness Young discussed the purpose of the Emergency Underground Cable Replacements, stating that the project is designed to address any unexpected failures to the underground system to restore customers back in service. She stated that work performed under this project typically involves cable and conduit replacement, while underground and pad-mounted transformer and switch replacements are made if outages result in both cable and equipment damage.[477] She said that the increased level of spending in this area is due to the Company's expectation that "the number of cable failures associated with URD residential subdivisions will increase over time as many URD residential systems are now over 30 years in service."[478]

Additionally, Ms. Young testified that the Company is noticing that temporarily repairing faulted cables does not properly restore the system where customers could experience repeat outages within a few months.[479] Therefore, the Company is shifting its strategy from temporarily repairing faulted cables to replacement of faulted cables. This change in strategy–she argued–requires an increased level of funding.[480]

Commission Decision

The Commission accepts OPC's recommendation to reduce forecasted spending of the Emergency Underground Cable Replacement Program to the average spending for 2021 - 2023 of $12.3 million. Using forecasted data, the Commission finds that Pepco's rate base expenses for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

[477] Young Rebuttal at 42.
[478] *Id*.
[479] *Id*.
[480] *Id*.

13. Downtown Resupply Investment Program

OPC

OPC witnesses Alvarez-Stephens evaluated Pepco's Downtown Resupply Program and described it as "a program to increase sub-transmission supply capacity and provide reliability improvements to replace aging infrastructure in the District of Columbia."[481] Alvarez-Stephens testified that the project is currently estimated to cost $824 million but the Company does not present the $824 million Downtown Resupply Program, nor the $242 million share of costs that will likely be borne by Maryland customers, anywhere in its MRP 2.[482] They acknowledged that upon further research, they were able to identify $86 million in Downtown Resupply project costs in Pepco's MYP2.

Alvarez-Stephens noted that the "largest dollar projects for the Downtown Resupply program are distribution- level projects located in the District of Columbia, with costs recovered only from Pepco DC ratepayers.[483] However, a significant number of subtransmission level projects are also part of the program. District of Columbia customers pay 100 percent of the distribution level costs incurred within the District, but the Company's subtransmission network costs are currently split 60 percent to its Maryland customers and 40 percent to its District of Columbia customers.

OPC witnesses Alvarez-Stephens argued that spending on this project would be premature and the Company gave brief consideration to alternatives.[484] Alvarez-Stephens recommended that $7.5 million in Downtown Resupply program costs incurred in 2021 and 2022 be disallowed from recovery from Maryland customers, and that $86.6 million in

[481] Alvarez-Stephens Direct at 68.
[482] *Id*.
[483] *Id*.
[484] *Id*. at 71.

capital spending forecast for the program be eliminated from MRP 2.[485] Additionally, they recommended that, before approving any future recovery of the program, the Commission should require Pepco to identify and rigorously evaluate the benefits and costs of all available options to the "problem" of a substation located on leased property, including the option of continuing to lease the property.[486]

Staff

Staff witness Lo stated that "it is uncertain the level of reliability improvement that the Company expects from the Downtown Resupply investment program and the Capital Grid Program in Maryland."[487] Furthermore, witness Lo testified that "Given the limited information available to me, I could not fully review these projects at this time. The data request responses and other material provided by the Company was insufficient to justify the necessity of these projects...."[488] However, Staff did not recommend a disallowance and will "consider reliability benefits as well as cost variances at the time of reconciliation whether the Company should be allowed to recover any funds associated with these projects."[489]

Pepco

Pepco witness Young described the program as "a multi-year program that consists of the rebuild and replacement of aging infrastructure at Pepco's F Street and L Street Substations, resupply of F Street, L Street and Georgetown Substations at the 69 kV level, replacement of aging self-contained fluid filled cables with solid dielectric cables, and the retirement of Pepco's I Street Substation."[490] Contrary to OPC's assessment, Pepco asserted

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[485] *Id*. at 72.
[486] *Id*.
[487] Lo Direct at 18.
[488] *Id*.
[489] *Id*.
[490] Young Rebuttal at 49.

that the Downtown Resupply Program does benefit Maryland customers. Specifically, Ms. Young highlighted that "sub-transmission facilities benefit customers across jurisdictions throughout Pepco's service territory, regardless of geographic location of those facilities."[491] In its initial brief, Pepco asserted that the Downtown Resupply Program was thoroughly vetted by the Company, and all information regarding the need for the Program and consideration of all potential alternatives was provided to the parties.[492]

Commission Decision

Considering the magnitude of the spend associated with the program over time and the fact this has been under discussion with the District of Columbia Public Service Commission for some time, it is concerning that direct testimony did not address this program.[493] At this time, the Commission is not yet convinced this program should impact the MYP2 budget for the time period approved by the Commission. The Company must provide more quantitative evidence and justifications to support the Program and show its more direct benefits to Maryland ratepayers.

The Commission acknowledges its precedent for jurisdictional cost sharing related to these types of costs, which also will need to be weighed in any future discussion of these costs. Using forecasted data, the Commission finds that Pepco's rate base expenses for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

[491] *Id*. at 49-50.
[492] Pepco Initial Brief at 40.
[493] Alvarez-Stephens Surrebuttal at 51-52.

14. New Business Customer Connections

OPC

OPC witnesses Alvarez-Stephens testified that Pepco's forecasted new customer connection spending for 2024-2027 is 40% higher than its actual/forecasted new customer connection spending for 2021-2023 (or $38.0 million).[494] Alvarez-Stephens expressed concern about such a significant percentage increase and testified that when Pepco was asked to provide information supporting the 40% increase, Pepco provided no information, but instead pointed to inflationary pressures.[495] Alvarez-Stephens expressed doubt that inflation alone would justify a 40% increase over a three-year period. Alvarez-Stephens argued that recent trends suggest that new customer connections could fall in the future. Higher interest rates underlying a sluggish housing market may reduce the need for new residential connections. And the continued prevalence of work-from-home appears to have reduced new commercial connections related to office space.[496] Alvarez-Stephens recommended the new customer connection capital spending forecasts proposed in Pepco's MYP2 be reduced by $61.7 million, to the 2021–2023 average annual amount of $38 million.[497]

Pepco

Pepco witness Young asserted that the Company has an obligation to provide service to the customers of Maryland, requiring the Company to invest in distribution infrastructure and services to support the State's continued growth. Witness Young testified that the increased level of investment is based on known customer requests, anticipated customer demand for new services, and historical performance to provide service for new and upgrade

[494] Alvarez-Stephens Direct at 76.
[495] *Id*. at 77.
[496] *Id*. at 77-78.
[497] *Id*. at 78.

service requests for residential, and commercial requests.[498] In its initial brief, Pepco noted that in 2022, the Company experienced an $8 million increase in costs associated with new customer connections, driven by higher than anticipated requests for residential and commercial service.[499]

AOBA

AOBA witness Oliver noted that the New Business Customer Connections budget is based on additions and upgrades to the Company's electric system. Mr. Oliver argued that billing determinants are based on a net of additions and subtractions from the system. For this reason, he argued that the two will never align.

Commission Decision

The Commission accepts OPC's recommendation to reduce forecasted spending by $61.7 million, to the 2021–2023 average annual amount of $38 million.[500] Using forecasted data, the Commission finds that Pepco's rate base expenses for MYP2 Rate Year 1 should be reflective of Appendix A, Commission Approved Revenue Requirements.

15. Smart Sensor Fault Indicator Program

Staff

Staff witness Austin testified that Project 75383: Pepco Distribution Smart Fault Sensors was one of two projects added after Pepco's MYP1 and that it was created to support a new technology program to improve the reliability of the distribution system with the installation of communication for fault circuit sensors.[501] He noted that this project is similar

[498] Young Rebuttal at 54.
[499] Pepco Initial Brief at 42.
[500] Alvarez-Stephens Direct at 78.
[501] Austin Direct at 19.

to the Distribution Sensors Program that Baltimore Gas and Electric Company (BGE) proposed in its second MYP application (Case No. 9692).[502] In that case, Staff recommended and the Commission ordered BGE to evaluate and demonstrate the effectiveness of these sensors in practice in a pilot project before a full deployment is initiated.[503] Witness Austin stated that Staff's recommendation regarding Pepco's Distribution Smart Fault Sensors program is the same as Staff recommended for BGE's Distribution Sensors Program. Here, Staff recommends that Pepco's Distribution Smart Fault Sensors program be designated a pilot program.[504] Additionally, Staff recommends that the Company "should be allowed to recover the funds it expended in calendar years 2021, 2022 and 2023, however, further expansion of this program should be subject to Pepco's demonstration that there are no risks to full scale deployment and that program benefits are being obtained as projected, in a filing with the Commission after the 2024/2025 evaluation period is concluded."[505] Witness Austin also testified that he did not recommend any disallowances for the Company's RY2 (CY2022) expenditures that fall under System Performance-Distribution category.[506]

Pepco

Witness Young initially recommended in rebuttal testimony that the Commission reject Staff's recommendation to pilot the Company's Smart Sensor Fault Indicator program arguing that overhead fault indicators have been used on Pepco's electric system for many years.[507] She stated that adding communications to these devices poses no risk to the electric system and will benefit Electric Operators in determining the location of an overhead fault,

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[502] *Id*.
[503] *Id*. at 20.
[504] *Id*.
[505] *Id*.
[506] *Id*.
[507] Young Rebuttal at 52-53.

and dispatching a first responder to isolate the fault quicker, thus improving customer outage duration time.[508] Furthermore, witness Young testified that BGE's program is for underground applications, which differs from Pepco's which will be used on the overhead distribution system.[509] However, subsequently the Company reversed its position and now accepts Staff's recommendation.[510]

Commission Decision

The Commission accepts Staff's recommendation that Pepco's Distribution Smart Fault Sensors program be designated a pilot program. The Company should be allowed to recover the funds it expended in calendar years 2021, 2022 and 2023; however, further expansion of this program should be subject to Pepco's demonstration that there are no risks to full scale deployment and that program benefits are being obtained as projected, in a filing with the Commission after the 2024/2025 evaluation period is concluded.

16. Smart Inverter Pilot Program

Pepco

Pepco's Smart Inverter Pilot Program is slated to target 100 customers and will demonstrate how the smart inverter: (a) mitigates localized voltage violations, (b) identifies a need for distribution system upgrades, (c) streamlines interconnection approval, (d) increases hosting capacity, and (e) improves power quality and grid stability.

The proposed pilot program costs $1,805,375 over the life of the MYP, with $375,000 in incentives and $1,430,375 in administrative costs.

[508] *Id*. at 53-54.
[509] *Id*. at 54.
[510] Pepco Initial Brief at 41.

Pepco stated that the Smart Inverter Program and its objectives will directly contribute to the modernization of Maryland's electric grid and is therefore best suited to be considered in this MYP, rather than transferred to another docket.[511]

Staff

Staff supports Pepco's Smart Inverter Pilot Program as it aligns with Staff's recommendation to study, test, and establish pilot programs that explore the impacts of smart inverter advanced mix-mode functions on the electric grid.[512]

SEIA/CHESSA

In a letter attached to witness Alo's rebuttal testimony (Schedule TOA-R) – 1), the Solar Energies Industries Association ("SEIA") and the Chesapeake Solar and Storage Association ("CHESSA") wrote to support Pepco's Smart Inverter Pilot Program. These organizations encourage Pepco to act quickly and learn from the pilot program and eventually seek to establish rules to codify the utilization of advanced functions of Smart Inverters.

OPC

OPC did not submit evidence related to Pepco's Smart Inverter Program. OPC initially stated that it recommends that the Commission remove this program from the instant rate case.[513] However, OPC subsequently reversed its initial position and OPC now "agrees with Staff's support of the Smart Inverter Pilot Program.[514]

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[511] Alo Rebuttal at 3-4; Wilson Direct at 4.
[512] Wilson Direct at 9.
[513] OPC's November 28, 2023 "Motion to Strike" at 27. ("Pepco's Smart Inverter Pilot Program raises technical questions better suited for PC 44 or a stand-alone docket than a rate case.")
[514] OPC Initial Brief at 56.

Commission Decision

The Commission supports Pepco's Smart Inverter Program and approves the program in concept. However, the Commission does have some concerns regarding the high administrative costs of this program. And the record appears to lack certain information about the budget and details surrounding the program.

Before submission of further details regarding the program's budget in Pepco's next rate case, the Commission directs Pepco to collaborate with the Commission's PC44 Interconnection Work Group on this pilot program to provide further cost details, status updates and discuss any preliminary conclusions regarding benefits. The Commission will address cost recovery for the Smart Inverter Pilot Program at a later date.

D. Depreciation

Depreciation is the method companies use to recover the original cost of their investment as well as any net salvage. Net salvage is the difference between the remaining market value of an asset at retirement and its cost of removal.

In this case, Staff and OPC witnesses proposed service lives that differed from those proposed by Pepco's witness for the various plant accounts. All of the witnesses calculated net salvage rates using the MD present value ("MD PV") method, which involves estimating future net salvage rates for each account and then discounting those rates to present value. However, the witnesses differed in their proposed depreciation rates and whether the net salvage should be calculated on account level or vintage level.

Pepco

Pepco witness Allis explained that for net salvage, his proposed depreciation rates are based on the MD Present Value Method ("MD PV") Method using a credit-adjusted risk-free rate ("CARFR") for the discount rate of 4.86%.[515] He noted that his calculation is consistent with more recent Commission precedent, through a "robust" depreciation study using industry standards.[516] He stated that Pepco's depreciation study resulted in an overall increase in the overall composite depreciation rate, reflects updates that incorporate reasonable estimates of lives for each account, and changes in net salvage which accommodate Commission precedent for present value recovery of these costs.[517]

Mr. Allis emphasized that Pepco's recommended estimated average service lives for almost all accounts are either the same as or reflect longer lives than those currently approved for the Company, and Pepco's recommended service lives result in an overall net decrease in depreciation expense.[518] Mr. Allis compared his calculations to those of Staff and OPC and deemed their findings to be unreliable, stating that their witnesses did not perform full depreciation studies but instead used Pepco's plant data and performed mathematical calculations without considering "real-world factors" influencing the length of service lives in the future.[519]

Pepco asserted that Staff's discount rate is based on data that does not match the time period of the data used for Pepco's depreciation study, and therefore does not comport with Commission precedent.[520] The Company added that OPC witness Garren, used a discount

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[515] Pepco Brief at 51.
[516] *Id.*
[517] *Id.*
[518] *Id.*
[519] *Id.* at 54.
[520] *Id.*

rate equal to the Company's ROR and a calculation at the account level, not by vintage level, which the Commission has rejected in previous cases.[521]

Pepco argued that the Commission should continue with recent precedent and approve the calculation of net salvage under the MD PV Method, using a discount rate equal to the Company's CARFR and a vintage level calculation of plant in service.[522]

Staff

Staff witness Garren proposed a $106.6 million in annual depreciation expense, which resulted in a total composite depreciation rate of 2.56%.[523] Mr. Garren used the PV method to calculate net salvage accrual on a vintage basis.[524] He explained that he used a discount rate of 5.31%, based on CARFR, which he calculated on the 30-Year all-in bond yields for A-rated U.S. utilities from June 30, 2022, through December 31, 2022.[525] According to Staff, the discount rate used for the determination of salvage did not necessarily need to match that used for the reporting of Asset Retirement Obligations ("AROs").[526]

Staff noted that the Parties calculated their depreciation adjustments based upon their recommendations of different Iowa curves and associated service lives for 10 electric distribution plant accounts and the recommended CARFR discount in the Present Value method of determining salvage.[527] The 10 accounts are: 361 – Structures and Improvements; 362 – Station Equipment; 364 – Poles, Towers and Fixtures; 366 – Underground Conduit; 367 – Underground Conductors and Devices; 368 – Line Transformers; 369.1 – Services –

[521] *Id*.
[522] *Id*.
[523] Staff Brief at 44.
[524] *Id*.
[525] *Id*.
[526] Staff Reply Brief. at 23.
[527] *Id*. at 20.

Overhead; 369.2 – Services – Underground; 369.3 – Services – Underground Cable; and 373.1 – Street Light and Signal Systems.[528]

The following chart, produced by Staff, identifies differences among Pepco, Staff, and OPC for the 10 reference accounts:[529]

Account	**Description**	**Pepco**	**Staff**	**OPC**
361	Structures and Improvements	60-R3	70-R3	60-R3
362	Station Equipment	55-R2	55-R2	59-R1.5
364	Poles, Towers and Fixtures	55-R2	65-R2	61-R2
366	Underground Conduit	60-R3	70-R3	66-R3
367	Underground Conductors and Devices	55-R4	55-R4	58-R4
368	Line Transformers	40-R2.5	40-R2.5	44-R2
369.1 369.2 369.3	Services – Overhead Services – Underground Services – Underground Cable	50-R3	60-R2	56-R2.5
373.1	Street Light and Signal Systems	50-R2.5	58-L1.5	50-R2.5

Staff disputed Pepco witness Allis' claim that his adjustment was more substantive because he calculated the adjustment by conducting a full depreciation study and using insight to consider future operational or technological impacts.[530] Staff argued that Mr. Allis' considerations used for his service life and Iowa Curve adjustments may overestimate retirement forces not currently observed in the plant mortality data, while other adjustments

[528] *Id.*
[529] *Id.*
[530] *Id.*

may estimate retirement forces with no significant impact on mortality data by the next Pepco depreciation study.[531]

Staff recommended that the Commission approve remaining life depreciation rates based upon Staff's recommended Iowa curves and service lives, with present value salvage determined using a discount rate of 5.31%.

<u>OPC</u>

OPC witness Garren recommended a depreciation rate of 7.14%. OPC urged the Commission to reject Pepco's Iowa curves and service life adjustments, asserting that for Pepco's eight plant accounts, Pepco witness Allis' proposed Iowa curves are too short to accurately reflect the plants' probable service lives.[532] Mr. Garren instead used a retirement method to develop an "observed life table" ("OLT"), showing the percentage of property surviving at each age interval (known as a "survivor curve") in order to analyze the service lives of Pepco's plant accounts and calculate depreciation rates.[533] Mr. Garren then calculated his recommended Iowa curve for each account.[534] He maintained that his recommended curves are a better mathematical fit to the OLT curves than those presented by Pepco, and Pepco's claims that increased electrification would result in shorter plant service lives are speculative and made without supporting evidence.[535]

In addition to recommending service life adjustments for the eight plant accounts, with the proposed Iowa curves from Pepco and OPC, OPC witness Garren proposed to use Pepco's rate of return ("ROR") approved by the Commission in the base rate case.[536]

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[531] *Id*. at 21.
[532] OPC Initial Brief at 51.
[533] *Id*. at 53.
[534] *Id*.
[535] *Id*.
[536] *Id*.

OPC did not recommend any adjustments to Pepco witness Allis' proposed future net salvage percentages before the application of the discount rate.[537] However, OPC opposed Pepco's proposed use of CARFR rather than Pepco's ROR as the appropriate discount rate to use in calculating present value of estimated future cost of removal, pointing to the Commission's relatively recent history, over the last 16 years, of using a utility's ROR as the discount rate for PV method calculations regarding net salvage.[538] OPC acknowledged that the Commission—which is not bound by past or traditional calculation practices in light of new circumstances—has since 2021 allowed parties to present evidence on the appropriate discount rate and alternatives to using the ROR, such as the CARFR used in recent cases.[539] However, OPC maintained that using the ROR has been effective in mitigating the impact of rising capital costs and the impact on customers, while CARFR does not directly impact customer rates.[540]

OPC also argued that, in addition to using the ROR, the PV method calculation should be performed on a composite level for each account, instead of on each vintage year for each account.[541] OPC stated that witness Garren's account level method of calculation was more transparent and easily replicated, requiring only one row per account, while Pepco witness Allis' vintage level calculation revealed that he applied the rate discount calculation on every vintage year for each account, comprising thousands of data points.[542] OPC asserted that Mr. Allis's vintage level calculation of present value net salvage rates increases the

537 *Id*.
538 *Id*.
539 *Id*. at 54.
540 *Id*.
541 *Id*. at 55.
542 *Id*.

annual depreciation accrual by about $11 million, but the account level calculation method would better promote just and reasonable customer rates.[543]

<u>Commission Decision</u>

The Supreme Court has defined depreciation as "the loss, not restored by current maintenance, which is due to all factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence."[544] The Court further held:

> [T]he company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting system has been correct. The calculations are mathematical, but the predictions underlying them are essentially matters of opinion.[545]

Historically, net salvage costs were recovered on a straight-line basis in the development of depreciation rates. In other words, the depreciation rate would fund the recovery of the asset plus an estimate of necessary retirement costs on an equal basis over the remaining life of the asset.[546] However, in recent years, the Commission has allowed recovery of net salvage costs on a present value basis, such that the depreciation rates reflect the present value of amounts required to fund the retirement of plant investment. In Case No. 9092, for example, the Commission found that "[t]he Present Value Method strikes a balance between the straight line and historical recovery proposals. … [B]ecause future costs are discounted to a 'present value,' today's ratepayers will pay only their fair share of recovery costs in 'real' dollars rather than the inflated amounts under Straight Line Method."

