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September 7, 2018

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

Re: Pennsylvania Public Utility Commission v. PECO Energy Company,
Docket Nos. R-2018-3000164

Dear Secretary Chiavetta:

Enclosed for electronic filing please find NRG Energy, Inc.'s Main Brief with regard to the above-referenced matter. Copies to be served in accordance with the attached Certificate of Service.

Sincerely,

Kristine E Marsilio

Kristine E. Marsilio

KEM/lww
Enclosure

cc: Hon. Christopher P. Pell w/enc.
Hon. F. Joseph Brady w/enc.
Cert. of Service w/enc.

CERTIFICATE OF SERVICE

I hereby certify that this day I served a copy of NRG Energy's Main Brief upon the persons listed below in the manner indicated in accordance with the requirements of 52 Pa. Code Section 1.54.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	R-2018-3000164
Office of Consumer Advocate	:	C-2018-3001112
Office of Small Business Advocate	:	C-2018-3001043
	:	
v.	:	
	:	
PECO Energy Company	:	

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I. INTRODUCTION AND PROCEDURAL HISTORY

A. Introduction

It is undisputed that PECO Energy Company ("PECO") allocates zero indirect expenses to residential default service. This is true despite the fact that PECO projects the sale of 8.6 billion kilowatt hours ("kWh") of electricity to over one million residential default service customers and projects to collect over $637 million in annual default service revenues from this business. As a result of allocating no indirect expenses to residential default service, PECO's current price to compare ("PTC") reflects zero information technology ("IT") costs, zero regulatory commission costs and zero consumer education costs. Notably, this means that PECO is supposedly operating a business upon which over one million residential customers rely for generation supply service without incurring any IT costs. It is unfathomable to accept the notion that PECO incurs no IT costs to provide essential electricity services as the default service provider for two-thirds of its residential customers. Indeed, PECO's entire "administrative costs" to run this massive default service business during the present quarter amount to a mere $118,314. Astonishingly, PECO's current PTC reflects *negative* administrative and general ("A&G") expenses related to default service. Common sense dictates that it would be impossible to run any business, let alone a business that is selling 8.6 billion kWh of electricity and generating hundreds of millions of dollars in revenues, with negative A&G expenses.

As a result of PECO's illogical allocation of all indirect expenses to residential distribution service, it is proposing to recover a disproportionately high amount of its costs through residential distribution charges. When a reasonable portion of PECO's indirect costs is reallocated from residential distribution service to residential default service, consistent with widely accepted accounting principles and standard business practices, PECO's revenues from distribution charges, using proposed rates for the Fully Projected Future Test Year ("FPFTY")

2019, would be reduced by $101 million. This would equate to an average reduction in residential distribution charges in the amount of .76 cents per kWh. More specifically, a residential customer using 1,000 kWh per month would see a decrease in his or her monthly distribution charges in the amount of $7.64, which would amount to $91.68 over the course of a year. Through the reallocation of $101 million in indirect costs from residential distribution service to residential default service, PECO would recover these costs through the PTC. The effect of this reallocation, which relies on commonly utilized allocators of revenues and number of customers, would be an increase in the PTC for residential default service from 7.15 cents per kWh to 8.40 cents per kWh, a 15 percent increase.

Chris Peterson, a forensic accountant, certified public accountant and expert witness in this proceeding, testified on behalf of NRG Energy, Inc. ("NRG") that it is common business practice across a variety of industries to allocate indirect costs to different segments or lines of a business. This assertion was not refuted by either PECO or the Office of Consumer Advocate ("OCA") – the only parties who submitted testimony in response to NRG's witness. Indeed, the Commission itself allocates indirect costs among the industries it regulates since it necessarily incurs costs, just like any other organization, that cannot be directly allocated to any particular industry group. However, in failing to allocate indirect costs within the residential rate classes to the separate and distinct functions of providing distribution service and default service to customers, PECO simply ignores this standard business practice. While widely accepted accounting principles warrant the use of commonly utilized allocation methods to allocate these shared/common costs to both aspects of the business – distribution service and default service – PECO illogically allocates all of its indirect expenses to distribution service.

Because of PECO's failure to allocate any indirect costs to default service and its proposal to annually recover over one hundred million dollars of indirect costs through its

distribution charges that should be recovered through its PTC for default service, it is providing misleading information to customers regarding the cost of default service. Moreover, as a result of PECO inflating its distribution charges and establishing an artificially low PTC, customers are not receiving fair and accurate information on a uniform basis – as required by the Public Utility Code and Commission precedent – that enables them to meaningfully compare prices charged by PECO for default generation service and prices offered by EGSs for competitive generation service.