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[543] *Id*.
[544] *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 167 (1934).
[545] *Id*. at 169.
[546] Order No. 88944, *In the Matter of the Application of Washington Gas Light Company for Authority to Increase Existing Rates and Charges and to Revise its Terms and Conditions for Gas Service*, Case No. 9481, slip op. at 62 (Dec. 11, 2018).

Accordingly, the Commission found that the Present Value Method "strikes an appropriate balance between the interests of current and future ratepayers."[547] The Commission sees no reason to depart from the Present Value Method in this case. The Commission has reviewed the record and finds that the Present Value Method should be adopted for the recovery of removal costs, as it continues to strike an appropriate balance between the interests of current and future ratepayers. Therefore, in this case, the Present Value Method will be applied to Pepco's net salvage costs.

The Commission approves Staff's recommended proposed net salvage rates, calculated under the MD Present Value Method, at the proposed 5.31% discount rate, as well as Staff's proposed future net salvage rates. The Commission has approved a net salvage rate different from a utility's weighted average cost of capital as seen in BGE Case No. 9692[548] and Potomac Edison Case No. 9695.[549] While the Commission has in the past approved the use of ROR as the discount rate to calculate estimated future cost of removal, the Commission is not bound to apply that decision to all rate cases, particularly when an alternative method is just and reasonable.

The Commission approves the vintage level method, used by Pepco and Staff, as a just and reasonable method of calculation of net salvage value. The Commission further approves Staff's recommended Iowa curves and adjustments. These adjustments, which provide for longer service lives for each account, are just and reasonable while mitigating customer costs.

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[547] Order No. 81517, *In the Matter of the Application of Potomac Electric Power Company for Authority to Revise Rates and Charges for Electric Service and Certain Rate Design Changes*, Case No. 9092, slip op. at 31 (July 19, 2007).
[548] *Order No. 90948* at 53, Case No. 9692.
[549] Proposed Order at 32, Case No. 9695 (September 6, 2023).

E. Annual reconciliation

1. Pepco's Case No. 9655 Reconciliation of Rate Year 1 and Rate Year 2 revenue requirement deficiencies through the MYP adjustment rider

Pepco

In his direct testimony and supplemental direct testimony, witness Leming submitted the Company's proposed Rate Years 1 and 2 revenue deficiencies from Case No. 9655. For Rate Year 1, the Company requested \$1.5 million based on its rate base being 0.4% higher and its operating income being 0.4% lower than that approved in Rate Year 1 in Case No 9655.[550] For Rate Year 2, the Company requested \$7.6 million, citing that its operating income was 2.7% lower than approved in Rate Year 2 in Case No. 9655.[551]

Pepco witness Blazunas proposed to recover Case No. 9655's Rate Year 1 and Rate Year 2 reconciliation imbalances in Rate Year 1 of the instant MYP based on the allocation methodology contained in the Company's MYP Adjustment Rider approved by the Commission in Case No. 9655.[552] However, the Company accepted Staff's proposal to allocate Rate Year 1 revenues from July 1, 2024 through March 31, 2025 and Rate Year 2 revenues from April 1, 2025 through March 31, 2026.[553]

Pepco witness Blazunas withdrew the Company's request to collect a carrying charge at Pepco's Weighted Average Cost of Capital ("WACC") on the Rate Year 1 and Rate Year 2 revenue requirement deficiencies during the periods they are being recovered.[554] However, Mr. Blazunas continued to contend it is appropriate to include a return at the Company's WACC on the Case No. 9655 Rate Year 2 deficiency from July 1, 2024 through March 31,

[550] Leming Direct at 60-63.
[551] Leming Supplemental Direct at 1-5.
[552] Blazunas Supplemental Direct at 2.
[553] Blazunas Rebuttal at 39-40.
[554] *Id*. at 40.

2025.[555] The Company provided its final proposed Rider MYP Adjustment rate design for periods July 1, 2024 through March 31, 2025 in Schedule (PRB-R) -14 (incorporating witness Leming's updated Case No. 9655 Rate Year 1 and Rate Year 2 revenue requirement deficiencies).[556]

Staff

Staff witness Austin performed a detailed prudency review of Pepco's various capital expenditures submitted in the Company's Rate Year 1 and Rate Year 2 Annual Informational Filing ("AIF"). As in Case No. 9655, the Company's filings divided its projects into nine categories.[557] Following his prudency review, Mr. Austin recommended that the Commission approve recovery of these expenses except for two projects related to the Company's National Harbor Battery Energy Storage System as well as the expenses contained in Pepco's "All Other Project Types" category.[558]

Following additional exchanges with the Company, the Company agreed not seek recovery for the National Harbor Battery Energy Storage Systems, and Mr. Austin withdrew his objection to the Company's expenses designated "all Other Projects".[559]

Staff witness Patterson disagreed with the Company's proposal to include carrying costs on the Case No. 9655 Rate Year 1 and Rate Year 2 reconciliation imbalances, which results in a Rate Year 1 reconciliation of $1,104,893 and Rate Year 2 reconciliation of $7,242,708.[560] Using Staff witness Patterson's reconciliation imbalances for Rate Year 1 and

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555 *Id*.
556 *Id*.
557 Those categories are (1) Capacity Expansion - Distribution, (2) Corrective Maintenance - Distribution, (3) Corrective Maintenance - Substation, (4) Facilities Relocation, (5) New Business Connections, (6) System Performance - Distribution, (7) System Performance - Substation, (8) System Performance - Automation, and (9) Smart Grid Smart Meters. Austin Direct at 5.
558 *Id*. at 3.
559 Austin Surrebuttal at 1-2.
560 Patterson Direct at 22-24.

Rate Year 2, Staff witness Hoppock proposed to allocate the imbalances based upon the approved revenue allocations from Case No. 9655.

Staff witness Hoppock recommended that the Case No. 9655 Rate Year 1 reconciliation imbalance be recovered through the Rider MYP Adjustment over the period July 1, 2024 through March 31, 2025.[561] He further recommended that any Case No. 9655 Rate Year 2 reconciliation imbalance be recovered through the Rider MYP Adjustment over the period April 1, 2025 through March 31, 2026 (i.e. Rate Year 2 of instant proceeding).[562]

OPC

OPC contended that the MYP format cannot result in just and reasonable rates.[563] OPC witnesses Alvarez-Stephens provide many arguments urging the Commission to abolish the reconciliation process entirely.[564] In short, OPC argued that Pepco's MRP shows that the Commission's goals for multi-year rate-making have not been met.[565] Rather, the reconciliation process discourages utilities from reducing O&M costs and capital spending between rate cases, harming customers.[566] By giving utilities advance approval of multi-year rate plans, OPC argued the Commission practically eliminates its own ability to exercise its cost disallowance rights. As a result, capital spending governance and information symmetry mitigation fall, and moral hazard in distribution plan development will increase.[567] OPC urged that the Commission: (1) eliminate the reconciliation process, and (2) perform the Lessons Learned proceeding envisioned when the Commission issued Order No. 89482.

561 Hoppock Rebuttal at 28-29.
562 *Id*.
563 Alvarez-Stephens Direct at 13.
564 *See generally* OPC Initial Brief at 7-22.
565 Alvarez-Stephens Direct at 15-17.
566 *Id*. at 96.
567 *Id*.

Alvarez-Stephens did propose adjustments to the period covered by the reconciliation process for years 2021 and 2022.[568] These projects included: Prospective Substation Equipment Replacement, Benning 69 kV Substation Rebuild, National Harbor Substation Livingston Road Energy Storage, and the Downtown Resupply Program.[569] OPC's justification for disallowing Prospective Substation Equipment Replacement, Benning 69 kV, National Harbor Substation, and Downtown Resupply Program are all discussed earlier in this Order. For the Livingston Road Energy Storage project OPC argued that due to the lack of project benefits that the Company was aware of and subsequent deficiencies in contractor progress monitoring and project management that the costs through 2022 should be disallowed.[570]

OPC witness Effron was responsible for making the adjustments to Pepco's revenue requirement for OPC witnesses Alvarez-Stephens recommendations. In direct testimony, Effron recommended reducing Pepco's requested revenue requirement by $1,650,000 in the year ended March 31, 2022, and $3,878,000 in the year ended March 31, 2023.[571] On surrebuttal the values were revised to $800,000 in the year ended March 31, 2022, and $2,596,000 in the year ended March 31, 2023.[572] Witness Effron cites Pepco witness Leming's errata rebuttal testimony for a breakdown of the associated adjustments which reveals that the only two recommendations from witnesses Alvarez-Stephens that impact the revenue requirement was Prospective Substation Equipment Replacement and Downtown Resupply Program.[573]

[568] *Id*. at 42-43.
[569] Alvarez-Stephens Direct at 10, Table 1.
[570] *Id*. at 67-68.
[571] Effron Direct at 22.
[572] Effron Surrebuttal at 13.
[573] Leming Errata Rebuttal at (RTL-R)-3.

AOBA

AOBA also argued that the entire MYP and associated reconciliation process allows utilities to potentially better mask unreasonable capital expenses. AOBA asserted that approval of Pepco's Rider MYP adjustments is not appropriate at this time. AOBA insisted that Pepco has not demonstrated the accuracy and prudency of the Company's actual reported costs that it seeks to recover.[574] AOBA cites the Commission's previous order authorizing Pepco's MYP in Case No. 9655 that discusses reviewing any spend on Pepco's 69 kV rebuild program at the conclusions of the MYP period. AOBA argues that this will not occur until June 2024 when the Company's annual information filing will be made and thus it would be inappropriate to the prudency review at this time.[575] AOBA witness B. Oliver also raised concerns with the timeframe afforded to parties to review Pepco's reconciliation requests in the simultaneous context of the projecting rates for an MYP.[576] Therefore, AOBA argued that the Commission should defer consideration of the prudency of these costs in either a separate proceeding or a second phase of this proceeding.[577]

Commission Decision

The Commission established a true-up process for an MYP, where the Commission would assess prudency of spend during the three years of the MYP. The first part of the reconciliation with the prudence review includes both the 1st and 2nd years of MYP during the rate case. The 3rd year of the true up will occur four (4) months after this MYP ends.[578]

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[574] AOBA Initial Brief at 40.
[575] *Id*. at 41.
[576] B. Oliver Direct at 38-39.
[577] AOBA Initial Brief at 41 and B. Oliver Direct at 39.
[578] Order No. 89482, Case No. 9618, para. 80.

The Commission established an asymmetrical true up that would attempt to incentivize the utilities to appropriately forecast their spend. The Commission stated:

> For any over- or under-collection funding during the final reconciliation at the conclusion of the Pilot MRP, the revenue difference shall be placed into a regulatory asset/liability and paid/repaid via a rider according to the authorized MRP rates previously in effect. The period for (re)payment shall be set on a case-by-case basis. In the case of over-collection, the carrying costs shall continue to apply during the period of any repayment to ratepayers. No carrying costs will be paid in cases of under-collection.[579]

Pepco has proposed to recover $8,393,000 in reconciliation for Rate Years 1 and 2 from ratepayers. After performing its prudency review of the Company's costs, Staff determined that no adjustments were required.[580] The Commission will not make adjustments for the two proposals from OPC that would have impacted the reconciliation revenue requirement. For prospective substation equipment, the Commission provided its explanation previously as to why costs will not be disallowed. For the Downtown Resupply Program, the Commission notes that only $37,000 were contested during the reconciliation period. The Commission is not yet convinced that this expenditure is imprudent. Still, this should not be taken as an endorsement of the Downtown Resupply Program and any attempt in the future to collect these costs shall include at a minimum the information previously discussed.

The Commission declines to adopt AOBA's recommendation to defer cost consideration of Rate Years 1 and 2 of Case No. 9655 to a separate proceeding or second phase. As summarized above, the Commission expects the first two years of an MYP to be reviewed for prudence during the pendency of the next rate case filing. While the Commission has been very clear that Pepco is not the pilot MYP utility, the Commission sees no reason to alter the approach it has adopted for reviewing prudency following approval of

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[579] *Id.*, para. 84.
[580] Staff Brief at 13-16.

an MYP. That said, the Commission will continue to require Pepco in any future requests to reconcile costs from previous MYPs to justify the individual projects and O&M spend for those years as it would within a traditional base rate case, as well as justification for any variances from the projected budgets to actual spend.[581] Since the Commission is allowing for cost recovery for only Year 1 in the Company's MYP2 proposal, based on the use of forecasted data, the Commission does not adopt OPC's request to remove the reconciliation process from the MYP. This issue should be rigorously considered in the upcoming lessons-learned proceedings.

For cost allocation, in the instant case, Pepco witness Blazunas proposed to allocate the Case No. 9655 reconciliation imbalances for Rate Years 1 and 2 based on the approved allocation method in Case No. 9655. In this proposal, Classes GT-3B and TN do not receive any revenue allocation in Case No. 9655, and are therefore not allocated any reconciliation in the instant MYP. Staff witness Hoppock agreed with witness Blazunas' proposal regarding reconciliation allocation. He proposed to recover these amounts through the Rider MYP Adjustment starting on July 1, 2024 because the earliest Pepco could begin billing the Rider MYP Adjustment is June 10, 2024 per the Settlement Agreement that extended the procedural schedule in the instant case.

The Commission accepts the Pepco-proposed and Staff-agreed reconciliation allocation methodology and therefore directs Pepco to allocate the Case No. 9655 reconciliation imbalances for Rate Years 1 and 2 based on the approved allocation method in Case No. 9655 and to collect these amounts via the Rider MYP Adjustment starting on July 1, 2024.

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[581] Order No. 89868 at 256. ("[U]ntil MRP regulations have been drafted and promulgated, the Commission expects compliance with those instructions in all future MRP proposals.")

Table 3 - Reconciliation Allocation Results

Class	CN 9655 Allocation Percentage	CN 9655 RY1 Reconciliation	CN 9655 RY2 Reconciliation
RESIDENTIAL (R)	56.98%	$629,629	$4,127,061
RTM	8.98%	$99,229	$650,421
GS-LV	3.18%	$35,139	$230,327
T	N/A	N/A	N/A
EV	N/A	N/A	N/A
MGT-LV	18.25%	$201,663	$1,321,848
MGT-3A	0.27%	$2,984	$19,556
GT-LV	4.13%	$45,637	$299,136
GT-3A	5.34%	$59,007	$386,776
GT-3B	0.00%	$0	$0
TM-RT	0.69%	$7,625	$49,977
SL	0.31%	$3,426	$22,453
SSL	1.86%	$20,553	$134,720
OL	N/A	N/A	N/A
TN	0.00%	$0	$0
TOTAL	**100.00%**	**$1,105,000**	**$7,243,000**

F. Cost of Capital

The cost of capital is the rate of return ("ROR") that a utility pays investors in common stock (equity) and bonds (debt) to attract and retain investment in a financially competitive market. The utility recovers its return on equity ("ROE") and cost of (or "return on") debt through charges paid by its ratepayers. While the cost of debt can be directly observed (as bonds are issued subject to specific interest rates), this rate case features competing cost of debt projections based on the projected movement of bond yields throughout the three-year effective period of rates.

The ROE also requires analysis, as it is typically estimated based on market conditions and different analytical approaches. Once the cost of debt and ROE are determined, they are weighted according to the percentage of debt and equity in the utility's capital structure. The sum of the weighted cost of debt and ROE is the utility's overall ROR. Although Pepco is a subsidiary of Exelon, and thus its stock is not publicly traded,[582] the Commission still must examine Pepco's level of risk and its capital structure (compared to comparably situated companies) to determine its cost of capital.

In this case, the Commission heard testimony on cost of capital from witnesses for Pepco, Staff, OPC, AOBA, and Walmart. In support of their recommendations, Pepco, Staff, OPC, and AOBA presented competing quantitative analyses. The Parties disagreed on several factors within their analyses, including the appropriate proxy groups to utilize, inputs to the discounted cash flow ("DCF"), inputs to the Capital Asset Pricing Model ("CAPM"), beta and market risk premium), the use of empirical CAPM ("ECAPM"), Utility Risk Premium, and Expected Earnings models, the elimination of outliers, the impacts of the current economic climate, and size adjustments.

[582] McKenzi Direct at 15, lines 17-19; and 24 at lines 17-19.

Proxy Groups

As part of their analyses, for purposes of comparison, the Parties attempted to create proxy groups of companies that they contended carry similar risk to Pepco's electric distribution business.[583]

Pepco

Pepco witness McKenzie created an electric-specific proxy group of 23 electric utilities that he referred to as the "Electric Group."[584] Witness McKenzie used the following criteria to identify his proxy group utilities:

(1) inclusion in the Electric Utility industry groups compiled by Value Line;

(2) payment of common dividends over the last six months and no announcement of a dividend cut since that time;

(3) no ongoing involvement in a major merger or acquisition that would distort quantitative results; and

(4) corporate credit ratings from Moody's and S&P within one notch of the Company's current ratings.[585]

Witness McKenzie also evaluated investors' risk perceptions for the Electric Group by looking at Value Line's primary risk indicator of Safety Rank, which is intended to capture the total risk of a stock, Value Line's Financial Strength Ratings, which serves as a guide to overall financial strength and creditworthiness, and beta values, which measures a utility's stock price volatility relative to the market as a whole and reflects the tendency of a stock's price to follow changes in the market.[586] Based on his analysis, witness McKenzie

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[583] Walmart witness Perry's direct testimony does not include discussion of the creation or use of a proxy group.
[584] McKenzie Direct at 26. Witness McKenzie also created a separate proxy group composed of companies in the competitive sector–i.e., a Non-Utility Group. Witness McKenzie did not, however, rely on this group to inform his ROE recommendation. *Id.* at 62.
[585] For Moody's, this resulted in a ratings range of Baa2, Baa1, and A3; for S&P the range was BBB+, A-, and A. *Id*.
[586] *Id*. at 27.

stated that a comparison of these risk indicators between his proxy Electric Group and Pepco shows that "investors would likely conclude that the overall investment risks for Pepco are generally comparable to those of the firms in the Electric Group."[587]

Staff

Staff witness Justi identified a proxy group of 31 electric utilities identified by Value Line as not undergoing a merger and not having a financial strength rating at or below B+. The proxy group also excluded Exelon Corporation as the parent company to Pepco in order to avoid circular reasoning. Staff witness Justi required each utility in the proxy group to have all relevant data necessary to conduct calculations under the DCF and CAPM methods,[588] and removed from his proxy group any company that had an ROE below seven percent or above 14 percent.[589]

Staff witness Justi described the difference between the proxy groups used by Pepco and Staff as Pepco witness McKenzie requiring his proxy group companies to have corporate credit ratings, according to Moody's and S&P, within one notch of the current rating of Pepco. Staff witness Justi noted that the majority of the companies removed by Pepco witness McKenzie because of this requirement are still rated as investment grade companies, and that the result was to have 10 companies that tend to return ROE calculations on the lower end of the range of outcomes removed from Pepco's proxy group, thereby inflating the outcomes of Pepco witness McKenzie's DCF and CAPM calculations. Staff witness Justi testified that the larger sample size of his investment grade proxy group includes more data and therefore produces more accurate results.[590]

[587] *Id*. at 28.
[588] Justi Direct at 18.
[589] *Id*. at 20.
[590] *Id*. at 32.

OPC

OPC witness Woolridge developed a proxy group of 22 publicly-held electric utility companies that have median operating revenues and net plant of $8.28 billion and $25.93 billion, respectively. He further explained that the proxy group on average receives 83 percent of its revenues from regulated electric operations; has a BBB+ bond rating from S&P and a Baa2 rating from Moody's, has a current average common equity ratio of 42.3 percent, and has an average earned return on common equity of 9.03 percent.[591]

Dr. Woolridge noted that Pepco's proxy group was similar to OPC's in size, ratings, average common equity ratio, and average earned return on common equity. OPC witness Woolridge concluded that the Pepco and OPC proxy groups carried similar investment risk to each other, and noted that Pepco has a lower investment risk than other electric utility companies.[592]

AOBA

AOBA witness Timothy Oliver recognized that Pepco witness McKenzie's proxy group could serve as a starting point for assessing electric distribution utility ROE requirements. He argued, however, that the risks and equity return requirements for the companies within Pepco witness McKenzie's proxy group should not be presumed to be comparable to or representative of the risks and return requirements of Pepco's distribution utility operations in Maryland. AOBA witness Oliver explained that Pepco witness McKenzie's proxy group includes utility holding companies with investment portfolios that often include significant non-utility and non-price regulated business activities, which carry higher risk and higher equity return requirements than electric distribution utilities. AOBA

[591] Woolridge Direct at 20.
[592] *Id*. at 20-21.

witness Oliver concluded that reliance on Pepco witness McKenzie's proxy group, without a downward adjustment for Pepco's lesser risk, would overstate Pepco's equity return requirements.[593]

In addition to using Pepco witness McKenzie's proxy group when performing his cost of equity analyses, AOBA witness Oliver also created a proxy group from Pepco witness McKenzie's proxy group, expanding it to include companies previously selected by former Pepco ROE witness D'Ascendis and excluding Exelon.[594]

1. Return on Equity

To determine their respective recommended ROE, Pepco, Staff, OPC, and AOBA used various models to perform their individual ROE analyses, including traditional and widely accepted approaches like the DCF and CAPM models, as well as newer and lesser-used approaches, such as the ECAPM, the Utility Risk Premium Model, and the Expected Earnings Approach. Table 4 shows the Parties' recommended ROEs for Pepco's electric operations.

Pepco witness McKenzie applied the DCF, CAPM, ECAPM, Risk Premium, and Expected Earnings methods to his proxy group of electric utilities, explaining that financial analysts and regulators regularly consider the results of multiple approaches when evaluating a fair ROE.[595] After analyzing the results of the different methods, Pepco witness McKenzie arrived at a cost of equity range for Pepco's electric operations of 10.0 percent to 11.0 percent, ultimately arriving at the midpoint of 10.5 percent as his proposal for a just and

[593] T. Oliver Direct at 15.
[594] *Id*. at 19.
[595] McKenzie Direct at 3 and 34.

reasonable ROE that he contends is adequate to compensate Pepco's investors while maintaining financial integrity and the ability to attract capital on reasonable terms.[596]

Staff witness Justi applied the DCF and CAPM methods to his proxy group of utilities, weighing the two methods equally.[597] Staff witness Justi disagreed with Pepco witness McKenzie's economic outlook - that expected inflation compensation is implicitly expected in the required ROR for long-term capital - instead, stating that the current economic environment does not warrant major changes to the existing ROE of 9.55 percent.[598] After analyzing the results of the different methods, Staff witness Justi arrived at a cost of equity range for Pepco's electric operations of 9.31 percent to 9.81 percent, ultimately arriving at the midpoint of 9.55 percent as his proposal for a just and reasonable ROE.[599]

Dr. Woolridge applied the DCF and CAPM methods to his proxy group and Pepco witness McKenzie's proxy group, relying primarily on the DCF model, and recommended an ROE of 9.375 percent; however, since Pepco's credit ratings indicate that its investment risk level is below the average of his proxy groups, he developed a risk adjustment that led him to recommend an ROE of 9.25 percent.[600] OPC witness Woolridge disagreed with Pepco witness McKenzie's ROE analysis, stating that despite the increase in inflation and interest rates over the past two years, long-term inflation expectations are about 2.25 percent; therefore the equity cost rate for utilities should not see an increase.[601]

AOBA witness Oliver applied the DCF and CAPM methods to his proxy group and Pepco witness McKenzie's proxy group, ultimately recommending that the Commission

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[596] *Id*. at 3.
[597] Justi Direct at 31.
[598] *Id*. at 14.
[599] *Id*. at 9.
[600] Woolridge Direct at 6.
[601] *Id*. at 8.

authorize an ROE for Pepco of 9.10 percent, thereby reflecting a 25-basis point downward adjustment to its currently authorized ROE of 9.55 percent and a 25-basis point MYP risk reduction adjustment.[602] AOBA witness Oliver disagreed with Pepco witness McKenzie's use of Value Line earnings growth estimates and betas for his proxy group, claiming that it introduced a significant upward bias in his ROE estimates and is out of line with other publicly available measures of earnings growth estimates and betas, and is therefore not reasonable to rely upon for an ROE determination.[603] AOBA witness Oliver also noted that the various cost of equity analyses performed by Pepco witness McKenzie resulted in a range from 8.9 to 11.4 percent, which he alleged was "sufficiently broad to render it essentially meaningless."[604]

While Walmart did not recommend a specific ROE, it did express concern about the reasonableness of Pepco's proposed ROE in light of the customer impact of the resulting revenue requirement increases, recent ROEs approved by the Commission as well as other state utility regulatory commissions, Pepco's current ROE, and the reduced risk associated with an MYP due to regulatory lag between rate cases and the use of a forward-looking test year.[605] As a result, Walmart recommended that the Commission approve an ROE that does not exceed Pepco's currently-approved ROE of 9.55 percent.[606]

[602] T. Oliver Direct at 9 and 19.
[603] *Id*. at 6.
[604] *Id*. 16.
[605] Perry Direct at 9.
[606] Walmart Initial Brief at 6.

Table 4 – Parties' Recommended ROE

Party	ROE Range	ROE Recommendation
Pepco	10.00 - 11.00%	10.50%
Staff	9.32 - 9.81%	9.55%
OPC	8.60 - 9.60%	9.25%
AOBA	Reduces Pepco's current 9.55% ROE by 25 basis points downward for gradualism and another 25 basis points for MYP risk reduction	9.10%

Discounted Cash Flow Analysis

Pepco

Pepco witness McKenzie explained that the DCF model is based on the assumption that the price of a share of common stock is equal to the present value of the expected cash flows (i.e., future dividends and stock price) that will be received while holding the stock, discounted at investors' required ROR. He further testified that the DCF model can be simplified to an equation reflecting "constant growth," where the cost of equity is equal to the ratio of the expected dividend per share in the coming year and the current price per share (called the dividend yield) plus the investor's long-term growth expectations.[607]

In his direct testimony, Pepco witness McKenzie explained that the DCF model required three steps. First, determine the expected dividend yield for the company, which is usually calculated based on an estimate of dividends to be paid in the coming year divided by

[607] McKenzie Direct at 38.

the current price of the stock.[608] Second, estimate investors' long-term growth expectations for the company. Third, add the company's dividend yield and estimated growth rate to arrive at an estimate of its cost of common equity.[609]

In determining Pepco's expected dividend yield, Pepco witness McKenzie used Value Line estimates of the dividends to be paid by each of the utilities in his proxy group over the next 12 months.[610] This annual dividend was then divided by a 30-day average stock price for each utility to arrive at the expected dividend yield. The dividend yields for the utilities in his proxy group ranged from 2.5 percent to 5.0 percent, with an average of 3.7 percent.[611]

When determining the long-term growth expectations, Pepco witness McKenzie indicated that, while there are many techniques that can be used to derive long-term growth rates, when applying the DCF model the only long-term growth expectation that matters is the value that investors expect. Pepco witness McKenzie testified that he relied on projected growth rates for the proxy groups published by Value Line, IBES, and Zacks, and that he calculated projected "sustainable growth rates" for the proxy companies.[612]

Pepco witness McKenzie testified that, in evaluating the results of the constant growth DCF model, it is essential that resulting values pass fundamental tests of reasonableness and economic logic. "Accordingly, DCF estimates that are implausibly low or high should be eliminated when evaluating the results of this method."[613] He noted that Staff

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[608] *Id*. at 38-39.
[609] *Id*. at 39.
[610] Pepco witness McKenzie also performed a DCF analysis on a "non-utility group," which he described as a group of low-risk firms in the competitive sector. He noted that he did not consider the analysis directly in arriving at his recommended ROE range of reasonableness, but that he does find the analysis to be a relevant consideration in evaluating a fair ROE for Pepco, given that it has to compete with non-regulated firms for capital. *Id*. at 62.
[611] *Id*.
[612] *Id*. at 41.
[613] *Id*. at 44.

and FERC agree that adjustments are justified where applications of the DCF approach produce illogical results.[614]

Based on his DCF analysis, Pepco witness McKenzie projected a range of ROEs with averages between 8.9 percent and 10.1 percent, and midpoints ranging between 9.2 percent and 11.5 percent.[615]

Staff

Staff witness Justi also performed a DCF analysis. He explained that the expected dividend growth rate data for his model was collected from Value Line, which provides analyst-projected three- to five-year dividend growth rates.[616] He collected expected earnings per share growth rates from analyst projections at Value Line, Yahoo, and Zack's, which provide three- to five-year or five-year expected growth rates.[617] After calculating the DCF ROE for the companies in his proxy sample, Staff witness Justi excluded any results that were below seven percent or above 14 percent in order to avoid illogically low or high findings, then averaged the ROE outputs for the remaining companies, which resulted in a range of ROEs with averages between 9.78 percent and 9.85 percent, with an overall average of 9.81 percent.[618]

OPC

Similar to Pepco, Dr. Woolridge employed the traditional constant-growth DCF model. He testified that "[t]he economics of the public utility business indicate that the industry is in the steady-state or constant-growth stage of a three-stage DCF," and that "the primary problem and controversy in applying the DCF model to estimate equity-cost rates

[614] *Id*. at 44-45.
[615] *Id*. at 47.
[616] *Id*. at 19.
[617] *Id*. at 20.
[618] Justi Direct at 20-21.

entails estimating investors' expected dividend growth rate."[619] OPC witness Woolridge further noted that, when using the DCF model, one must be sensitive to several factors, including estimating the dividend yield and the expected growth rate as they tend to vary and be dependent upon multiple other factors.[620]

For his proxy group, Dr. Woolridge testified that the mean and median dividend yields using the 30-day, 90-day, and 180-day average stock prices ranged from 3.90 to 4.60 percent, and that he used the midpoint of 4.25 percent as his dividend yield. He performed the same analysis for Pepco witness McKenzie's proxy group, with mean and median dividend yields ranging from 3.7 to 4.20 percent, resulting in a midpoint of 4.00 percent for the dividend yield.[621]

OPC witness Woolridge also performed the expected growth rate analysis for the proxy groups, stating that he "reviewed Value Line's historical and projected growth rate estimates for earnings per share ("EPS"), dividends per share ("DPS"), and book value per share ("BVPS")," and "utilized the average EPS growth rate forecasts of Wall Street analysts as provided by Yahoo, Zacks, and S&P Cap IQ."[622] Dr. Woolridge asserted that there is upward bias in analysts' long-term EPS growth rate forecasts, and that stock prices reflect the bias, thereby requiring a downward adjustment to the DCF growth rate.[623] Dr. Woolridge's DCF analysis resulted in an ROE range between 9.50 and 9.60 percent.[624]

Dr. Woolridge raised several issues with Pepco witness McKenzie's DCF analysis, including the asymmetric elimination of low-end DCF results and the excessive use of the

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619 Woolridge Direct at 32.
620 *Id*. at 32-33.
621 *Id*. at 33.
622 *Id*. at 35.
623 *Id*. at 40 and 42.
624 *Id*. at 45.

aforementioned overly optimistic and upwardly biased EPS growth rate forecasts. He explained that "[b]y eliminating low-end outliers while keeping the same number of high-end outliers, Mr. McKenzie biases his DCF equity cost rate study and reports a higher DCF equity cost rate than the data indicate," and that by exclusively relying on the projected growth rates of Wall Street analysts and Value Line, Pepco witness McKenzie improperly inflated his growth rate estimates.[625]

OPC witness Woolridge also asserted that Staff witness Justi overstated his DCF equity cost rate due to his exclusive use of the "overly-optimistic and upwardly biased" EPS growth rate forecasts of Value Line and Wall Street analysts.[626]

AOBA

AOBA witness T. Oliver employed annual high and low stock price data and earnings growth projections from Zacks, Seeking Alpha, and Yahoo in a traditional constant growth DCF model. He noted that, because he made no explicit adjustment for the reduced risk of a distribution utility from that of a holding company, "the results of the DCF analysis should be viewed as an upper bound for an appropriate return of equity for a distribution utility such as Pepco."[627] AOBA witness Oliver took issue with Pepco witness McKenzie's over-reliance on Value Line estimates in performing his DCF analysis.[628] AOBA witness Oliver's average DCF result was 8.589 percent.[629]

Walmart

Walmart witness Perry did not perform a DCF analysis.

[625] *Id*. at 9.
[626] Woolridge Rebuttal at 3.
[627] T. Oliver Direct at 20.
[628] *Id*. at 21.
[629] *Id*. at 22.

Capital Asset Pricing Model Analysis

Pepco

Pepco witness McKenzie testified that the CAPM "is a theory of market equilibrium that measures risk using the beta coefficient," which measures the tendency of a stock's price to follow changes in the market. He explained that a stock that tends to respond less to market movements has a beta less than 1.0, while stocks that tend to move more than the market have betas greater than 1.0. Pepco witness McKenzie testified that, like the DCF Model, CAPM is a forward-looking model based on expectations of the future.[630] He also testified that the CAPM is considered to be the most widely referenced method among both academicians and professionals for estimating the cost of equity, and thus provides important insight into investors' required rate of return for utility stocks.[631]

In his direct testimony, Pepco witness McKenzie explained that application of the CAPM to his proxy group involved estimating the expected market rate of return by conducting a DCF analysis on the dividend paying firms in the S&P 500. "The dividend yield for each firm is obtained from Value Line, and the growth rate is equal to the average of the earnings growth projections for each firm published by IBES, Value Line, and Zacks, with each firm's dividend yield and growth rate being weighted by its proportionate share of total market value."[632] Pepco witness McKenzie removed companies with growth rates that were negative or greater than 20 percent, resulting in an average growth rate over the next five years of 9.5 percent, which he combined with a year-ahead dividend yield of 2.1 percent to arrive at an 11.6 percent current cost of common equity estimate.[633]

[630] McKenzie Direct at 47.
[631] *Id*. at 48.
[632] *Id*.
[633] *Id*. at 49.

Pepco witness McKenzie also testified that the CAPM does not fully account for observed differences in rates of return attributable to firm size, thereby requiring a modification to recognize the impact of size distinctions, as measured by the market capitalization for the firms in his proxy group.[634] After adjusting for the impact of firm size, Pepco witness McKenzie projected an average ROE for his proxy group of 11.0 percent.[635]

Staff

Staff witness Justi also performed a CAPM analysis.[636] He defined the risk-free rate of return for his model as the six-month average yield of the US 30-year treasury bond as of the end of each trading day with data between April 24, 2023 and October 20, 2023, or 4.16 percent. The market rate of return for his model was the risk-free rate added to his calculated historical risk premium, or 11.33 percent.[637] Finally, Staff witness Justi calculated the betas for his CAPM analysis using beta calculation tools provided by S&P Capital IQ, then conducting both Blume and Vasicek adjustments.[638]

Based on his CAPM analysis, Staff witness Justi projected ROEs for his betas of 8.91 percent and 9.73 percent, with an overall average of 9.32 percent.[639]

OPC

For his CAPM analysis, Dr. Woolridge used a risk-free interest rate of 4.40 percent based on historical Treasury yields,[640] betas published by Value Line and S&P Capital IQ,[641]

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[634] *Id*. at 49-50.
[635] *Id*. at 52.
[636] Justi Direct at 8.
[637] *Id*. at 22.
[638] *Id*. at 23-24.
[639] *Id*. at 31.
[640] Woolridge Direct at 48-49.
[641] *Id*. at 52.

and a market risk premium of 5.25 percent.[642] Based on his CAPM analysis, OPC witness Woolridge calculated CAPM ROEs of 8.60 percent for his proxy group and 8.65 percent for Pepco witness McKenzie's proxy group.[643]

Dr. Woolridge took issue with several aspects of Pepco witness McKenzie's CAPM analysis, including the use of a highly overstated market risk premium of 7.80 percent, the use of unrealistic assumptions regarding future economic and earnings growth and stock returns, and the inclusion of an unwarranted utility size adjustment.[644]

OPC witness Woolridge also asserted that Staff witness Justi's CAPM analysis included an inflated and flawed measure of the market because he used only historical data to measure his equity risk premium-a practice he claimed is well-known to be erroneous and overstate the true market equity[645]-thereby leading to an overstated CAPM analysis ROE.[646]

AOBA

AOBA witness Oliver stated that the risk-free rate used in a CAPM analysis should be based on recent actual 30-year Treasury rates. He used the rate as of November 27, 2023, 4.57 percent.[647] AOBA witness Oliver took issue with Pepco witness McKenzie's CAPM analysis based on the over-reliance on Value Line estimates and the use of beta coefficients to avoid addressing the absence of data required to assess the differences in risk associated with stock price volatility, noting that beta coefficients and other market-based measures of risk cannot be computed for a company that does not have publicly traded stock. Instead,

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[642] *Id*. at 62.
[643] *Id*. at 63.
[644] *Id*. at 10.
[645] Woolridge Rebuttal at 5.
[646] *Id*. at 9.
[647] T. Oliver Direct at 20.

AOBA witness T. Oliver elected to account for such risk differentials through adjustments to the assumed risk premiums.[648]

AOBA witness Oliver's average CAPM result was 8.94 percent.[649]

Walmart

Walmart witness Perry did not perform a CAPM analysis.

Empirical Capital Asset Pricing Model Analysis

Pepco

Pepco witness McKenzie also presented testimony on ECAPM, a modified version of the CAPM. He noted that empirical tests of the CAPM have shown that low-beta securities earn somewhat higher returns than the standard CAPM would predict, while high-beta securities earn less than predicted. For utility stocks, which tend to have betas less than 1.0, this implies that CAPM tends to understate the cost of equity.[650]

Pepco witness McKenzie explained that, like the CAPM formula, the ECAPM represents a stock's required return as a function of the risk-free rate, plus a risk premium. This risk premium is composed of two parts: (1) the market risk premium, weighted by a factor of 25 percent, and (2) a company-specific risk premium based on the stock's relative volatility, weighted by 75 percent. Thus ECAPM, with its associated weighting factors, recognizes the observed relationship between standard CAPM estimates and the cost of capital documented in the financial research; it also corrects for the understated returns that would otherwise be produced for low-beta stocks.[651]

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[648] *Id*. at 21.
[649] *Id*. at 22.
[650] McKenzie Direct at 52-53.
[651] *Id*. at 54.

Pepco witness McKenzie explained further that his applications of the ECAPM were based on the same forward-looking market rate of return, risk-free rates, and beta values used with his CAPM analysis. He applied the forward-looking ECAPM approach to the firms in his proxy group which, after incorporating the size adjustment corresponding to the market capitalization of the individual utilities, yielded an average cost of equity estimate of 11.2 percent.[652]

Staff

Staff witness Justi did not perform an ECAPM analysis, stating that he disagreed with Pepco witness McKenzie that the ECAPM is necessary and more accurate than the CAPM, and that the Commission has noted concerns with the method.[653]

OPC

Dr. Woolridge did not perform an ECAPM analysis. He described the ECAPM as "nothing more than an ad hoc version of the CAPM" that has not been theoretically or empirically validated. OPC witness Woolridge also stated that he was not aware of any tests of the CAPM that use adjusted betas such as those used by Pepco witness McKenzie in his ECAPM analysis.[654]

AOBA

AOBA witness Oliver did not perform an ECAPM analysis.

Walmart

Walmart witness Perry did not perform an ECAPM analysis.

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[652] *Id*. at 55-56.
[653] Justi Direct at 48.
[654] Woolridge Direct at 72-73.