The lower PTC also enhances PECO's ability to attract and retain default service customers, making it more difficult for EGSs to compete in the retail market. In addition, the disproportionate allocation of indirect costs to residential distribution service results in shopping customers who receive their generation supply from EGSs paying too much for distribution service. The reallocations proposed by NRG, along with the commensurate reductions to distribution charges and increases to the PTC, would begin to rectify PECO's misallocation of costs to residential distribution service, improve the functioning of the competitive market and be in the public interest.

In summary, by allocating all indirect costs attributable to the residential classes to residential distribution service and allocating zero indirect costs to residential default service, PECO has failed to carry its affirmative burden to establish the justness and reasonableness of every component of its rate request. Therefore, it is necessary for the Commission to mandate that PECO reallocate indirect costs from residential distribution service to residential default service in a manner that is consistent with NRG's proposals, and require PECO to implement the commensurate distribution charge reductions and PTC increases.

B. Procedural History

On March 29, 2018, PECO filed Tariff Electric-Pa. P.U.C. No. 6, in which PECO proposed rates designed to produce an increase in PECO's annual distribution revenue of approximately $82 million. NRG filed a Petition to Intervene on May 4, 2018, which was granted without limitation by Prehearing Order #2 issued by Deputy Chief Administrative Law Judge Christopher Pell and Administrative Law Judge F. Joseph Brady (collectively "ALJs") on June 1, 2018.[1] NRG adopts the remaining procedural history that is set forth in the "Background" section of the Joint Petition for Partial Settlement ("Settlement"), which was filed on August 28, 2018.

During this proceeding, NRG served the Direct Testimony of Chris Peterson, which is marked as NRG St. No. 1, and was accompanied by NRG Exhibits C-1 through C-18 on June 26, 2018. NRG also served the Surrebuttal Testimony of Chris Peterson, which is marked as NRG St. No. 1-SR (Rev), and was accompanied by NRG Exhibits C-19, C-20 (Rev), C-21 and C-22 on August 8, 2018. In addition, NRG offered NRG Cross Examination Exhibit 1 during the evidentiary hearing held on August 21, 2018. These testimonies and exhibits were admitted into the record on August 21, 2018.

As noted in the Settlement (pages 1-2), NRG opposes the Settlement only to the extent that it is based on PECO's allocation of certain indirect costs to residential distribution service instead of residential default service, and the effect of reallocating those costs to residential default service, with a commensurate reduction in the level of residential distribution charges. This issue has been reserved for briefing by the parties.

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[1] NRG has five affiliate companies that are licensed by the Commission as electric generation suppliers ("EGSs") to provide electricity or electric generation supply services to retail customers throughout Pennsylvania. These EGSs, which include Reliant Energy Northeast LLC d/b/a NRG Home and NRG Business, Green Mountain Energy Company, Energy Plus Holdings LLC, Independence Energy Group d/b/a Cirro Energy and XOOM Energy Pennsylvania, LLC, serve customers PECO's distribution service territory. NRG St. No. 1 at 3; NRG St. No. 1-SR (Rev) at 1.

NRG submits this Main Brief in accordance with the ALJs' Corrected Briefing Order issued on August 24, 2108. By this Main Brief, NRG contends that PECO should be required to reallocate a reasonable portion of its indirect costs from residential distribution service to residential default service, using the allocation method proposed by NRG's witness. Further, PECO should be directed to reduce its distribution charges and increase its PTC to reflect this reallocation of indirect costs. The only impact of these proposals on the Settlement is that PECO would be recovering a portion of its agreed upon distribution revenue requirements for the residential class through the PTC paid by residential default service customers rather than through distribution charges paid by residential distribution customers.

II. STATEMENT OF THE CASE

NRG refers to and hereby incorporates Section I, Introduction and Procedural History, of this Main Brief for the Statement of the Case.

III. SUMMARY OF ARGUMENT

As the party requesting the rate increase, PECO has an affirmative burden under the Public Utility Code and well-established case law to establish the justness and reasonableness of every element of its proposal. The party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. In general rate increase proceedings, the utility's burden remains throughout the course of the proceeding. Under Pennsylvania law, no similar burden is placed on a party proposing an adjustment to a utility base rate filing. Rather, it is sufficient for a party proposing an adjustment to present evidence or analysis tending to demonstrate the reasonableness of the adjustment.