Utility Risk Premium Model Analysis

Pepco

Pepco witness McKenzie also presented testimony on the Utility Risk Premium Model for determining ROE, which he described as extending the risk-return tradeoff observed with bonds to estimate investors' required rate of return on common stocks.[655] He explained that, under this model, "[t]he cost of equity is estimated by first determining the additional return investors require to forgo the relative safety of bonds and to bear the greater risks associated with common stock, and by then adding this equity risk premium to the current yield on bonds." Pepco witness McKenzie testified that this approach is based on the fundamental risk-return principle which holds that investors will require a premium in the form of a higher return in order to assume additional risk.[656] He further testified that estimates of equity risk premiums for utilities are based on surveys of previously authorized ROEs, which are presumed to reflect regulatory commissions' best estimates of the cost of equity.[657] For his estimates, Pepco witness McKenzie relied on data compiled by S&P Global Market Intelligence and published in its RRA Regulatory Focus Report.[658]

Pepco witness McKenzie also noted that the magnitude of equity risk premiums is not constant and tends to move inversely with interest rates. "In other words, when interest rate levels are relatively high, equity risk premiums narrow, and when interest rates are relatively low, equity risk premiums widen. The implication of this inverse relationship is that the cost of equity does not move as much as, or in lockstep with, interest rates."[659] He further testified that, in using regression analysis, "the equity risk premium for electric utilities increases by

[655] McKenzie Direct at 56.
[656] *Id*.
[657] *Id*. at 56-57.
[658] *Id*. at 57.
[659] *Id*. at 57-58.

approximately 43 basis points for each percentage point drop in the yield on average public utility bonds."[660] He noted that "with an average yield on public utility bonds for the six months ending March 2023 of 5.75 [percent], this implies a current equity risk premium of 4.89 [percent] for electric utilities. Adding this equity risk premium to the average yield on Baa-rated utility bonds implies a current ROE of 10.64 [percent]."[661]

Staff

Staff witness Justi did not perform an analysis of the Utility Risk Premium Model, stating that the approach should be given little weight compared to the more focused, market-based analysis that comes from the two most common financial valuation tools, the DCF and the CAPM.[662]

OPC

Dr. Woolridge did not perform an analysis of the Utility Risk Premium Model, but identified two issues with Pepco witness McKenzie's analysis that resulted in what he considered an inflated ROE. First, the bond's yield-to-maturity as a base yield led to an overstatement of investors' return expectations, and second, the risk premium produced by Pepco's analysis was overstated as a measure of investor return requirements, producing an inflated equity cost rate.[663]

AOBA

AOBA witness Oliver did not perform an analysis of the Utility Risk Premium Model.

[660] *Id*. at 59.
[661] *Id*.
[662] Justi Direct at 50.
[663] Woolridge Direct at 97.

Walmart

Walmart witness Perry did not perform an analysis of the Utility Risk Premium Model.

Expected Earnings Approach Analysis

Pepco

Pepco witness McKenzie also presented testimony on the Expected Earnings Approach, which he characterized as consistent with the economic underpinnings for a just and reasonable rate of return established by the U.S. Supreme Court in Bluefield and Hope.[664] He also stated that Expected Earnings Approach avoids the complexities and limitations of capital market methods and instead focuses on the returns earned on book equity, which are readily available to investors. He further stated, "[t]he simple, but powerful concept underlying the expected earnings approach is that investors compare each investment alternative with the next best opportunity."

In applying the Expected Earnings Approach, Pepco witness McKenzie compared the actual earnings of the companies in his proxy group and the book value of their investment to the allowed return of Pepco.[665] The projections for the proxy group suggest an average ROE of 11.4 percent.[666]

Staff

Staff witness Justi did not perform an analysis of the Expected Earnings Approach, asserting that cost of capital should be based on market value, not book value, due in part to the fact that utilities can directly influence their book value and that the approach relies on

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[664] McKenzie Direct at 59.
[665] *Id*. at 60.
[666] *Id*. at 62.

projection through 2027, which involves a forecast horizon that is too long and a margin of error that is therefore too wide.[667]

OPC

OPC witness Woolridge did not perform an analysis of the Expected Earnings Approach, and suggested that the Commission ignore Pepco witness McKenzie's Expected Earnings Approach analysis in setting an ROE for Pepco. In support of his position, he stated that Pepco witness McKenzie's approach did not measure the market cost of equity capital, is independent of most cost of capital indicators, and involves ROE ratios that are largely the result of federal and state regulation rather than competitive market forces.[668]

AOBA

AOBA witness Oliver did not perform an analysis of the Expected Earnings Approach.

Walmart

Walmart witness Perry did not perform an analysis of the Expected Earnings Approach.

2. Capital Structure

Pepco proposed a capital structure of 50.50 percent common equity and 49.50 percent long-term debt. Pepco witness Tomney testified that this proposed capital structure is consistent with Pepco's goals and objectives to maintain its current credit ratings and target equity ratio of at least 50 percent.[669] She further explained that the proposed capital structure

[667] Justi Direct at 53.
[668] Woolridge Direct at 100-102.
[669] Tomney Direct at 12.

is reasonable given an average common equity ratio of 52.0 percent and a range of 40.8 percent to 65.0 percent for the companies in Pepco witness McKenzie's proxy group.[670]

Staff, OPC, and AOBA agreed to Pepco's proposed capital structure of 50.50 percent common equity and 49.50 percent long-term debt,[671] though Dr. Woolridge did note that the capital structure has more equity capital and less financial risk than OPC and Pepco's proxy groups.[672]

3. Cost of Debt

Pepco

The overall ROR is the weighted average, based on Pepco's forecasted ratios of common equity and long-term debt, of the projected embedded cost of debt for each year of the MYP as well as Pepco witness McKenzie's recommended 10.5 percent ROE.[673] Pepco proposed long-term debt cost rates of 4.99 percent in 2024-2025, 5.04 percent for 2025-2026, 5.06 percent for 2026-2027, and 5.07 percent for 2027.[674] Pepco witness Tomney explained that the forecasted cost of debt reflects forecasted debt issuances in the budget during the MYP period as well as the bridge years, and that the cost of debt includes Pepco's $85 million and $100 million 10-year long-term bond issuances, $40 million 15-year long-term bond issuance, and $125 million 30-year long-term bond issuance that were priced and closed on February 28, 2023.[675] She further explained that the projected embedded cost of debt for each of the bridge years and the MYP years (4.97 percent) represents the overall cost

[670] *Id*. at 13-14.
[671] McKenzie Direct at 10, Justi Direct at 13, Woolridge Direct at 5, and T. Oliver Direct at 10.
[672] Woolridge Direct at 9.
[673] Tomney Direct at 10-11.
[674] *See* Woolridge Direct at 4.
[675] Tomney Direct at 14.

for all long-term debt projected to be outstanding at the end of each period, including any new long-term debt issuances and retirements planned for each of those periods.[676]

Pepco witness Tomney also proposed an overall ROR of 7.77 percent, 7.79 percent, 7.80 percent, and 7.81 percent for the MYP periods ending March 31 of 2025, 2026, and 2027, and the 12-months ending December 31, 2027, respectively. Pepco proposed an ROR based on the forecasted embedded cost of debt from April 1, 2024 through December 31, 2027, which does not change the overall ROR by more than three basis points over the MYP periods. The year over year increase in the cost of debt is based on projected issuances and retirements.[677]

Pepco witness Tomney noted that, while the Commission authorized an ROR in Case No. 9655 that included a fixed cost of debt (4.82 percent) for the three-year rate effective period (April 1, 2021-March 31, 2024) with no ability to recognize any fluctuation in actual interest rates, that decision led to Pepco and its customers being exposed to a higher cost of debt than was actually experienced, resulting in an over-recovery for Pepco.[678] As a result, Pepco requests the Commission's approval to include in the reconciliation process the actual cost of long-term debt beginning in the MYP proposed in this proceeding and going forward in order to allow Pepco to recover the actual cost of debt, while protecting customers by returning to them any potential value associated with a lower actual cost of debt.[679] In other words, while currently the ROR is based on the authorized cost of debt and authorized ROE, weighted by the authorized capital structure, Pepco's proposal would allow for the use of the

[676] *Id*. at 14 and 16.
[677] *Id*. at 11.
[678] The over-recovery was for the 12-months ending March 31, 2022. Pepco projects an over-recovery for the cost of debt for the 12-months ending March 31, 2023 and an under-recovery of the cost of debt for the 12-months ending March 31, 2024. *Id*. at 15-16.
[679] *Id*. at 16-17.

actual cost of debt in the calculation of the ROR, while maintaining the authorized ROE and capital structure.[680]

Pepco witness Barnett further testified on the request, noting that long-term debt rates are market driven and therefore may differ from the authorized cost of debt during the MYP–something over which Pepco has no control. He goes on to assert that allowing the true-up for the actual cost of long-term debt in the MYP reconciliations would protect customers from paying long-term debt costs that are not actually experienced.[681] Pepco witness Barnett stated that allowing the cost of debt true-up in the reconciliation process would not change Pepco's financing objectives for issuing long-term debt in the capital markets; rather, Pepco would remain committed to maintaining a strong balance sheet and its investment grade credit ratings, which help to ensure that it can issue debt in the most cost effective manner at the time.[682]

In the alternative, if the Commission were to deny the reconciliation approach, Pepco witness Barnett proposed that the Commission permit Pepco to enter into what is known as a forward starting interest rate hedging mechanism, locking into a specific interest rate for up to 70 percent of the principal of an issuance. If the interest rate at the time of the issuance was higher than the agreed upon rate in the hedging mechanism, Pepco would receive proceeds representing the difference in interest rates. Conversely, if the interest rates at the time of issuance were lower than the agreed upon rate in the hedging mechanism, Pepco would pay the proceeds representing the difference in interest rates.[683]

[680] *Id*. at 20.
[681] Barnett Direct at 55.
[682] *Id*. at 56.
[683] *Id*. at 57.

Staff

Based upon Staff witness Justi's ROE recommendation of 9.55 percent, the implied rate of return proposed by Staff is 7.15 percent.[684]

Staff witness Justi recommended that the Commission reject Pepco's request for the interest rate true-up mechanism. While he acknowledged that there is value to the proposal from the perspective of reducing interest rate risk, he noted greater value in maintaining the incentive for the Company to manage its cost of debt. Furthermore, Staff witness Justi pointed out that the proposal would shift risk from the utility to ratepayers, and that electric distribution utilities are generally very low risk companies.[685] If the Commission were to accept Pepco's proposal, Staff witness Justi asserted that Pepco would become "meaningfully less risky," thus warranting a corresponding downward adjustment to the ROE.[686]

OPC

Using Pepco's proposed capital structure and long-term debt cost rates, as well as his recommended 9.25 percent ROE, Dr. Woolridge proposed an overall rate of return for Pepco of 7.14 percent in 2024-2025, 7.17 percent in 2025-2026, 7.18 percent in 2026-2027, and 7.18 percent in 2027.[687]

AOBA

AOBA witness Oliver asserted that, in light of the Commission's determinations in Case No. 9618, Order No. 89482, the use of a fixed capital structure, return on equity, and costs of long-term debt for the MYP period is appropriate. Furthermore, a fixed rate of return

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[684] Justi Direct at 13.
[685] *Id*. at 59.
[686] *Id*. at 60.
[687] Woolridge Direct at 6.

would additionally be applicable if the Commission does not approve an MYP for Pepco in this proceeding.[688]

AOBA witness Oliver further recommended that the Commission reject Pepco's proposal to reconcile its costs of long-term debt over its proposed MYP, and instead find that utilization of 5.04 percent - the average cost of Pepco's long-term debt for its proposed MYP - is reasonable for all periods of a revenue requirement.[689]

Using Pepco's proposed capital structure, his proposed adjusted costs for long-term debt, and his ROE recommendation, AOBA witness Oliver recommended an overall rate of return for Pepco of 7.21 for the historical test year and bridge years, and 7.09 for each MYP period.[690]

Commission Decision

In determining a utility's appropriate rate of return, the Commission adheres to the general principles established in the U.S. Supreme Court's Bluefield[691] and Hope[692] decisions. Stated succinctly, the Bluefield and Hope cases require returns that are sufficient to attract capital on reasonable terms, maintain the utility's financial integrity, and provide investors with the opportunity to earn a return comparable to investments carrying similar risks.[693]

The Commission must also ensure that a public utility charges just and reasonable rates for the regulated services that it provides.[694] Pursuant to well-established regulatory

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[688] T. Oliver Direct at 6.
[689] *Id*. at 6 and 24.
[690] *Id*. at 24.
[691] *Bluefield Waterworks and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).
[692] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("*Hope*").
[693] *Hope* at 603.
[694] A "just and reasonable rate" is one that: (1) does not violate any provision of the Public Utilities Article of the Maryland Code, (2) fully considers and is consistent with the public good, and (3) will result in an operating

principles, regulated utilities are allowed the opportunity to recover the costs of prudently incurred debt financing and to earn a return on equity financing.

In a proceeding involving a change in rates, the burden of proof is on the proponent of the change. Thus, in the instant matter, Pepco bears the burden to support every element of its request for a rate increase. As testified to by all parties, long standing Supreme Court precedent—primarily Bluefield and Hope—established a standard by which the Commission is to consider certain factors when determining whether to allow a change in a utility's rates so as to allow the recovery of financing costs.

The Parties in this rate proceeding have used a variety of models, methodologies, and assumptions to determine an ROE for Pepco. Given that the cost of equity cannot be observed directly, the Commission must carefully consider both traditional methods and new approaches, when justified. Nonetheless, the Commission has previously addressed concerns with the use of the ECAPM and size adjustments.[695]

To be sure, the ultimate ROE set by the Commission must reflect observable market information, including comparisons with equity returns earned by comparable companies. There are numerous judgment calls when making those calculations, including the selection and weighting of the various methods for comparing companies, the selection of those comparable companies, and the inputs to the various formulae for estimating future cash flows and risk levels.

The Commission is also concerned by the testimony regarding the impact on ROEs of using midpoints versus medians or averages, and the possibility that reliance on midpoints

income to the public service company that yields, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a reasonable return on the fair value of the public service company's property used and useful in providing service to the public. PUA §§ 4-101, 4-201.

[695] Order No. 89868 at 155.

exclusively may give undue weight to outliers and analyst discretion, while undervaluing the distribution of the bulk of data points.

The overall spectrum of recommended ROEs encompassed Pepco's 10.5 percent (the highest), Staff's 9.55 percent, OPC's 9.25 percent, and AOBA's 9.10 percent (the lowest). For reference purposes, the average ROE authorized by state regulatory commissions for investor-owned utilities in 2020, 2021, 2022, and 2023 was 9.45 percent, and the average ROE authorized for distribution-only utilities over the same time period was 9.12 percent.[696]

The Commission finds, as an initial matter, that Pepco's recommended 10.5 percent cost of equity is unsupported by the record in this proceeding. Pepco's request is a significant increase from its current ROE of 9.55 percent, does not reflect current market conditions, and does not conform to this Commission's gradualism precedent.[697] Furthermore, while the ROEs recommended by OPC and AOBA - 9.25 and 9.10 percent, respectively - are not as drastic of a change from the current ROE as Pepco's recommendation, they are lower than recent national averages for investor-owned utilities and, in the case of AOBA, is based upon the Commission's approval of an MYP which, as addressed elsewhere, is not relevant.

The Commission finds that an ROE of 9.50 percent for Pepco's distribution service is appropriate, within the zone of reasonableness, supported by the evidence presented, and consistent with statutory and other legal standards. The Commission also finds that this ROE is comparable to returns investors expect to earn on investments of similar risk as demonstrated through the use of the witnesses' proxy groups, is sufficient to assure

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[696] *See* Perry Direct at 12.

[697] The Commission has noted that, "it is important that the Commission make gradual changes, and otherwise encourage a regulatory environment that does not surprise investors with changes that impact them adversely." Maillog No. 204346: Order No. 87884, *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. 9418. slip op. at 101 (Nov. 15, 2016).

confidence in Pepco's financial integrity, and is adequate to maintain and support Pepco's credit and attract needed capital. The Commission notes that Pepco's business should be enhanced with the concerted push for decarbonization and increased electrification. Finally, this approved ROE is consistent with the nationwide average of awarded ROEs for electric utilities in recent years and at present, which have stayed steady even as interest rates have fluctuated.[698]

The Commission also finds that a fixed cost of debt based on Pepco's actual cost of debt at the time of filing is appropriate as this is a single year MRP. The Commission therefore approves a fixed cost of debt of 4.71 percent for the rate period approved in this Order, finding that it is supported by the evidence and provides Pepco with a reasonable opportunity of recovering its actual cost of debt. The Commission also denies Pepco's proposal for reconciliation of its long-term debt costs as unnecessary given the decision to set rates on the basis of a single test year, and the Commission sees value in the incentive provided to the Company in its management of its cost of debt.[699]

Finally, the Commission approves Pepco's proposed capital structure, which was unopposed by the Parties. The long-standing precedent in Maryland is that a utility's actual test-year-ending capital structure should be used when determining its authorized rate of return in a base rate proceeding, absent evidence that the actual capital structure would impose an undue burden on ratepayers. Pepco's proposed capital structure was not challenged by other Parties and is in line with Pepco's actual capital structure and with those historically approved by this Commission. Pepco's approved overall rate of return, based on the Commission's decisions in this case, is 7.13 percent.

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[698] Woolridge Direct at 15.
[699] The Commission recently made similar findings for fixed cost of debt and reconciliation of debt in BGE Case No. 9692, *Order No. 90948*, at 243-244.

G. Cost of Service

Cost of Service Study (COSS) - Jurisdictional COSS (JCOSS) and Class COSS (CCOSS)

Pepco developed both a Jurisdictional and a Class Cost of Service Study ("JCOSS") to guide the allocation of Pepco's costs during the test period (in this case, the one year ending on March 31, 2022). During the rate-design process, the Commission relies upon these studies, as well as other parties' criticisms of it, to determine whether the revenue allocated to Pepco and to each of Pepco's customer classes is adequate and covers the costs of that class. The JCOSS allocates the electric distribution costs between Pepco's Maryland and District of Columbia service territories. Once the electric distribution costs have been allocated between Maryland and the District of Columbia, the CCOSS allows the Commission to focus on the allocation of costs within Pepco's Maryland rate classes.

The Class Cost of Service Study ("CCOSS") estimates the ROR for each customer class and calculates the Relative Rate of Return (RROR) based upon the system average ROR for all customer classes. The principles of cost causation and gradualism largely determine the final ROR for each class. Regarding the ROR, a class with a return equal to the system average ROR has an RROR of 1.00. An RROR over 1.00 indicates that this customer class is over-earning and effectively subsidizing other classes. Similarly, an RROR under 1.00 indicates that this customer class is under-earning and effectively being subsidized by other classes.

The common goal of rate design is to move all class RRORs closer to an RROR of 1.00. Historically, the Commission has balanced that goal against the principle of gradualism to avoid sudden and sharp rate increases within customer classes.

1. Jurisdictional Cost of Service

Pepco

Pepco witness Leming developed the Company's JCOSS using allocations and assignments consistent with those presented in Pepco's previous rate case (Case No. 9655). He testified that Pepco does not maintain historic financial records on a distribution-only basis. Instead, Pepco's records include Standard Offer Service (SOS), transmission, and distribution lines of business.[700] Relying upon FERC's Uniform System of Accounts (USoA), Pepco calculates its historic distribution-only cost of service. The FERC USoA defines and describes accounts that are specific to the distribution function of an electric utility and contain the majority of costs, on both the plant and expense side.[701]

In Schedule RTL-3, witness Leming assigned and allocated each element of Pepco's unadjusted rate base, revenues, and expenses to the Company's Maryland jurisdiction. All other costs assigned and allocated outside of Maryland are in the "Other" jurisdiction.[702] Electric Plant in Service (EPIS) for distribution plant accounts 360-368 are assigned to Maryland directly. EPIS for sub-transmission plant accounts are allocated between jurisdictions using the Average and Excess Non-Coincident Peak Demand (AED-NCP) method. The Commission found these jurisdictional allocations and assignments to be reasonable in Case No. 9655.[703]

Staff

Staff witness Delgado reviewed the Company's proposed JCOSS and agreed that it is consistent with the Commission's findings in Case No. 9655. Witness Delgado noted that

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[700] Leming Direct at 47.
[701] *Id. See also,* Schedule (RTL)-2.
[702] Schedule (RTL)-3.
[703] Order No. 89868 at 377, Case No. 9655, *Potomac Electric Power Company's Application for an Electric Multi-Year Rate Plan*.

Maryland's RROR decreased from 1.21 in Case No. 9655 to 1.08 in the present case. Staff recommended no adjustments to the Company's JCOSS.[704]

Commission Decision

Consistent with the Commission's previous finding in Case No. 9655 that the Company's jurisdictional allocation of distribution costs was reasonable, the Commission accepts Pepco's proposed JCOSS in the present case.

2. Class Cost of Service

Pepco

Pepco witness Schafer developed the Company's CCOSS results using similar cost allocation methods as it employed in prior rate cases, with a few exceptions, which the Commission addresses below.[705] Pepco further contends that the Commission should reject AOBA's position that the Commission should disregard the Company's CCOSS altogether.[706] Pursuant to Order No. 89482, Pepco submitted only one CCOSS based upon historic data set for the duration of the MYP.[707]

Subtransmission-related plant facilities are allocated using an Average and Excess Non-Coincident Area Peak Demand (AED-NCAP). Distribution plant at the primary- and secondary-voltage levels is allocated to customer classes using NCAP and/or the sum of customer maximum (NCD) demands.[708] Various FERC accounts designating customer-related distribution plant (Accounts 369-373, excluding 370.1) are allocated and assigned in

[704] Delgado Direct at 19-20.
[705] Schafer Direct at 5, and 10-12.
[706] Pepco Initial Brief at 65, citing B. Oliver Direct at 55.
[707] Case No. 9618, Order No. 89482 at 55 (Feb. 4, 2020).
[708] Schafer Direct at 10.

the same manner as in prior rate cases.[709] Pepco's complete CCOSS is contained as schedules attached to Schafer's Rebuttal testimony.

<u>Staff</u>

Staff witness Delgado agreed with Pepco's CCOSS and largely agreed with the Company's proposed changes to its prior studies. However, Staff proposed to update the methodology used to calculate Pepco's administrative adjustment to include FERC Account 909 and consistently calculate human resource costs.

<u>AOBA</u>

AOBA argued that the Commission should disregard the Company's CCOSS altogether, contending that the use of a CCOSS test period that is more than two years prior to the start of the MYP. AOBA observes that Pepco's continued application of the same CCOSS results in its evaluation of rates for its proposed Rate Year 3E, which is six years after the end of the period on which its CCOSS has been developed.[710]

<u>OPC</u>

OPC witness Nelson argued that Pepco's calculation of demand allocators using four-year average demand data for use in the CCOSS leads to abnormally developed demand allocators and unreasonably shifts costs to the residential classes, and recommends that Pepco calculate demand allocators based on data from a recent single year. In surrebuttal testimony, OPC witness Nelson continues to argued against the use of four-year average demand data for the calculation of demand allocators, however witness Nelson ultimately does not object to calculating demand allocators based on four-year averages, so long as the

[709] *Id*. at 10-11. Pursuant to Order No. 87884, FERC Account 370.1, which contains the AMI meters, is allocated based upon a three-part factor using demand, sales and meter costs.
[710] B. Oliver Direct at 19-20.

Commission considers the fact that the company may have over-allocated costs to residential customers. Furthermore, OPC recommends the creation and submission of multi-year CCOSS's based on future test years that align with the timeframe of the Multi-Year Rate Case to allow parties to better evaluate the impact of revenue allocation proposals.

Commission Decision

The Commission accepts the Company's proposed CCOSS, subject to the specific adjustments discussed below. Staff and Pepco noted the consistency between the Company's proposed CCOSS that was found to be reasonable by the Commission in Case No. 9655. Additionally, the objections raised by AOBA are largely based upon the amount of time between Pepco's CCOSS (2021) and the Rate Year 3E.[711] Because the Commission has determined that this case will not be based upon a full MYP, AOBA's objections are largely moot.

The result of the Company's CCOSS RROR results (with Staff's approval) are listed below:

Table 5 - Class Cost of Service Study RROR Results

CCOSS RROR Results	
Class	**Pepco (with Staff Agreement) CCOSS RROR**
R	0.87
R-TM	0.85
GS, LV, T, and OL	1.59
MGT-LV	1.22

[711] *Id*. at 55.

MGT-3A	0.46
GT-LV	1.35
GT-3B	4.05
GT-3A	0.66
TM-RT	0.39
SL	0.12
SSL	1.65
TN	2.42
PC-PIV	-0.10
Total	1.00

CCOSS Issues

a. Proposed inclusion of a new customer class–Public Charging–Plug-In Vehicles (PC-PIV)

Pepco

Pepco proposed to create a new customer class-Public Charging–Plug-In Vehicles (PC-PIV). The Company previously included this class as a subsection of the General Service Low Voltage Class (GS, LV, T, OL) in Case No. 9655.[712] The allocators used to present costs are largely the same as in Case No. 9655. Pepco did not record any revenue for PC-PIV during the test year.[713]

[712] Schafer Direct at 14.
[713] *Id.*

Staff

Staff stated no objection to including PC-PIV as a new individual rate class. The allocators are largely the same as those used in Case No. 9655, and new allocators were developed adequately.[714]

Commission Decision

The Commission approves the creation of a separate customer class designated Public Charging – Plug-In Vehicles (PC-PIV).

b. Pepco's change in the functionalization of total Allowance of Funds Used During Construction (AFUDC)

Pepco

Pepco stated that prior to Case No. 9655, Total Distribution AFUDC balances for FERC accounts 360-373 were prorated between the "sub-transmission" and "distribution" sub-functions. This was based on an historical analysis of AFUDC project balances in Electric Plant in Service (EPIS) accounts.[715] In Case No. 9655, these AFUDC balances were allocated entirely to the distribution sub-function. In the instant case, Pepco determined that AFUDC for the distribution sub-function is embedded in the distribution plant accounts. Contrary to Case No. 9655, only sub-transmission is recorded separately. Therefore, in the present case, total distribution AFUDC for FERC accounts 360-373 is entirely related to the sub-transmission sub-function and shown in the Sub-transmission AFUDC section.[716]

Pepco stated that in the present case, General Plant AFUDC and Intangible Plant AFUDC use the Sub-Transmission and Distribution Plant (STDPLT) allocator, which is

[714] Delgado Direct at 8.
[715] Schafer Direct at 16.
[716] *Id.*

consistent with how General Plant and Intangible Plant are allocated elsewhere in the CCOSS.[717]

Staff

Staff agreed with Pepco's change in the functionalization of total AFUDC. Because the related FERC accounts are now functionalized as sub-transmission, the AFUDC distribution balance is no longer populated. Therefore, the Distribution AFUDC allocator becomes obsolete in the instant case.[718]

Commission Decision

The Commission approves Pepco's proposed changes to the functionalization of AFUDC, as agreed to by Staff.

c. Pepco's Updated Calculation of Demand Allocators Using Four-Year Average Demand Data

Pepco

In Case No. 9655, demand allocations were calculated based on historical test year demand. In the instant case, Pepco calculated its demand allocators based upon averaged demands rather than historical test year demands.[719]

Pepco calculated the averaged demands using the methodology approved by the Commission in Case Nos. 9645 (BGE), 9655 (Pepco) and 9681 (Delmarva Power & Light Company). Pepco used four years (2018-2021) of AED, NCAP, and NCD data to determine demand allocators for all metered classes on a per-customer average basis for each year.[720] Pepco then averaged the four years of per-customer average demand data to obtain a four-

[717] Schafer Direct at 16-17.
[718] Delgado Direct at 9-10.
[719] Schafer Direct at 15.
[720] *Id.*

year, per-customer average.[721] Pepco then multiplied the four-years, per-customer averages (for AED, NCAP, and NCD) by the historical test-year average customer count. The Company then utilized the resulting four-year, per-customer average AED, NCAP, and NCD to develop the demand allocators.[722]

Pepco also noted that OPC did not oppose the four-year demand allocators in BGE's Case No. 9692, despite BGE's use of the same time frame and methodology.[723]

Staff

Staff agreed with Pepco and noted that the Company has developed its demand allocators using Staff's own recommended methodology in Pepco's previous MYP rate case - Case No. 9655.[724] Additionally, the purpose of using multiple years of demand data instead of a single year presented in the historical test year is to address the year-to-year volatility to which customer demand is susceptible.[725]

OPC

OPC witness Nelson recommended against calculating demand allocators based on four-year averages from 2018-2021.[726] Instead, Mr. Nelson recommended calculating demand allocators based upon data from a single recent year - at least the 2021 calendar year, if not the historic test year ending in March 2022.[727] Mr. Nelson contended that the use of the four-year average is skewed due to the use of demand data that occurred during the COVID-19 lockdowns, which unreasonably shifts costs onto residential customers.[728]

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[721] *Id.*
[722] *Id. See also* Schedule (LCS)-5 at 3 and 6.
[723] Schafer Rebuttal at 13.
[724] Delgado Direct at 10-11.
[725] *Id*. at 11.
[726] Nelson Surrebuttal at 2.
[727] Nelson Direct at 24; Nelson Surrebuttal at 2-3.
[728] Nelson Direct at 23-25.

In his surrebuttal testimony, Mr. Nelson stated that, upon review of the Company's updated CCOSS, although his prior concerns remain, he did not object to the use of demand allocators based upon four-year averages, provided that the data—which reflects unreasonable cost shifts towards residential customers—is taken in to account when considering revenue apportionment.[729]

Commission Decision

The Commission accepts Pepco's four-year average demand allocators. As Staff stated, a four-year, per-customer average demand better accounts for year-to-year volatility that exists in MYPs. Additionally, the Company's four-year, per-customer average demand is consistent with prior Commission directives, including Pepco's last rate case–Case No. 9655.

d. Pepco's updated meter allocation study

Pepco

Historically, Pepco allocated meter costs by taking meter counts by their assigned bin number[730] at the rate class level and multiplying by the average unit costs for each bin number. Pepco's meter allocation study directly assigns legacy meter and Advanced Metering Infrastructure (AMI) booked plant costs at the rate class level in order to develop the allocation factors that are used to allocate FERC Accounts 370 and 370.1, respectively.[731] According to Pepco, this allows the total dollars used in the development of the allocation factor to more closely match the actual booked cost.[732]

Staff

[729] Nelson Surrebuttal at 1-2, and 19.
[730] Bin numbers primarily identify whether a meter is a legacy meter or a smart meter.
[731] Schafer Direct at 17.
[732] *Id.*

Staff stated that Pepco's new means of allocating meter costs is reasonable. This new method allows Pepco to determine the number of bins that correspond with each rate class and determine the type and cost of the meter associated with each bin. This improves the accuracy of the meter allocation study. This proposed change directly affects the PLANT370, LMETA, and WAVGAMI allocators, which are partly based on the meter allocation study.

Commission Decision

The Commission approves the changes to Pepco's meter allocation study, as agreed to by Staff, for the reasons stated by both parties.

e. Staff's proposal to update the methodology used to calculate Pepco's administrative adjustment to include FERC Account 909 and consistently calculate human resource costs

Staff

Staff proposed adjustments to Pepco's administrative adjustment component of the "administrative charge." The administrative charge reflects the administrative costs that utilities incur for providing electric Standard Offer Service (SOS), and only applies to customers who receive their electric supply from SOS. The purpose of the administrative adjustment component of the administrative charge is to capture the SOS-related administrative costs that may be embedded within distribution rates.[733] Once identified, the administrative adjustment portion is credited to all distribution customers, including customers who receive electric supply through an electric retail supplier. The credit prevents SOS customers from paying what is already embedded in distribution rates and prevents retail supply customers subsidizing SOS-related costs.

[733] Staff Brief at 34-35.

The administrative adjustment component of the administrative charge is issued as a credit to all distribution customers to minimize the potential indirect subsidization of SOS customers for SOS-related administrative costs in distribution rates.[734] The five components of the administrative charge are: (1) the administrative adjustment, (2) SOS-related administrative incremental costs, (3) SOS-related uncollectible costs, (4) Cash Working Capital (CWC), and (5) an applicable return.[735] Staff's issues related only to the administrative adjustment portion of Pepco's proposed administrative charge.

In calculating its administrative adjustment, Staff argued that Pepco did not follow Staff's previously recommended method of including FERC Accounts 909–Misc. General Expenses–in the administrative adjustment.[736] In Case No. 9610 and in Case No. 9681, the Commission decided to include portions of FERC Account 909 in the Companies' respective administrative adjustment component of the administrative charge. In Case No. 9681,[737] Staff witness Sproul recommended a methodology in which the call center headcount in the Maryland jurisdiction would be multiplied by the percentage of SOS-related incoming calls of 48.45% and then multiplied by the commodity revenue to total revenue of 37%. The resulting headcount would be 3.05.[738]

Staff incorporated witness Sproul's methodology into the instant case. FERC Account 909 in the Company's CCOSS is $357,333. Multiplying this amount by the proportion of the test year's commodity revenue to total electric revenue results in $132,213.21 as SOS-related costs. SOS-related costs for FERC Account 909 are then allocated to each customer class

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[734] Delgado Direct at 20.
[735] *Id*. at 20-21.
[736] 18 CFR § 367.9090. Staff argued that the parties agreed to apply FERC Account 909 in the settlement agreement in Case No. 9681. *Id*. at 26.
[737] Case No. 9681, Delmarva Power & Light Company's Application for an Electric Multi-Year Plan.
[738] Delgado Direct at 28.

based upon customer usage for the year ending March 2022. Staff also determined the call center headcount for the human resources component of Account 909. The results are as follows:[739]

Table 6 – Administrative Adjustment

Description	Pepco	Staff
Billing System Amortization Expense	$1,473,604	$1,473,604
Billing System Unamortized Costs	$319,291	$319,291
Credit & Collections	$1,509,959	$1,509,959
Billing	$1,940,924	$1,940,924
Call Center	$1,820,386	$1,820,386
Regulatory	$30,025	$30,025
Accounting	$48,211	$48,211
Legal	$19,709	$19,709
Human Resources	$98,758	$84,791
FERC Account 909	$0	$132,213
Total Revenue Requirement	$7,260,867	$7,379,113
Total Administrative Adjustment	**$1.16**	**$1.18**
MWH (12me March 2022)	6,254,886	6,254,886

As this chart demonstrates, Staff's proposed adjustments result in a 0.02 mill per kWh increase in the administrative adjustment over Pepco's proposed 1.16 adjustment.

[739] *Id*. at 29.

Pepco

Pepco agreed with Staff to use the same methodology for calculating human resources costs in the administrative adjustment as in Case No. 9681.[740] However, Pepco disagreed with Staff's inclusion of FERC Account 909–Informational and Instructional Costs–in the administrative adjustment. Rather, Pepco argued that its bill inserts are unrelated to SOS.[741] To the extent that Pepco should include these costs in the administrative adjustment, the Company agreed with Staff's calculation of those costs for purposes of the administrative adjustment.[742]

Staff Rebuttal

In rebuttal, Staff noted that the Company has sent notices to residential customers about changes in Standard Offer Service rates, PJM fuel mix, budget billing during peak periods, and billing assistance throughout the years.[743] Therefore, Staff continues to recommend that the Company include FERC account 909 in the administrative adjustment.

Commission Decision

The Commission accepts Staff's recommendation and orders Pepco to adjust its administrative adjustment pursuant to the methodology set forth by Staff witness Delgado and consistent with the Commission's prior ruling in Case No. 9681.

f. OPC's proposal for the Commission to direct utilities to file multi-year COSS based upon future test years aligned with the MYP

OPC

[740] Schafer Rebuttal at 20.
[741] *Id.* Pepco contends that its three bill inserts during the test year were: (1) a "Call Before You Dig" insert (April 2021), (2) a "Stay Safe Around Electricity" insert (July 2021), and (3) a "Be Prepared for Changing Weather" insert (December 2021). Pepco stated there was no advertising related to energy conservation during the test year.
[742] Schafer Rebuttal at 21.
[743] Delgado Surrebuttal at 6.

OPC recommended, for future MYPs, that the Commission order utilities to file multi-year CCOSS with future test years aligned with the MYP so that stakeholders can better evaluate customer class movement towards RROR parity.[744] OPC argued that as MYPs have transitioned from the pilot stage to implementation, and as utilities have proposed substantial revenue increases over the course of their MYPs, it is no longer possible for stakeholders to estimate the UROR impact of revenue increases without access to multi-year data based on future test years.[745] Additionally, the Company forecasts large shifts in class load responsibilities that are not reflected in a CCOSS reflecting the 2021 historic test year.[746]

Pepco

Pepco disagreed with OPC's proposal. The Company noted that Order No. 89482 specifically approved the recommendation that the CCOSS for an MYP should be based on historic data and set for the duration of the MYP.[747] Additionally, should an evaluation of the use of a historical test year for the CCOSS need to take place, the Company agreed with the Commission's statement in Order No. 90948 that a general proceeding, open to all stakeholders, would be the appropriate venue to evaluate potential modifications to MYPs.[748]

[744] Nelson Direct at 42-43.
[745] *Id*. at 54.
[746] *Id.*
[747] Schafer Rebuttal at 15; Order No. 89482, slip op. at 28.
[748] *Id*. *See also* Blazunas Rebuttal at 10; *Application of Baltimore Gas and Electric Company for an Electric and Gas Multi-Year* Plan, Case No. 9692, Order No.90948 at 9-10 (Dec. 14, 2023).

Staff

Staff also disagreed with OPC's proposal. Staff agreed with Pepco that the Commission established a multi-year framework in Order No. 89482, which established that utility filings for MYPs should include a CCOSS based on a historical test year rather than future test years.[749] Additionally, Staff noted that multi-year CCOSS are not advisable due to inherent uncertainty in forecasting inputs for future test years.[750]

AOBA

AOBA generally agreed with OPC. AOBA contends that Company witnesses Blazunas and Schafer have a "narrow" view of the world by contending that any change in the CCOSS filing must be made within the context of a general proceeding.[751] AOBA argued that the Commission is still in the "lessons learned" process of Pepco's initial "pilot" MYP, and there does not appear to be enough time to present issues regarding the continued use of historical CCOSS in the "lessons learned" process and still have the Commission's determinations on such generic matters incorporated into the instant rate case.

AOBA further stated that Pepco's rate classes are changing at very different rates, and changes in electric service requirements have varied noticeably across classes in recent years. In that context, AOBA argued that a historical CCOSS that will be five years out-of-date by the last year of the Company's proposed extended MYP cannot reasonably be relied upon to depict class cost responsibilities throughout the years of Pepco's proposed MYP.[752]

[749] Delgado Surrebuttal at 6-7.
[750] *Id*.
[751] B. Oliver Surrebuttal at 19-20.
[752] *Id*.

Commission Decision

The Commission accepts Pepco and Staff's recommendation and rejects OPC's proposal to direct utilities to file multi-year CCOSS based upon the future test years aligned with the MYP. In Order No. 89482, the Commission stated that: "[t]he Commission agrees with the [Working Group] recommendation that the COSS methods should be developed on a case-by-case basis and that both the class [COSS] and JCOSS should be based on historic data and set for the duration of the MRP."[753]

Additionally, as discussed earlier, the Commission's approach using forecasted data renders a CCOSS based upon future test years less necessary. The Commission will therefore address the desirability of multi-year CCOSS filings in the MYP lessons-learned proceedings, open to all stakeholders.

H. Rate Design

Rate Design involves two functions: (1) the design of inter-class rates, which addresses the assignment of the utility's revenue requirement between the various customer classes, and (2) the design of intra-class rates, which involves the manner in which the class revenue requirement will be collected from customers. In order to determine how much of any rate increase (or decrease) should be assigned to a particular customer rate class, the Commission begins with the actual RORs reflected in the CCOSS. These results are then translated into a relative ROR compared to the utility's system average or overall ROR. This percentage is then compared with the actual earning by that rate class, resulting in a relative or unitized ROR (RROR) for each class.

[753] Order No. 89482 at 28.