PECO has not carried its burden of proving that the allocation of all indirect costs associated with the residential rate classes to residential distribution service is just and reasonable or in the public interest. By contrast, NRG has presented compelling evidence and

analysis showing that PECO's proposal to allocate no indirect costs to residential default service is not just and reasonable or in the public interest.

As a threshold matter, because it is illogical from an accounting perspective to allocate all indirect costs to one segment or function of a business, the allocation of all indirect costs to distribution service results in PECO's distribution charges being too high. Because PECO's residential distribution charges are overstated, residential customers who purchase their generation service from EGSs are paying for services they are not receiving and are subsidizing customers who are taking default service from PECO. Reallocating a reasonable portion of indirect costs to residential default service, which is consistent with the practices of other industries and organizations, would result in consumers paying distribution charges that more accurately reflect the costs incurred by PECO to provide distribution service.

Moreover, by allocating no indirect costs to residential default service, PECO is necessarily recovering costs of default service through its distribution charges, in violation of the Commission's regulations, which require that the PTC "be designed to recover all default service costs, including generation, transmission and other default service cost elements, incurred in serving the average member of a customer class."[2] Importantly, through its misallocations, PECO is also providing misleading information to consumers about the costs of default service. As a result, customers are not able to make informed choices regarding the purchase of electricity services in the retail market. Absent significant modifications to PECO's cost allocations, customers will not have fair and accurate information enabling them to compare prices and services on a uniform basis. As Mr. Peterson testified, "rather than having an opportunity to make apples-to-apples comparisons, or even apples-to-oranges comparisons,

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[2] 52 Pa. Code § 54.187(e) (emphasis supplied).

PECO consumers will continue to participate in the retail market making apples-to-cucumbers comparisons." NRG St. No. 1 at 4-5.

NRG has further demonstrated that a reasonable approach for remedying PECO's misallocation of indirect costs is to reallocate a portion of PECO's indirect costs from distribution service to default service. The method advanced by NRG uses two allocators, including revenues and number of customers, which are both based on widely accepted accounting principles for allocating costs across different segments or functions of businesses, and upon which PECO has relied to allocate costs. The reallocation process proposed by NRG is consistent with the Commission's regulations, which prohibit EDCs from recovering default service costs through the distribution rate and require that such costs be reallocated to the default service rate, with the distribution rate reduced and the PTC for default service increased accordingly.[3]

The indirect expenses that PECO allocates solely to residential distribution service include A&G, as well as Customer Service, Sales, and Intangible Plant, General Plant and Common Plant Depreciation/Amortization. By allocating these indirect expenses entirely to residential distribution services, PECO fails to address that a significant portion of these costs are incurred to provide residential default service. For instance, if PECO were to operate a separate functional division that provides default service – a standard employed by the Commission during PECO's 1997 restructuring proceeding – it would necessarily incur these types of expenses. In that proceeding, the Commission noted that a separately-functioning generation division would require A&G services and therefore directed an adjustment so that some level of A&G costs would be removed from transmission and distribution ("T&D") rates. Further, PECO's failure to allocate indirect costs to default service is contrary to the Commission's 2007

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3 52 Pa. Code § 54.187(e).

Policy Statement, which identifies A&G expenses related to default service as a necessary component of the PTC, yet PECO's current PTC reflects negative A&G expenses related to default service.

Through the reallocation process, using PECO's proposed rates for the FPFTY 2019, NRG's expert witness has identified the amount of $101 million of a total of $196 million in indirect costs that was improperly allocated wholly to residential distribution service. The effect of reallocating indirect costs in the manner proposed by NRG would result in PECO recovering a lower amount of costs through its residential distribution charges. As calculated in this proceeding, the average reduction would be .76 cents per kWh. The impact of this reallocation on PECO's PTC is a 1.25 cent per kWh increase, or about 15 percent, increasing it from 7.15 cents to 8.40 cents per kWh.

Implementation of NRG's proposal to properly allocate PECO's indirect costs would result in consumers paying distribution charges that more accurately reflect the costs incurred by PECO to provide distribution service. Additionally, consumers receiving default service from PECO would pay a PTC that more accurately reflects the costs incurred by PECO to provide default service. As a result, the information received by residential customers would allow for more meaningful comparisons between PECO's PTC and the prices offered by EGSs. While the outcome would still not produce a complete apples-to-apples comparison, these adjustments would permit customers to compare prices and services on a more uniform basis and enhance their ability to make informed choices regarding the purchase of electricity services. With default service rates more accurately reflecting the costs to provide default service, EGSs would be better positioned to offer more competitively-priced products.

IV. ARGUMENT

A. OVERVIEW OF NRG PROPOSAL

In this base rate proceeding, NRG proposes an adjustment to PECO's cost allocations so that a reasonable portion of indirect costs incurred to serve residential customers is reallocated from residential distribution service to residential default service. This modification is necessary to begin to rectify the illogical approach used by PECO through which it allocates all indirect costs associated with serving the residential classes to residential distribution service. By directing PECO to allocate a reasonable portion of indirect costs to residential default service, consistent with widely accepted accounting principles and standard business practices across a variety of industries, the Commission would ensure that PECO's distribution charges more accurately reflect the costs of providing residential distribution service.

Further, as required by the Commission's regulations, these costs would instead be recovered through PECO's PTC for default service. In this manner, consumers would have an opportunity to more meaningfully compare on a uniform basis the prices charged by PECO for default generation service with the prices offered by EGSs for competitive generation service.[4] Through directing the implementation of NRG's proposals, the Commission could begin to rectify the misallocation of indirect costs by PECO, reduce the subsidization of distribution service by default service customers and improve the overall functioning of the electric retail competitive market.

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[4] For a more complete description of NRG's proposal, please refer to Section I (Introduction and Procedural History) and Section IV.C. (NRG Proposal to Reallocate Costs) of this Main Brief.

B. PECO'S PROVISION OF DEFAULT SERVICE AND APPLICABLE LAW

1. PECO Has The Burden of Proof

As the party requesting the distribution rate increase, PECO has the burden of proving the justness and reasonableness of every element of its requested rate increase. Section 315(a) of the Public Utility Code ("Code") provides as follows:[5]

> Reasonableness of rates – In any proceeding upon the motion of the Commission involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

Further, the Commonwealth Court has held that Code Section 315(a) "places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial."[6]

The Pennsylvania Supreme Court has found that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Specifically, the party with the burden of proof must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary."[7] Further, it is well-settled that the "degree of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of the evidence."[8] Additionally, the evidence must be substantial and legally credible, and cannot be mere "suspicion" or a "scintilla" of evidence.[9]

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5 66 Pa.C.S. § 315.

6 *Lower Frederick Twp. v. Pa. P.U.C.*, 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980) (citations omitted). *See also, Brockway Glass v. Pa. P.U.C.*, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

7 *Burleson v. Pa. P.U.C.*, 461 A.2d 1234, 1236 (Pa. 1983).

8 *Lansberry v. Pa. P.U.C.*, 578 A.2d 600, 602 (Pa. Commw. 1990).

9 *Lansberry*, 578 A.2d at 602.

Under Pennsylvania law, no similar burden is placed on a party proposing an adjustment to a utility base rate filing.[10] "In general rate increase proceedings, it is well established that the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utility's burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one, and that burden remains with the public utility throughout the course of the rate proceeding."[11]

The Commission recognizes this standard in its rate determinations.[12] The party proposing an adjustment to a ratemaking claim bears the burden only of presenting evidence or analysis tending to demonstrate the reasonableness of the adjustment.[13] Thus, PECO has an affirmative burden to establish the justness and reasonableness of every component of its rate request, including its proposal to allocate all indirect costs attributable to the residential classes to residential distribution service.

Accordingly, it is unnecessary for NRG to prove that PECO's proposed allocation to residential distribution service of all indirect costs attributable to the residential classes is unjust and unreasonable, or not in the public interest. To prevail in its challenge, Pennsylvania law requires only that NRG show that PECO failed to meet its burden of proof. While subtle, this critical distinction shows that parties opposing a utility in a rate proceeding need only to shift the burden of going forward to prevail.

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10 *PUC v. Appalachian Utilities, Inc.*, Docket No. R-2015-2478098 et al., Opinion and Order entered March 10, 2016 adopting the Recommended Decision dated February 19, 2016, at 19, 2016 Pa. PUC LEXIS 62.

11 *Appalachian* at 19. *See also Berner v. Pa. P.U.C.*, 382 Pa. 622, 116 A.2d 7638 (1955) (Pennsylvania Supreme Court made it patently clear that it is the utility who bears the burden of proving the justness and reasonableness of every aspect of the rate request and that the burden never shifts to those challenging it).