A RROR greater than 1.0 signifies that a rate class has a return (or contribution) that is greater than the system average, and a RROR that is lower than 1.0 indicates a class return that is less than average. If all customer rate classes have a RROR of 1.0, then each class is contributing equally to the utility's overall ROR based upon its COSS. As a matter of policy, the Commission strives to bring all classes closer to a RROR of 1.0 in each rate case, to reflect cost causation for each class. However, this goal is tempered with notions of gradualism in order to avoid rate shock from the customers of any particular rate class.

Once the revenue requirement is apportioned among the various classes, intra-class rates may be assigned. Almost all rate classes have a fixed customer charge, which is designed to recover fixed utility costs, such as the cost of customer meters. Additionally, Pepco customers have a volumetric distribution charge, which is designed to cover variable costs. That is, each customer's bill has a fixed, monthly customer charge and a volumetric, per-kW charge. Intra-class rate design is guided by important policy considerations, including gradualism, energy conservation, economic impacts, and cost causation.

1. Rate Design Proposals

Pepco

Pepco witness Blazunas utilized a four-step methodology for revenue apportionment with the goal of moving customer class's rates in-line with the system average rate of return. Pepco stated that its rate design is based upon the Commission's ratemaking principles of cost causation and gradualism and relies upon the Company's latest customer and energy sales forecasts. Pepco's methodology also proposes to gradually remove seasonal volumetric distribution rate differentials for applicable classes.[754]

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[754] Blazunas Direct at 1.

Pepco's four-step methodology consists of the following process:

Step One: Pepco excludes rate classes from the allocation of the additional revenue requirement that are significant outliers (Class RROR above 1.10).

Step Two: The Company allocates a portion of the increased revenue requirement to classes within a RROR of 0.9 and 1.1. Any classes that meet this criterion shall receive an allocated increase equal to the overall system average increase (as a percentage).

Step Three: Pepco determines which rate classes have a relative rate of return significantly lower than the system average rate of return. Any classes that meet this criterion receive an allocated increase greater than the overall system average increase. The Company uses a multiplier of 1.16.

Step Four: Pepco allocates the remainder of the revenue requirement increase to all remaining rate classes in proportion to their current level of annualized distribution revenue. This step excludes classes that were excluded or allocated revenue from Steps 1, 2, or 3.[755]

Witness Blazunas developed Pepco's rate design proposal for Rate Years 1-3 (April 1, 2024 – March 31, 2027) and Rate Year 3E (April 1, 2024 – December 31, 2024) using similar methodologies adopted in previous rate cases with a few notable changes discussed in the "Rate Design Issues" section below.

Staff

Staff witness Hoppock generally agreed with Pepco's proposed rate design, with additional changes and a revised apportionment and rate design, which the Commission addresses in the "Rate Design Issues" section below. In general, Staff proposed a slightly different four-step method using Staff witness Delgado's CCOSS and Staff witness Patterson's proposed revenue requirement, as follows:

Step One: Staff excludes highly over-earning rate classes (RROR over 2.0) from the allocation of additional revenue requirement. This step excludes classes GT-3B and TN.

[755] *Id*. at 8.

> Step Two: Staff increases the revenue requirement by the system average revenue increase for classes within 10% of the system average RROR (between an RROR of 0.9 and 1.1).
>
> Step Three: Staff allocates revenue increases to under-earning classes (RROR less than 0.9) using a multiplying factor of the system percentage increase in distribution revenue (Staff uses a multiplier of 1.18). Staff chose this multiplier because it moves classes towards an RROR of 1.0 while keeping the highest bill impact below 10%.
>
> Step Four: Staff allocates the remaining revenue to the remaining rate classes in proportion to their RRORs based on their historic test-year distribution revenue.[756]

OPC

OPC witness Nelson responded to Pepco's proposed revenue and rate design and provided a traditional two-step rate design method.[757] OPC also provided an adapted two-step rate design method that witness Nelson calls the "Bill Impacts Based Approach."[758]

Witness Nelson presented OPC's two-step method using an updated CCOSS using demand allocators that reflect a more recent year (either 2021 calendar year or historic test year ending March 2022). OPC's two step methodology consists of:

> Step One: OPC applies an increase to significantly under-earning classes only and uses a multiplier of 1.16 times the system average increase. OPC identifies significantly under-earning classes as classes SL, TM-RT, and MGT-3A, with RRORs of .09, .38 and .59, respectively.
>
> Step Two: OPC applies an increase proportional to each class's relative historic test year annualized distribution revenue to all classes that were not allocated a step one increase and were not excluded for being a highly over-earning class.[759]

OPC presents its "Bill Impacts Based Approach" by further adapting its two-step methodology and uses bill impacts to serve as the guiding metric for apportioning revenues. This approach would apportion revenues such that all customer classes share in a bill

[756] Hoppock Direct at 64-67.
[757] Nelson Direct at 57-77.
[758] *Id*. at 42-56.
[759] *Id*. at 46-47.

increase within a narrower band.[760] OPC stated that it is unreasonable to allocate significant MYP revenue increases using traditional single year RROR metrics, and it is impossible to measure multi-year RRORs without future CCOSS data. In addition to the two-step approach described above, the "Bill Impacts based approach" would also:

(1) Cap the total bill increase to any rate class at 21%;

(2) Cap the distribution bill increase for any rate class at 30%; and

(3) Shift revenues away from rate classes with RRORs significantly above the system average.[761]

OPC's approach to rate design does not treat Pepco's two residential classes–R and RTM–as under-earning. Therefore, residential customers would see a lower percent of revenue increase as compared to Pepco's four-step method, as demonstrated by Table 7:[762]

Walmart

Walmart took no position regarding Pepco's proposed CCOSS. However, it reserved the right to comment on any changes proposed by other parties.[763]

Walmart witness Perry does not oppose Pepco's proposed revenue allocation and does not present an explicit rate design methodology within their testimony. Despite this, Walmart does alternatively recommend that the Commission start with the revenue allocation proposed by Pepco, and then apply the overall revenue reduction (i.e., the difference between the requested revenue requirement and the approved revenue requirement) to rate classes with a proposed RROR above 1.0 (with the exception that in no rate class with a current RROR above 1.0 be moved to an RROR below 1.0).

[760] *Id. at 54-55*
[761] *Id*. at 55.
[762] Nelson Direct at 55.
[763] Perry Direct at 16.

Walmart also recommended that for Class MGT-LV II, any revenue increase that is not allocated to the customer charge, be allocated equally between the energy-based distribution charge and the demand charge. If there is a decrease in the revenue requirement, Walmart witness Perry argued that such a decrease should be applied only to the energy-based distribution charges to bring these charges closer to their cost-of-service based level.

2. Rate Design Issues

A. General Rate Design Issues

Pepco

Pepco rejected OPC's proposed two-step methodology and its additional "Bill Impacts Based Approach" to allocating revenue. The Company stated that OPC's methodology represents a departure from the guiding ratemaking principles of cost causation and gradualism underlying Commission precedent.[764] Pepco witness Blazunas stated that both Pepco and Staff used a multiplier in Step Four that was approved by the Commission in prior recent cases for uniformly under-earning classes.[765]

Pepco further argued that the Commission should reject OPC witness Nelson's recommendation that any rate increase from the instant proceeding be implemented in equivalent increments to avoid rate shock.[766] The Company's proposal includes the Economic Relief and Recovery Rider (Rider ERR), which Pepco witness Blazunas argued was designed to provide offsetting credits in RY1 and RY2 via accelerated tax benefits in

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764 Blazunas Rebuttal at 8-9.

765 *Id*.

766 *Id*. at 33, citing Efron Direct at 20 - "I am proposing to accelerate the amortization of tax benefits by $6 million in MRP RY1 and $9.6 million in RY2." – as proposing a similar gradual implementation of rate increases as that proposed by the Company.

order to allow a consistent and gradual year-over-year rate increase during the proposed MYP.[767]

Staff

Staff proposed an alternative four-step revenue allocation method using Staff witness Delgado's CCOSS and Staff witness Patterson's proposed revenue requirement, as described above. Staff argued that Pepco's proposed methodology will cause unnecessary rate shock and unpredictability, whereas Staff's multiplier of 1.18 ensures the highest bill impact remains below 10%.[768]

Staff disagreed with OPC's two-step methodology and Bill Impacts Method, especially the portion that does not treat Classes R and RTM as under-earning classes. Staff argued that if Pepco does treat these residential classes as under-earning, future residential classes will likely under-earn again in the future.[769]

OPC

As described above, OPC disagreed with Pepco and Staff and proposed its own two-Step methodology with an additional adjusted "Bill Impact Based approach." OPC claimed these alternative proposals are more equitable and that allocating MYP revenue increases through traditional single-year RROR metrics is unreasonable.[770]

As noted, OPC does not treat Classes R and RTM as under-earning and therefore does not allocate a Step One increase to these rate classes. OPC rejected Staff's four-step approach as inequitable and a departure from Commission precedent.

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[767] Blazunas Rebuttal at 33.
[768] Hoppock Direct at 65.
[769] Hoppock Surrebuttal at 4-5 ("[T]he Commission has consistently treated Schedules R and RTM as under-earning classes over Pepco's prior five rate cases, in all of which these classes had a UROR of .59 or higher, and in no instance has Schedule R or RTM become over-earning in the subsequent CCOSS.").
[770] Nelson Direct at 54.

In his surrebuttal testimony, witness Nelson recognized that his "Bill Impacts Based approach" departs from Commission precedent.[771] Mr. Nelson therefore focused on his two-step approach and specified this as his recommendation. Witness Nelson noted that the Commission has rejected the four-step methodology on multiple occasions. Mr. Nelson cited from Pepco's last rate case (Case No. 9655), in which the Commission stated that it "sees no reason to deviate from its current practice of using the two-step method to allocate revenue."[772]

Walmart

Walmart does not oppose Pepco's proposed revenue allocations. However, if the Commission determines a different and lower revenue requirement and allocation, Walmart argued that the Commission should take steps to further reduce interclass subsidies. Specifically, Walmart recommended that the Commission start with the revenue allocation proposed by Pepco. Next, the Commission should apply the overall revenue reduction (i.e. the difference between the requested revenue requirement and the approved revenue requirement) to those rate classes with a proposed RROR above 1.0, except that in no event should an over-earning rate class (RROR above 1.0 be moved to an under-earning position (RROR below 1.0).[773]

Walmart also recommended that for Class MGT-LV II, the Company should allocate any revenue increase outside the customer charge equally between the energy-based distribution charge and the demand charge. Should there be a decrease in revenue for Class MGT-LV-II, Walmart witness Perry argued that the decrease should apply only to the

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[771] Nelson Surrebuttal at 19.
[772] Nelson Surrebuttal at 21-22, *citing Potomac Electric Power Company's Application for an Electric Multi-Year Rate Plan*, Case No. 9655, Order No. 89868 at 195 (June 28, 2021).
[773] Perry Direct at 20.

energy-based charges to bring these charges closer to their CCOSS levels.[774] Walmart argued that the shift in demand cost responsibility from lower load factor customers to higher load factor customers (like Walmart) is a misallocation of cost causation because higher-load customers overpay for the demand-related costs that Pepco incurs to serve them.[775]

AOBA

AOBA disagreed with Pepco's proposed four-step methodology, noting that this approach has not yielded adequate results in the past, especially for Classes GT-3B and TN. These classes have very high RRORs with little past improvement. AOBA argued that simply exempting Classes GT-3B and TN in Case No. 9655 did not substantially remedy their significant over-earning status, and no reason exists to believe that similar treatment in this proceeding will produce different results.[776] AOBA argued that six of Pepco's rate classes have moved further from RROR parity since Pepco's last rate case.[777]

Regarding Classes GT-3B and TN, witness Bruce Oliver recommends an immediate lowering of the RRORs for these classes, because both classes are comparatively small and the recommended lowering of their RRORs would not have an undue impact on other rate classes.[778]

Commission Decision

The Commission adopts Pepco's four-step methodology for designing rates in this case, subject to the additional issues raised by the parties and discussed below. Pepco's

[774] Walmart is primarily served by Pepco's MGT-LV II rate class, and that rate class consists of (1) a fixed monthly customer charge, (2) a summer distribution charge, (3) a winter distribution charge, and (4) a demand charge. Citing Blazunas Direct, Schedule (PRB – 13) at 98, Walmart noted that Pepco does not plan any structural changes to the MGT-LV II rate class. *Id*. at 21.
[775] *Id*. at 23.
[776] B. Oliver Direct at 53.
[777] *Id*. at 51-52.
[778] *Id*. at 53-54.

proposed methodology is consistent with Commission policy regarding gradualism and cost causation. It is also consistent with methods authorized in prior rate cases. Pepco's proposed revenue allocations result in largely identical class percentage allocations of the distribution revenue requirement increase as that proposed by Staff, with the main difference between rate design methodologies being the multiplier that is used in step three of both proposals.[779]

As noted by Staff and the Company, the Commission has never relied upon bill impacts as the guiding metric for revenue allocation, and OPC acknowledges this to be true. The Commission is not inclined to deviate from precedent regarding the reliance upon cost causation and gradualism as the guiding metrics for revenue allocation.

The Commission adopted a two-step allocation in BGE Case No. 9692.[780] However, in that case, a high percent of the revenue increase was allocated to all under-earning classes in step one. OPC's proposed step one in the present case only allocates 1.16 times the system average to significantly under-earning classes. Compared to Pepco's four-step method, OPC witness Nelson's two-step approach does not consider Schedules MGT-LV, R, and RTM as "significantly under-earning."

The chart below compares the Revenue Allocation Results from the various proposals of the parties:

[779] Blazunas Rebuttal at 7 and Table 1.
[780] *Order No. 90948* at 251-254.

Table 7 – Revenue Allocation Results

Rate Class	Current UROR (Pepco Rebuttal)	Company (Pepco Rebuttal)	Staff	OPC (2-Step)*	OPC (Bill Impacts Based)	Walmart
R	0.87	59.67%	60.70%	51.45%	49.54%	79.25%
RTM	0.85	9.03%	9.19%	7.82%	7.82%	12.04%
GS-LV	1.58	2.88%	2.72%	4.05%	3.90%	0.00%
MGT-LV	1.22	16.91%	16.03%	23.85%	27.29%	0.00%
MGT-3A	0.46	0.26%	0.26%	0.26%	0.44%	0.34%
GT-LV	1.35	3.82%	3.62%	5.38%	3.83%	0.00%
GT-3A	0.66	5.30%	5.39%	4.58%	4.58%	7.06%
GT-3B	4.05	0.00%	0.00%	0.00%	0.00%	0.00%
TM-RT	0.39	0.69%	0.70%	0.69%	0.69%	0.92%
SL	0.12	0.29%	0.30%	0.29%	0.29%	0.39%
SSL	1.65	1.15%	1.09%	1.62%	1.62%	0.00%
TN	2.42	0.00%	0.00%	0.00%	0.00%	0.00%
TOTAL	**1.00**	**100.00%**	**100.00%**	**99.99%**	**100.00%**	**100.00%**
Over-Earning:		**24.76%**	**23.46%**	**34.90%**	**36.64%**	**0.00%**
Under-Earning:		**75.24%**	**76.54%**	**65.09%**	**63.36%**	**100.00%**
*Note: Numbers do not sum to 100						

Table 8 - Commission-Determined Revenue Allocation Results

Class	Allocation Percentage	Total Revenue Allocation	Current RROR	Proposed RROR
RESIDENTIAL (R)	59.67%	$26,632,256	0.87	0.93
RTM	9.03%	$4,032,043	0.85	0.89
GS-LV	2.52%	$1,126,837	1.58	1.47
T	0.08%	$36,039	0.00	0.00
EV	0.00%	$46	0.00	0.00
MGT-LV	15.64%	$6,978,793	1.22	1.12
MGT-3A	0.26%	$113,983	0.46	0.52
GT-LV	3.53%	$1,575,792	1.35	1.22
GT-3A	5.30%	$2,364,377	0.66	0.71
GT-3B	0.00%	$0	4.05	3.34
TM-RT	0.69%	$307,210	0.39	0.45
SL	0.55%	$244,039	0.12	0.38
SSL	2.68%	$1,194,100	1.65	1.72
OL	0.05%	$23,483	0.00	0.00
TN	0.00%	$0	2.42	2.00
TOTAL	**100.00%**	**$44,629,000**	**1.00**	**1.00**

Table 9 - Commission-Determined Average Total Residential Bill Impact[781]

	Montgomery County		Prince George's County	
	$	**%**	**$**	**%**
Residential (R)	**$5.72**	**3.52%**	**$5.72**	**3.53%**

As this chart shows, both Staff and the Company's four-step proposals result in similar class percentage allocations of the distribution revenue requirement increase. However, OPC's revenue allocation proposals are less aggressive with respect to allocating more of the distribution revenue requirement increase to under-earning rate classes (i.e all rate classes with a RROR less than 1.0, without regard for whether it is significantly less than 1.0) and allocating less of the distribution revenue requirement increase to over-earning rate classes (i.e., all rate classes with a RROR greater than 1.0, without regard to whether it is significantly greater than 1.0). The Commission believes that Pepco's (and Staff's) four-step approach is more equitable to all ratepayers.

B. Pepco's Proposed Rate Year 3 Extension Time Period (RY3E)

Pepco

Pepco proposed a nine-month extension for this MYP (RY3) from April 2027 through December 2027 in order to position future MYP applications to occur on non-overlapping years for Maryland utilities. Should the Commission deny the Company's request, Pepco would accept Staff's alternative proposal for a nine-month extension with RY3 rates subject to later reconciliation.[782]

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[781] The Bill Impacts presented are inclusive of current energy rates.
[782] Blazunas Direct at 4-5, and 21.

Staff

Staff recommends a nine-month extension at RY3 rates subject to reconciliation, and thus does not have a recommended rate design allocation for Pepco's proposed RY3 extension period.

AOBA

AOBA does not support the MYP in concept and therefore does not support a nine-month extension. Although AOBA generally supports an extended procedural schedule to accommodate Commission Staff, the proposed RY3E does not guarantee administrative convenience as a non-Exelon utility may file a rate proceeding that would add a regulatory burden on Commission Staff anyway.

MEA

MEA accepts Staff's alternative proposal for a nine-month extension at RY3 rates subject to later reconciliation.

Commission Decision

Based upon its overall findings in this case, the Commission finds that this issue is now moot.

3. Pepco's proposed increase in customer charges for rate classes

Pepco

Pepco initially proposed increasing customer charges for all rate classes. However, Pepco later agreed with Staff to leave the customer charge for Schedule RTM unchanged.[783] Pepco proposed that each rate class (except RTM) receive an increase in the customer charge

[783] *Id*. Blazunas Rebuttal at 19.

of between 2.62% and 2.89% per year over the entire MYP.[784] According to Pepco's proposal, the Company's residential rate class will receive a $0.22 - $0.23 increase in the customer charge each rate year and an overall increase in the customer charge of 2.62% over the course of the MYP.[785] However, for the first year of the MYP, Staff and Pepco agreed to a 2.68% increase in the customer charge.[786]

Pepco witness Schafer denied OPC's suggestion that the Company has any incentive to shift costs from large commercial customers to residential customers. Pepco argued that its decoupling mechanism and the Bill Stabilization Adjustment ("BSA") removes the link between the sales of electricity and revenue, thus rebutting OPC's suggestion that the Company has an incentive to make subjective allocation decisions in the CCOSS and rate design to shift costs from one class to another due to price elasticities of demand.[787]

Pepco also rejected OPC's contention that the Company has not demonstrated cost causation with regard to its customer charge increase. Regarding Pepco's service lines, witness Schafer noted that its classification of service lines as 100% customer-related is supported by the National Association of Regulatory Utility Commissioners (NARUC).[788]

Witness Schafer also rejected OPC's argument that uncollectible accounts should not be 100% customer related. Again, citing NARUC, he noted that its Electric Utility Cost Manual states that accounts 901-905 "are generally classified as customer-related."[789] The Company classifies account 904 "Uncollectible Accounts" with allocator "CUST904" in its CCOSS. Pepco witness Schafer argued that although witness Nelson may disagree with the

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[784] Schedule (PRB-R)–5 at 2.
[785] *Id*. at 1.
[786] Schedule (PRB)–7 at 1.
[787] Schafer Rebuttal at 10-11; Blazunas Rebuttal at 21-22.
[788] Schafer Rebuttal at 16; NARUC, *Electric Utility Cost Allocation Manual at 87.*
[789] NARUC, *Electric Utility Cost Allocation Manual* at 103.

Company's classification of Account 904, he has not provided a compelling reason to deviate from the Company's classification.[790] Finally, witness Schafer rejected OPC's contention that Pepco's records and collection expenses are too high. Mr. Schafer claimed OPC draws this conclusion by wrongly comparing balances in specific FERC accounts at other utilities with the "Customer Records and Collections" unbundled cost shown on Schedule (LCS)-3 attached to Schafer Direct. This false comparison renders witness Nelson's argument unsupported.[791]

Staff

Staff witness Hoppock supports the Company's proposed customer charge increases for all rate schedules except RTM. Staff opposed an increase in the Schedule RTM customer charge because it results in a movement of the customer charge from 85% to 95% of the unit cost in the CCOSS, and this movement is inconsistent with the Commission's precedent of recovering some customer-attributable costs through volumetric rates. Witness Hoppock also noted that the current Schedule RTM customer charge of $17.74 a month is markedly higher than the highest residential customer charge for electric service in Maryland amongst all electric utilities.

Staff recommends that the Schedule RTM customer charge remain unchanged.

OPC

OPC witness Nelson recommended that the Commission reject the Company's proposal to increase the customer charge for Schedules R and RTM and instead maintain the current charges for these rate classes. Witness Nelson asserted that: (1) the Company has not

[790] Schafer Rebuttal at 17. Witness Schafer also noted that this classification is an industry standard and has been accepted by the Commission in Case Nos. 9655, 9602, 9443, 9418, and 9336. *Id*. at 18.
[791] *Id*. at 19.

demonstrated that its proposed customer charge increase reflects cost causation, (2) the Company's proposed customer charge increase contradicts state policy goals encouraging energy efficiency and conservation, and (3) increasing the customer charge disproportionately harms low-usage customers, who tend to be low-income.

Regarding OPC's contention that the Company has failed to demonstrate that its proposed customer charge increase reflects cost causation, witness Nelson raised three issues:

> (1) Service Lines–Mr. Nelson criticized Pepco's decision to classify service lines as 100% customer-related. He argued the Company's customer charge should recover no more than the cost of the conductor needed to serve the customer with the lowest demand requirements.[792]
>
> (2) Uncollectible Amounts–OPC claimed that including uncollectible accounts in the customer charge disproportionately impacts low-use customers, who also tend to be low-income. Thus, there is a risk that including uncollectible amounts in the customer charge could exacerbate customer debt for those most disproportionately impacted by fixed charge increases.[793]
>
> (3) Customer Records and Collections–Witness Nelson testified that Pepco's customer records and collection expenses are inexplicably high, almost double the amount of similar expenses that BGE provided in its recent MYP Application.[794]

OPC also argued that the Company has an incentive to inflate its customer charge because, all else being equal, recovering costs through fixed customer charges stabilizes the Company's revenue within a given year.[795]

Finally, OPC argued that Pepco's customer charge increase contradicts state policy goals encouraging energy efficiency and conservation, because customer charge increases are offset by decreases to the volumetric charge.[796]

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[792] Nelson Direct at 67. OPC contends that the Company's classification of service lines as customer-related contributes $2.31-$3.23 in monthly customer unit costs.
[793] Nelson Direct at 67-68. OPC contends that the Company's calculation of monthly customer-related unit costs includes $1.15 and $0.47 for Schedules R and RTM respectively for uncollectible accounts.
[794] Nelson Direct at 68. OPC contends that these inflated costs contribute $10.02 and $10.46 for Schedules R and RTM respectively.
[795] *Id*. at 69.
[796] *Id*. at 71-72.

Commission Decision

The Commission accepts Pepco's explanation for the cost-basis of the amounts in the residential customer charge and agrees with Staff and Pepco that the record supports the proposed customer charges increases. Given that the Commission has adopted an approach using forecasted data that limits Pepco's cost recovery in this MYP 2 to Rate Year 1, the Commission only approves a customer charge for the first year. As noted by OPC, the Commission only approved a customer charge increase for one year of the MYP in Case No. 9655.[797]

After reviewing the testimony and the current proportions of customer charges to volumetric distribution charges, the Commission approves Staff and Pepco's proposed customer charge increase of 2.68% for the residential rate class for the rate year from April 1, 2024 thru March 31, 2025, except for Schedule RTM. The Commission agrees that Schedule RTM's customer charge should remain unchanged. Furthermore, the Commission accepts the Staff and Pepco proposed customer charge increases for all other rate classes. This results in the following changes in the customer charge for each of Pepco's rate classes:

Table 10 - Customer Charge Results

Customer Class	Current Customer Charge	Commission Decision Customer Charge	% Change
R	$8.22	$8.44	2.68%
RTM	$17.74	$17.74	0.00%
GS-LV	$12.31	$12.66	2.84%

[797] Nelson Direct at 65.

T	$12.51	$12.87	2.88%
EV	$4.63	$4.76	2.81%
MGT LV	$46.24	$47.56	2.85%
MGT 3A	$43.91	$45.15	2.82%
GT LV	$375.70	$386.37	2.84%
GT 3A	$352.75	$362.77	2.84%
GT 3B	$331.11	$340.51	2.84%
TM RT	$4,178.45	$4,513.65	8.02%

4. Staff's proposed adjustment to Pepco's Billing Determinant Forecast for Class R and consideration for future billing determinant forecasts

Staff

Staff recommended increasing the Class R customer count forecast by 1,800 per month over the forecast period because in Pepco's billing determinants for November 2022 - August 2023, Class R customer counts are 1,800 per month higher than what Pepco is forecasting. According to Staff, this adjustment is consistent with a similar adjustment made in Pepco Case No. 9655 and will not change the forecasted average usage per customer and will increase Pepco's baseline revenue for Class R by $1,121,166 for each rate year.[798]

Pepco

Although Pepco does not expect the gap between actual and forecast customer counts to widen further, the Company does expect continued higher customer counts.[799] Therefore,

[798] Hoppock Direct at 19-20.
[799] Coursey Rebuttal 3.

Pepco agreed with Staff's recommended customer and sales adjustments and has incorporated these adjustments into rebuttal testimony.[800]

Commission Decision

The Commission approves this undisputed adjustment and Pepco's agreement to increase its Class R customer count by 1,800 per month over the forecast period.

5. Pepco's proposed Economic Relief and Recovery ("ERR") Rider to provide offsets by way of accelerated tax benefits

Pepco

Pepco designed the ERR Rider to provide offsetting credits equal in value to approximately $69.624 million provided by way of accelerated tax benefits in order to allow a consistent and gradual year-over-year rate increase. Pepco proposed having this rider in effect from April 1, 2024 through March 31, 2026.

Pepco rejected AOBA's basis for opposing the ERR Rider offsets, noting that this offset mitigates the impact of the distribution revenue increase to customers, thereby smoothing the rate increase.[801] The Commission, in BGE Case No. 9692, made direct reference to economic uncertainties in its approval of rate offsets.[802]

Staff

Staff agreed with Pepco's ERR Rider and stated that if the Commission decides to change the years the offset is in effect or requires Pepco to submit an update in the future, the language of the rider can be resolved in the compliance filing.

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[800] Leming Rebuttal at 4-5; Coursey Rebuttal at 1-2.
[801] Blazunas Direct at 4-5.
[802] *Application of Baltimore Gas and Electric Company for an Electric and Gas Multi-Year Plan*, Case No. 9692, Order No. 90948 at 260 ("Lastly, as noted above, the Commission finds that the current economic environment justifies the continued use of accelerated tax benefits in this MYP for the 2024 rate year in order to cushion ratepayers from rate shock at a time of economic vulnerability.").

AOBA

AOBA opposed the use of the ERR Rider, arguing that it masks the full impact of Pepco's proposed capital spending. AOBA argued that Pepco's proposal for the use of offsets to its requested revenue increase in this proceeding represents an abuse of the ERR Rider concept. Deferring recovery of substantial revenue requirements to future years–AOBA argued–is not an appropriate remedy of Pepco's increasing capital expenditures.[803]

According to AOBA, because the State of Maryland no longer faces the upheaval of the COVID-19 pandemic, ratemaking tools such as the ERR Rider offsets that were accepted by the Commission in Case No. 9655, should be reserved for application in more critical situations.[804]

Commission Decision

The Commission hereby rejects Pepco's request for an Economic Relief and Recovery Rider to provide offsets by way of accelerated tax benefits for the rate year beginning April 1, 2024. As discussed above, the Commission is disallowing offsets in this rate case.

6. Pepco's continued inclusion of the Bill Stabilization Adjustment ("BSA") Rider in the MYP

Pepco

Pepco proposed continuing the BSA Rider in this MYP and stated that the BSA functions as a monthly adjustment that lowers distribution rates if Pepco receives more distribution revenue than the approved target distribution revenue per customer per month

[803] B. Oliver Direct at 6.
[804] *Id*.

and increases distribution rates if Pepco receives less distribution revenue than the approved revenue per-customer, per-month targets.[805]

Pepco rejected AOBA's recommendation of a regulatory asset as a departure from Commission precedent. Pepco observed that the Commission has approved two multi-year rate plans for utilities with decoupling mechanisms since 2021 (Case Nos. 9681 and 9692), and argued that any change to the structure of the BSA (i.e., AOBA's suggested recommendation to remove commercial demand-metered class from the BSA) should be considered on a statewide basis.[806]

Pepco disagreed with OPC's assertion that the Company failed to address the overlap between its BSA and its proposed MYP reconciliation process. The Company directly addressed this complementary relationship in its testimony.[807] Furthermore, although Pepco's proposal in the instant proceeding does not state that the Company's support of state policy goals such as energy efficiency and distributed energy resources are contingent upon approval of the BSA, the BSA removes the disincentive for the Company to actively support these initiatives and so should continue as a component of the Company's MYP.

Staff

Staff supports the continuation of Pepco's BSA Rider in the MYP and stated that retaining the BSA likely reduces future revenue reconciliation amounts.[808] Staff also agreed

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[805] For Pepco's proposed monthly revenue-per-customer targets on a rate class-specific basis to be used in future calculations of the BSA for each year of the MYP as revenue proofs, *see* Blazunas' Schedule (PRB)–8.
[806] Blazunas Rebuttal at 44.
[807] Blazunas Direct at 26 ("The BSA and the Rider 'MYP Adjustment' are separate mechanisms that are designed to achieve different objectives. The BSA is a symmetric mechanism designed to decouple the Company's distribution revenues from customers' usage. The Rider 'MYP Adjustment' reconciliation process is meant to address 'imbalances' between the Company's approved revenue requirement and actual revenue requirement over the course of the MYP.").
[808] Hoppock Direct at 2.

that the Company has satisfied the four requirements in Order No. 89868 to continue decoupling in MYPs.[809]

OPC

OPC recommended rejecting the BSA Rider because Pepco has failed to link policy as an extension of its BSA mechanism, and Pepco has not addressed the overlap between the BSA process and the MYP reconciliation process. OPC also argued that the Company only articulated the potential benefits and failed to make tangible proposals that effectuate decoupling's potential.

If the Commission does approve the BSA Rider, OPC argued that the approval should be conditioned upon Pepco proposing performance improvements tied to metrics such as DER Interconnection, Load Management, and State greenhouse gas goals.

AOBA

AOBA recommended that the Commission act to offset BSA deferred revenue balances accumulated for each rate class during the COVID-19 pandemic and provide Pepco with socialized recovery of those offsets through a regulatory asset. AOBA also recommended the removal of commercial demand-metered rate classes from the BSA.

AOBA supports a regulatory asset because much of what Pepco describes as weather impacts might actually be behavioral changes imposed by government restrictions during the COVID-19 pandemic.

Commission Decision

Historically, the Commission has granted utilities' requested BSA Riders in single-year rate cases. The Commission therefore approves Pepco's proposed BSA in the present

[809] *Id*. at 61.

case. The Commission accepts the Company's and Staff's arguments that the BSA and the MYP Adjustment are separate mechanisms with different goals.

AOBA and OPC have provided the Commission no persuasive reason to deviate from its current practice of allowing monthly adjustments based on monthly distribution revenue.

7. The removal of seasonal differentiation in distribution volumetric rates

Pepco

Pepco proposed to gradually remove the seasonally differentiated volumetric distribution rates for all classes (R, RTM, R-PIV, PIV, R-TOU-P, GS-LV, T, EV, and TN (and Rider SL-TN). Witness Blazunas testified that seasonally differentiated rates are from pre-restructuring days and have no cost causation basis. Additionally, removing seasonal differentiation is customer friendly and creates more predictable rates.[810]

Pepco stated that it is the only Maryland utility with different rates in the winter and summer. The gradual removal of the seasonal component of volumetric distribution rates for these rate schedules will bring their volumetric distribution rate designs into alignment with Pepco's other rate schedules as well as Maryland's other utilities.[811]

The Company also accepted Staff's recommendation against reducing the seasonal differentiation in RY1 for rate schedules R, RTM, and GS-LV, unless the maximum effective percentage rate change for winter volumetric rates, inclusive of the RY1 offset and the Rider MYP Adjustment rate in RY1, is less than 17%.[812]

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[810] Blazumas Direct at 39-40.
[811] *Id*. at 40.
[812] Blazunas Rebuttal at 14-15, and 22.

Staff

As noted, Staff agreed with the removal of seasonally differentiated rates, but has concerns with the rate shock implications that this would have for Classes R, RTM, and GS-LV as the resulting rate increases in RY1 in winter would be 24-29%. Witness Hoppock therefore recommended against reducing the seasonal differentiation in RY1 for rate schedules R, RTM, and GS-LV, unless the maximum effective percentage rate change for winter volumetric rates, inclusive of the RY1 offset and the Rider MYP Adjustment rate in RY1, is less than 17% over the course of the MYP.[813] Witness Hoppock selected 17% as the threshold because it is the highest percentage effective change in demand charges under witness Blazunas' rate design.[814]

OPC

OPC disagreed with Pepco's proposal to gradually eliminate the seasonal differentiation of volumetric rates for certain classes. OPC does not believe Pepco has demonstrated that this proposal is cost-based. OPC requests the Commission to order Pepco to provide a cost analysis of its approach to gradually remove this seasonal differentiation.[815]

Commission Decision

In the instant case, the Commission approves the current seasonal rates for the year April 1, 2024 thru March 31, 2025. However, the Commission advises Pepco that it intends to eliminate the seasonally-differentiated rate structure in its next rate case. When Pepco files its next rate case, its application shall include a proposal to gradually eliminate the seasonally differentiated rate structure in its proposed rate design. Pepco may also file alternative rate

[813] Hoppock Direct at 63-64.
[814] *Id*. at 64.
[815] Nelson Direct at 62.

design proposals within its application. The Commission directs Pepco to provide notice (through language on the bill or otherwise) to its customers that seasonal rates will be eliminated in the future.

The Commission further directs Pepco to provide a cost analysis and customer impact study of the gradual elimination of seasonal rates in its next rate case. The Commission may revisit the issue of Pepco's seasonal rate removal in the context of its proceedings on Time-of-Use rates.

8. Pepco's creation of a new Income Tax Adjustment Rider (ITA Rider) for the purpose of recovering/refunding the revenue requirement associated with federal or state corporate income tax rate changes that occur between rate cases

Pepco withdrew its proposed Income Tax Adjustment (ITA) Rider. The Commission notes that a similar proposal in Case No. 9692 was rejected by the Commission, and in the instant Case both OPC and Staff oppose the creation of a new Income Tax Adjustment Rider.[816]

9. Pepco's proposal to set demand charges to be nearly identical to the volumetric charges for Classes MGT-LV, MGT-3A, GT-LV, GT-3A, and GT-3B

Pepco

Pepco proposed to set the rates for the classes referenced above in a manner that maintains the relative amount of revenue recovered by the respective demand and volumetric charges. This proposal results in demand charge changes that are nearly identical to the volumetric charge changes on a percentage basis.

[816] Blazunas Rebuttal at 40.

Staff

Staff agreed with Pepco's proposal to set rates that maintain the relative amount of revenue recovered by these charges.

Walmart

Walmart recommended that for Class MGT-LV II, the Company should allocate any revenue increase outside the customer charge equally between the energy-based distribution charge and the demand charge. Should there be a decrease in revenue for Class MGT-LV-II, Walmart argued that the decrease should apply only to the energy-based charges to bring these charges closer to their CCOSS levels.[817] As it stands, the shift in demand cost responsibility from lower load factor customers to higher load factor customers (like Walmart) is a misuse of the principle of cost causation because higher-load customers overpay for the demand-related costs that Pepco incurs to serve them.[818]

Commission Decision

The Commission accepts Pepco and Staff's positions and directs Pepco to set demand charges to be nearly identical to the volumetric charges for Classes MGT-LV, MGT-3A, GT-LV, GT-3A, and GT-3B.

The Commission denies Walmart's request as inconsistent with the Commission's ruling in Order No. 90948, in which Walmart requested identical relief from BGE.[819] The Commission remains appreciative of the concerns Walmart raises, but Walmart provides no persuasive reason for the Commission to deviate from its prior ruling.

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[817] Walmart is primarily served by Pepco's MGT-LV II rate, and that rate class consists of (1) a fixed monthly customer charge, (2) a summer distribution charge, (3) a winter distribution charge, and (4) a demand charge. Citing Blazunas Direct, Schedule (PRB–13) at 98; Walmart noted that the Company does not plan any structural changes to the MGT-LV II rate class. Perry Direct at 21.
[818] *Id*. at 23.
[819] *Order No. 90948* at 268-270.

10. Pepco's proposed Target Revenue Adjustment for Class SL to adjust rates due to forecast decreasing sales

Pepco

Pepco proposed an adjustment to increase Class SL rates in RY2, RY3, and RY3E prior to applying the incremental revenue requirement due to the declining forecasted kWh sales for this class. Pepco does not agree with Staff's position that this targeted adjustment is a form of decoupling and maintains that, without the Target Revenue Adjustment, proposed rates would not collect the Company's full incremental revenue requirement.[820]

Staff

Staff opposed this Target Revenue Adjustment for Class SL because this adjustment is a form of decoupling, and Class SL is not a Rider BSA rate. Staff noted that this effectively decouples the allocated revenue requirement for Class SL from the Class SL sales. Staff also noted that Pepco has proposed similar revenue adjustments for Classes TN and OL in the past which the Commission has rejected.

Commission Decision

The Commission rejects the Company's proposal to increase Class SL rates in RY2, RY3 and RY3E. Additionally, the Commission notes that this issue is moot given the decision to approve rates based on forecasted data for Pepco in this case.

[820] Blazunas Rebuttal at 37.

11. Pepco's proposed rate design methodology for Class R-TOU-P

Pepco

Pepco sets R-TOU-P distribution volumetric rates based upon changes to Class R rates and maintaining the same on-peak and off-peak ratio as the current rates. Pepco accepted Staff witness Hoppock's recommendation to set Schedule R-TOU-P rates using the method used to update these rates in Maillog No. 242246, and Pepco incorporates this recommendation into its rate design.[821]

Staff

Staff proposed that Pepco's R-TOU-P rates be set using the method that Pepco used to update these rates in ML No. 242246 and recommends that this method incorporate Pepco's current CCOSS results. Staff stated that Pepco's proposal is a different methodology than Pepco has used for its most recent update of R-TOU-P rates to comply with Commission Order No. 90298. As noted, Pepco accepted Staff's proposal.

Commission Decision

The Commission accepts the agreed-upon methodology between the Company and Staff. The Commission directs Pepco to follow past Commission orders and filings in complying with R-TOU-P Rate Design methodology.