12 *Pa. P.U.C. v. Equitable Gas Co.*, 57 Pa. P.U.C. 423, 471 (1983). *See also University of Pennsylvania v. Pa. P.U.C.*, 86 Pa. Commw. 410, 485 A.2d 1217 (1984); *Pa. P.U.C. v. PPL Elect Util. Corp.*, 237 PUR 4th 419 (Pa. PUC 2004).

13 *See, e.g., PUC v. PECO*, Docket No. R-891364, et al., Opinion and Order entered May 16, 1990, 1990 Pa. PUC LEXIS 15; *PUC v. Breezewood Telephone Company*, Docket No. R-901666, Opinion and Order entered January 31, 1991, 1991 Pa. PUC LEXIS 45.

NRG has presented evidence and an analysis showing that PECO's proposal to allocate all indirect costs associated with the residential rate classes to residential distribution service, while allocating none of these indirect costs to residential default service, is not just and reasonable and is not in the public interest. NRG has further demonstrated that a reasonable approach for remedying PECO's misallocation is to reallocate a portion of PECO's indirect costs from distribution service to default service, using the number of customers or the level of revenues to allocate these costs.

2. Restructuring of Electric Market

As a result of the enactment of the Electric Competition and Choice Act in 1996 ("Competition Act"),[14] retail customers in Pennsylvania gained direct access to the competitive market for the generation and sale of electricity.[15] Prior to the passage of the Competition Act, electric utilities provided generation, transmission and distribution services to retail customers through bundled rates regulated by the Commission.[16] Under the Competition Act, the generation of electricity is no longer regulated as a public utility function, while the provision of T&D functions continue to be regulated as a natural monopoly. In order to facilitate electric choice, the EDCs, including PECO, were required to unbundle their rates to show separate charges for transmission, distribution and generation services.[17]

To implement the Competition Act, the Commission required the EDCs to file restructuring plans that allocated costs to distribution, transmission and generation functions. An important component of the restructuring plans involved a determination by the Commission of the appropriate level of stranded costs for each EDC, which reflected the long-term investments in generation, transmission and distribution facilities to meet their obligation to

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14 66 Pa. C.S. §§ 2801-2812.
15 66 Pa. C.S. § 2802(3).
16 66 Pa. C.S. § 2802(13).
17 66 Pa. C.S. § 2802(13) and (16).

serve customers within their defined service territories, and other transition costs. At the conclusion of the restructuring proceedings, the Commission issued orders addressing stranded cost recovery and other transition issues and establishing unbundled rates.[18]

PECO set forth a proposal for unbundling its rates through its restructuring plan, which was addressed by the Commission in 1997. The Commission started with PECO's then existing bundled rate for transmission, distribution and generation services. From that amount, the Commission subtracted T&D costs to arrive at a number that represented the costs of generation services. To calculate a shopping credit, which is now known as the PTC, the Commission determined an appropriate level of stranded costs for recovery through the competitive transition charge and subtracted that amount from the costs of generation services. The resulting shopping credit was the amount that a customer could avoid paying to PECO by choosing an EGS to provide electric generation service.[19]

Since the initial implementation of the Competition Act by the Commission, customers may receive electric generation supply from an EGS they choose in the competitive retail market. If they do not select an EGS, they receive such supply from the default service provider, which is currently the incumbent EDC in the respective service territory. When customers receive their generation supply from the default service provider, it is called default service. Currently, PECO serves as the default service provider for its customers who do not select EGSs to supply their generation service. [20]

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18 *See, e.g., Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code*, Docket No. R-00973953 (Order entered December 23, 1997) ("*1997 Restructuring Order*"). A relevant excerpt of the 1997 Restructuring Order is included in NRG Exhibit CP-5.

19 *1997 Restructuring Order.*

20 *See* 52 Pa. Code §§ 54.182-54.183.

3. *PECO Is Not Permitted to Recover Default Service Costs Through Distribution Rates*

The Commission has made clear on numerous occasions that the PTC charged by an EDC must reflect the costs of providing default service. In doing so, the Commission has stressed the importance of ensuring that such costs are not recovered through distribution charges. The Commission has also indicated that the remedy for fixing a scenario where default service costs are embedded in distribution rates is to reallocate those costs, so that distribution rates are decreased and the PTC is increased. Finally, the Commission has confirmed that issues regarding proper recovery of default service costs should be examined in distribution rate proceedings.

a. Default Service Regulations

Customers who do not select an EGS receive generation service, called default service, from their default service providers which are currently the EDCs.[21] Default service providers, including PECO, are required to provide this electric generation supply service under a Commission-approved competitive procurement process.[22] The rate that customers pay the EDC for the default service is called the PTC.