12. AOBA's proposal for Pepco to immediately reduce the revenues for Class GT-3B and Class TN to ensure they have an RROR no greater than 1.5

AOBA

AOBA stated that two of Pepco's rate classes with extremely high RRORs (GT-3B and TN) have shown only minor improvements since Pepco applied its four-step

[821] *Id*. at 14.

methodology in Case No. 9655.[822] Witness Oliver contended that the Company's application of zero increases to those classes does little more than institutionalize their highly inappropriate rate burdens.[823] AOBA claims that the Company relies upon prior Commission decisions rather than address the changed circumstances of the present case.[824]

Witness Oliver recommended that the Company immediately reduce the revenue requirements for Classes GT-3B and TN such that neither class has a UROR of greater than 1.5 after adjusting for class revenue requirements.[825] Witness Oliver contended that this immediate reduction is feasible because both classes are comparatively small (revenue-wise and customer-wise), and the recommended reduction would not have an unduly large impact on other rate cases.[826]

<u>Pepco</u>

Pepco contended that this proposed adjustment is counter to Commission precedent. In fact, in Case No. 9602, the Commission rejected AOBA's proposed reductions to the revenue requirements of Classes GT-3B and TN, in part because the rate design reduced the revenue requirements for those two classes.[827] Additionally, Pepco claims that the general RROR trend for these classes has been toward the system average in recent cases.[828]

<u>Commission Decision</u>

The Commission accepts Pepco's proposal, and rejects AOBA's proposed immediate reductions for Classes GT-3B and TN. Classes GT-3B and TN will receive no revenue

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[822] B. Oliver Direct at 51-52.
[823] *Id*. at 52.
[824] *Id*. at 52-53.
[825] *Id*. at 53.
[826] *Id*. at 54.
[827] Blazunas Rebuttal at 12.
[828] *Id*.

increase and these classes RROR have reduced over the past few rate cases.[829] The Commission notes that the RRORs of Pepco's GT-3B and TN classes are not extremely high or over-earning compared to BGE's Amtrak rate class.[830] The Commission historically does not approve revenue reductions for specific classes. Further, because these classes are small, shifts in RRORs are more volatile within the class. AOBA's requested revenue requirement reduction for classes GT-3B and TN is therefore denied.

13. Proposed Tariff Changes

Pepco proposed the following changes to its tariffs:

> (1) The Company's proposed Rider ERR and Rider MYP Adjustment included in the revised tariff sheets provided as Schedule (PRB)-13;[831]
>
> (2) The Company's removal of its proposed Income Tax Adjustment as reflected in Schedule (PRB)-13;[832]
>
> (3) The Company's removal of references to Schedule "GS-3A" from the availability section of the tariff for Reserved Delivery Capacity Service (Rider "RDCS"). This change is appropriate because the Company does not have a Schedule "GS 3A";[833]
>
> (4) The Company incorporation of the increase of an 1,800-customer count per month in Schedule R;[834]
>
> (5) The Company's agreement to transfer five unmetered Schedule GS-LV customers with load less than 1,800 watts per device to Schedule TN service;[835]
>
> (6) The Company's acceptance of Staff's recommendation that for its next MYP, Pepco will provide supporting analysis of the assumption that all commercial EV charging occurs under Schedule GS-LV; [836] and

[829] Hoppock Rebuttal at Staff DR 77-2 showing the CCOSS RORs and URORs by rate class that Pepco submitted the past five base rate cases.
[830] Order No. 90948 at 254-260.
[831] Blazunas Direct at 58.
[832] *Id*. at 57.
[833] Blazunas Direct at 58.
[834] Coursey Rebuttal at 3.
[835] Pepco Ex. DH-SR1; Hoppock Surrebuttal at 21-22.
[836] Coursey Rebuttal at 4.

(7) The Company's acceptance of Staff witness Hoppock's recommendation to set Schedule R-TOU-P rates using the method used to update these rates in Maillog No. 242246.[837]

Commission Decision

The Commission accepts the above proposed tariff changes and directs Pepco to include the aforementioned tariff changes in a compliance filing in the future. The Commission notes that the above tariff changes were either undisputed or agreed upon by all parties that commented on the specific change.

14. Other Rate Design Issues

a. Residential Sales Forecast

OPC

Pepco witness Coursey laid out all of the data upon which Pepco created its various forecasts in this case.[838] OPC witness Nelson recommended that the Commission direct Pepco to propose a methodology to include building electrification, distributed solar and weather variables based on climate change into its forecasted sales growth.[839] OPC contended that incorporating this data is consistent with Maryland's policy trends. Additionally, OPC contended that excluding this data from sales forecasts unreasonably deflates the kWh sales forecasts over the MYP and unduly escalates residential rates.[840]

[837] Blazunas Rebuttal at 14.
[838] Coursey Schedule (JTC)-1. Pepco retained an independent contractor, Itron, to conduct these forecasts using MetrixND statistical software.
[839] Nelson Direct at 28-42.
[840] *Id*. at 28.

1. Distributed Solar Forecasts

The Company forecasted distributed solar by extending historic trends into future periods using an exponential smoothing model.[841] OPC witness Nelson argued that this methodology is unreasonable because it assumes that solar growth will remain elevated for five years into the future just because solar growth was elevated for a few months in 2022.[842] He argued that in developing its forecast, the Company failed to control for the drivers of solar growth. As a result, data through November 2023 shows the Company's solar forecasts substantially over-estimated residential solar additions.[843]

As an alternative, OPC recommended that Pepco forecast residential solar based on a simple average of the past three years of incremental monthly additions, which would reduce the Company's forecast to 1,901 kW per month.[844] OPC asserted that Pepco's sales forecast should be informed by a more reasonable model that projects solar growth in a manner more consistent with the past five years and less influenced by outlier data for a few months in 2022.[845]

2. Building Electrification

OPC witness Nelson stated that Pepco did not make any explicit assumptions regarding building electrification impacts.[846] Given that state and federal policymakers are combining with market forces to make building electrification more attractive, OPC argued that failure to include these patterns in forecasts is unreasonable and will under-estimate

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[841] *Id*. at 31.
[842] *Id*. at 31-32.
[843] *See* Nelson Direct at 35, Figure 2.
[844] Nelson Surrebuttal at 15.
[845] Nelson Direct at 37.
[846] *Id*. at 37-38.

sales, in OPC's view.[847] Like the Company's unreasonably high solar forecasts, witness Nelson argued that excluding building electrification data will inflate distribution rates that unduly burden customers.

3. Weather Variables

The Company's residential sales forecast uses two weather variables: Heating Degree Days and Cooling Degree Days with incorporated humidity. Both are calculated using temperature and Temperature Humidity respectively.[848] The Company forecasted weather variables based on normalized temperatures calculated based on 30-year averages for each day of the year from 1992-2001.[849] OPC contended that using data back to 1992 is likely to under-estimate the impact of climate change. By under-estimating warming temperatures, OPC argued that the Company's approach likely under-estimates summer sales and over-estimates winter sales.[850] OPC recommended that Pepco apply a modest increase to the normalized weather over time.[851]

In his surrebuttal testimony, OPC witness Nelson ultimately recommended that, in its next MYP, the Company should develop a more robust approach to forecasting solar growth, as well as building electrification and weather variables to account for a changing climate.[852]

Pepco

Pepco disagreed with OPC's criticisms of its forecast methodology on all three topics.

[847] *Id*. at 38-39.
[848] *Id*. at 40-41. *Citing* Pepco witness Coursey Schedule (JTC)-1.
[849] Nelson Direct at 40-41.
[850] *Id*. at 41.
[851] *Id*. at 41-42.
[852] Nelson Rebuttal at 15.

4. Distributed Solar Forecasts

Pepco argued that solar growth is difficult to predict at its current phase of adoption and therefore will be prone to significant levels of error no matter how good the model is.[853] Pepco agreed with Staff's recommendation to review its solar forecasting for its next rate case.

5. Building Electrification and Weather Variables

Pepco disagreed with OPC that the Company excludes building electrification in its billing determinants forecast. OPC stated that Pepco's clear assumption that existing electrification is modeled but future policy impacts are not part of the forecast.[854] The Company argued that it accounted for policies that were known at the time of the Case No. 9702 billing determinant forecast or the filing of direct testimony in the instant case.[855] The Company claims that this is a reasonable approach that results in a reasonable forecast.[856]

Regarding OPC witness Nelson's proposed changes in weather variables due to climate change, Pepco argued that the seasonal effects of warming weather often offset each other.[857] Moreover, contrary to OPC witness Nelson's concern that the net impact is to under-forecast sales, Pepco insists that history suggests the opposite is true.[858] Pepco stated

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[853] Coursey Rebuttal at 6.
[854] *Id*. at 10.
[855] *Id*. The New Building Energy Performance Standards resulting from the Climate Solutions Now Act were not finalized by the Maryland Department of the Environment until November 2023, about a year after the Company produced its billing determinant forecast in this case.
[856] Hoppock Direct at 15. (Confirming that Pepco has complied with the Commission's previous requirement in Order No. 89868 for sufficient granularity in future utility forecasts at the beginning of a rate case.
[857] Coursey Rebuttal at 14; "[W]e use weather normals, weather normal assumptions, about what the weather will be going out into the future that drives our forecasts and those weather assumptions are based on 30 year averages from the past." Hearing Transcript, Vol. 2, 520: 11-16 (March 8, 2024). ("30-year weather normals" refers to U.S. Weather Bureau normal data for normalization, i.e., a 30-year average updated every 10 years. *See e.g.*, Order No. 68122, *In the Matter of Maryland Natural Gas for Authority to Increase Rates and Charges for Gas Service*, Case No. 8119 (Sep. 20, 1988)).
[858] Coursey Rebuttal at 14.

that data in four of the last five years indicate that the 30-year weather normals have on average led to an over-forecast of residential sales.[859] Finally, Pepco asserted that OPC provides no quantified impact with which the Company should adjust its forecast to incorporate OPC's concerns. The Company proposed that the Commission address OPC's recommended forecast changes in future rate cases.

Staff

Staff noted discrepancies between Pepco's solar actuals and its forecasts from October 2022 thru October 2023.[860] As a result, Staff recommended that the Commission require Pepco to submit as part of its next MYP rate case, a review of its solar forecasting method used in its billing determinant forecasts along with an explanation of any change in solar forecasting methodology employed in its next MYP rate case, if applicable.[861]

Commission Decision

The issues with the Company's forecast models are effectively moot in light of the shift to rates based on forecasted data. The Commission does not reject OPC's proposals to adjust future forecasts to better address distributed solar, building electrification, and climate-change based weather variables. However, the Commission finds that these issues are not currently ripe for a resolution in this instant case. Based upon currently available data, it is unclear that sufficient data exists regarding future building electrification as well as future data from the National Oceanic Atmospheric Administration ("NOAA") regarding climate-change related weather variables. The Commission will therefore address these forecast supplements in its the MYP lessons-learned proceedings.

[859] *Id*. at 14.
[860] Hoppock Rebuttal at 11.
[861] *Id*. at 13.

The Commission therefore agrees with the Company and Staff (and to a lesser extent, OPC) and directs that these issues will be addressed in the MYP lessons-learned proceedings, with any findings adopted in Pepco's future rate cases.

b. Pepco Street-Lighting

Staff

Staff recommended proposed rate increases for Schedules SL and SSL based on the percentage increase in revenue for each rate class in each rate year, subject to rounding, due to uncertainty regarding the CCOSS results for these classes.[862] Consistent with witness Blazunas, this results in all conventional, non-LED, street lights having fixed charges that are equal to or higher than the fixed charges for LED streetlights. Also, the LED O&M charges are equal to the conventional, non-LED streetlight charges for customer supplied maintenance.[863]

Due to billing discrepancies in Case No. 9706, the Company and Staff identified under-billing or over-billing in 10 municipalities. Pepco included Capital Project 87526 (Pepco Streetlights Capital) in the instant rate case to automate and improve the asset management and billing processes for Pepco MD streetlights, budgeting $660,000 in 2023 and $1,410,000 in 2024. Staff therefore proposed placing streetlight billing error costs, including automating connections between Pepco's streetlight inventory database and billing system database, in a regulatory asset and disallowing recovery pending resolution of Case

[862] Hoppock Direct at 72.
[863] *Id*.

No. 9706.[864] Staff will remove Project 87526 costs from rate base and adjust depreciation expense as well as remove any other known costs.

Pepco

Pepco agreed with both of Staff's proposals.

Commission Decision

The Commission accepts and incorporates both of Staff's recommendations to ensure a system average increase for Pepco's street lighting classes SL and SSL, pending resolution of the billing issues in Case No. 9706. The Commission also accepts and directs the Company to remove these billing errors from Rate Base and establish a regulatory asset to include the billing error costs as they are incurred.

3. Miscellaneous

a. Benchmarking Study

Staff

Staff witness Patterson testified that variance reports on budget and actuals do not evaluate or measure the sufficiency of a company's costs.[865] He suggested that a preferred method to assess the reasonableness of costs included within the operating budgets of a utility is through a benchmarking analysis.[866] He argued that a variance analysis may be misleading because of the Company's ability to change course on spending as it deems

[864] In Case No. 9706, Proposed Order at 24, Pepco witness Stewart that the Company did not intend to collect under-billed because the error was Pepco's. In the Proposed Order, the PULJ noted that "Pursuant to an agreement between Pepco and Staff, incremental costs associated with both resolving streetlight billing errors and automating connections between Pepco's streetlight inventory database have been removed from Pepco's pending rate case, Case No. 9702"). Proposed Order. at 22.
[865] Patterson Direct at 4.
[866] *Id*.

appropriate, and its internal bias.[867] Mr. Patterson proposed that a useful way to evaluate Pepco's costs is through a comparison to other organizations via a benchmarking analysis.[868] He noted that Staff had asked Pepco whether it conducted a study of its costs in order to assess reasonableness and Pepco responded that financial benchmarking is done at the PHI (Pepco Holding Incorporated) level. At the PHI level, witness Patterson found that the PHI level benchmarking data provided to Staff suggested that the costs to serve customers seem to be higher in comparison to peers.[869] Staff witness Patterson recommended that the Commission "require Pepco to provide a benchmarking study based on Pepco-only costs in future MYP cases."[870] He argued that this will provide Staff and other parties with the ability to better analyze the reasonableness of Pepco's costs.[871]

Pepco

Pepco witness Barnett testified that while he understood Staff's interest in obtaining financial benchmarking information at the Pepco-level, he disagreed with Staff's assessment that it would provide the ability to better understand the reasonableness of Pepco's costs for purposes of its MYP revenue requirement.[872] Mr. Barnett asserted that the Company engages in a rigorous process to develop long range planning for O&M (Operations & Maintenance) given Pepco's obligation to provide safe and reliable service at reasonable costs. He noted that there are several opportunities for intervenors to challenge the reasonableness of proposed costs. Mr. Barnett suggested that a better way to assess the reasonableness of O&M

[867] *Id*. at 11.
[868] *Id*. at 12.
[869] *Id*. at 13.
[870] *Id*.
[871] *Id*.
[872] Barnett Rebuttal at 25.

increases is through year over year trend analysis.[873] Mr. Barnett also stated that the Company does not currently perform the financial benchmarking at the Pepco MD level proposed by Staff witness Patterson and if the Commission accepted Staff's request it would be a new process that the Company would need to develop, which would create significant additional work for Pepco.[874]

Commission Decision

The Commission finds that Staff's proposal for a financial benchmarking analysis at the Pepco level is reasonable and directs the Company to determine how much it would cost to perform such assessment, and to work with Staff and OPC to determine what data should be in the report. The Commission directs the Company to provide the cost estimate in time for the study to be developed before the next base rate case.

b. Electric Vehicles Cost Benefit Analysis

Pepco

Pepco's MYP2 includes requests for cost recovery for the Company's existing EV programs approved in Case No. 9478.[875] Pepco witness Hledik assessed the programs and grouped them into two broad categories designed to promote the development of charging infrastructure and programs designed "to encourage EV charging during lower-cost off=peak hours."[876] Mr. Hledik analyzed the cost effectiveness of Pepco's EV programs using three of the cost effectiveness assessments established in the Electric Vehicle Benefits Cost

[873] *Id*. at 26.
[874] *Id*. at 28.
[875] Donohoo-Vallett Direct at 19. *See* Order No. 90036, *In the Matter of the Petition of the Electric Vehicle Work Group for Implementation of a Statewide Electric Vehicle Portfolio*, Case No. 9478 (Jan.2022).
[876] Hledik Direct at 14.

Assessment Working Group Report.[877] Mr. Hledik's analysis found that all of Pepco's existing EV programs are cost effective.

OPC

OPC witness Lane reviewed Mr. Hledik's analysis and determined it complied with the Maryland EV-BCA Framework.[878] Therefore OPC recommended that the Commission allow Pepco to recover incurred and forecasted costs relating to the existing EV programs authorized in Case No. 9478.

Staff

Staff witness McAuliffe raised certain concerns with Pepco's Electric Vehicle Cost Benefit Analysis and recommended the Commission not use the analysis to draw any conclusions regarding Pepco's EV portfolio, nor should the analysis be used as support for future programs. Witness McAuliff explained the appropriate time to consider the EV portfolio is after the pilot concludes in 2023.[879] Witness McAuliff still supported moving the costs associated with the program into rate base but for the Commission to not make a prudency determination.[880]

On surrebuttal, witness McAuliffe continued to defend his criticism of the Company's analysis but also noted the Commission's decision in BGE Case No. 9692 to direct the PC44 EV Workgroup to consider and address changes to the EV-BCA methodology previously approved in 9478. Witness McAuliffe recommended a similar ruling be made in the instant case.[881]

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877 OPC Initial Brief at 55.
878 Lane Direct at 61.
879 McAuliffe Direct at 12-13.
880 *Id*. at 12.
881 McAuliffe Surrebuttal at 2-5.

Commission Decision

As in BGE Case No. 9692, the Commission notes the continued disagreement between some parties regarding the application of the BCA methodology in Case No. 9478. The EV Workgroup will be filing a report with recommendations on June 3, 2024, after considering and addressing disagreements associated with the BCA methodology for EVs.[882] Phase 1 costs (costs associated with authorized programs in Case No. 9478) are approved and may be moved into the revenue requirement, with prudence to be determined at the end of the rate-effective period.

IV. CONCLUSION

The goal of any ratemaking proceeding is for the Commission to ensure that the rates approved for a public utility to charge customers for regulated service are just and reasonable. In this Order, the Commission rejects Pepco's MYP request and adopts an approach that authorizes the Company's MYP for Rate Year 1 which reflects historical test year costs and some forward-looking costs and preserves the annual reconciliation. This decision allows Pepco to achieve its appropriate revenue requirement while the Commission considers MYP lessons learned.

Having duly considered the entire record in this proceeding, including all of the filed and oral testimony and exhibits, as well as public comments, and taking into account recent Commission decisions, the Commission hereby authorizes an increase in rates of $44,629,000, with an overall ROR of 7.13% based on a ROE of 9.50% on an adjusted rate base of $2,408,076,000. The Commission finds that these terms, along with the decisions stated elsewhere in this Order, encompass just and reasonable rates that will adequately

[882] *Order No. 90948*, Case No. 9692, at 216.

compensate the Company, will not induce rate shock, and will not unduly burden any one class of customers.

IT IS THEREFORE, this 10th day of June, in the year of Two Thousand Twenty-Four, by the Public Service Commission of Maryland, **ORDERED:**

(1) that the Multi-Year Rate Application filed by Potomac Electric Power Company on May 16, 2023 (as supplemented by the Company over the course of this proceeding), seeking an increase in its electric distribution rates of $117.2 million for the twelve months ending March 31, 2025, $160.5 million for the twelve months ending March 31, 2026, $193.2 million for the twelve months ending March 31, 2027, and $213.6 million for the proposed nine-month extension period ending December 31, 2027, is hereby denied, as discussed in the body of this Order;

(2) that Pepco is hereby authorized to increase its Maryland electric distribution rates by no more than the amounts provided in Appendix A, labeled "Commission Approved Revenue Requirements" for service rendered on or after June 10, 2024, consistent with the findings in this Order;

(3) that Pepco's Smart Inverter Program is approved as a pilot and the Company is directed to work with the Commission's PC 44 work group to explore the impact of smart inverter technology;

(4) that Pepco is directed to file tariffs in compliance with this Order with the effective dates prescribed herein, subject to acceptance by the Commission; and

(5) that any motions or requests not granted herein are deemed denied.

/s/ Frederick H. Hoover, Jr.

/s/ Michael T. Richard

/s/ Kumar P. Barve

/s/ Bonnie A. Suchman
Commissioners