The Commission's regulations establish requirements for the design of default service rates and the recovery of reasonable costs. Specifically, they require the PTC to "be designed to recover all default service costs, including generation, transmission and other default service cost elements, incurred in serving the average member of a customer class."[23] The regulations further prohibit an EDC from recovering default service costs through the distribution rate. The Commission's rules also provide that when costs are reallocated from the distribution rate to the

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21 52 Pa. Code §§ 54.181 (relating to purpose), 54.182 (relating to definitions) and 54.183 (relating to default service provider).

22 *See* 52 Pa. Code §§ 54.184-54.186, 54.188.

23 52 Pa. Code § 54.187(e) (emphasis supplied).

default service rate, they may not be recovered through the distribution rate. Rather, the regulations mandate that "[t]he distribution rate shall be reduced to reflect costs reallocated to the default service rate."[24]

b. 2007 Policy Statement

The Commission clarified this requirement through its Default Service and Retail Electric Markets-Statement of Policy on May 10, 2007 ("Policy Statement") adopted on May 10, 2007, which addresses various elements of the default service regulatory framework, including default service program terms, electric generation supply procurement and competitive bid solicitation process.[25] Specifically, the Policy Statement lists the default service cost elements that should be included in the PTC.[26]

These elements entail the costs for providing generation service, such as wholesale energy, capacity, ancillary, transmission and congestion costs, as well as applicable taxes and costs for alternative energy portfolio standard compliance. They also include supply management costs (i.e., bidding, contracting, hedging, scheduling and forecasting services), and A&G expenses related to those activities. In addition, the Policy Statement identifies several administrative costs for inclusion in the PTC, including billing, collection, education, regulatory, litigation, tariff filings, working capital, information system, and associated A&G expenses related to default service.[27] The Policy Statement also states that "EDC rates should be scrutinized for any generation related costs that remain embedded in distribution rates."[28]

In adopting the Policy Statement, the Commission indicated that while "utility rates were unbundled into transmission, distribution and generation components as part of the restructuring

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24 52 Pa. Code § 54.187(e).
25 52 Pa. Code §§ 69.1801-69.1817.
26 52 Pa. Code § 69.1808.
27 52 Pa. Code § 69.1808 (a).
28 52 Pa. Code § 69.1808 (b).

process, there is a significant concern on the part of the Commission and others that some generation costs have been improperly allocated, or 'embedded' in EDC distribution rates."[29] The Commission noted that that it had not undertaken a full-fledged review of distribution rates with the goal of resolving this issue, citing the continued existence of rate caps that were agreed to in the restructuring settlements. With the impending expiration of rate caps, the Commission determined that no obstacles existed to taking this issue up for consideration.

To that end, the Commission expressed the preference for this issue to be addressed in the next distribution rate case for each EDC. For those EDCs that did not initiate base rate cases by 2007, the Commission reserved the right to initiate a cost allocation proceeding to resolve the issue.[30]

c. Other Commission Directives

The Commission has continued to recognize the possibility of the further unbundling of commodity costs from distribution rates to ensure that PTCs reflect all costs of default service. Specifically, during the Retail Markets Investigation in 2013, the Commission addressed comments suggesting a further unbundling of commodity costs from distribution rates. While declining to launch a generic review of this topic, the Commission noted that with respect to further unbundling, it "agrees with this concept and has strived to address these issues as they have arisen in distribution rate cases."[31] The Commission also stressed that it was not precluded from addressing the further unbundling of commodity costs and distribution rates in another proceeding in the future.[32]

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29 *Default Service and Retail Electric Markets, Docket No. M-00072009 (Final Policy Statement entered May 10, 2007), 37 Pa. B. 5019 ("Policy Statement Order"),* at 8-9.

30 *Id.*

31 *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (Order entered February 15, 2013) ("*RMI End State Order*"), at 21.

32 *RMI End State Order* at 21.

4. *PECO's Distribution Rates Have Not Yet Been Fully Unbundled*

Despite the Commission's efforts to do so during the 1997 restructuring proceeding, PECO's rates were not fully unbundled at that time and the Commission indicated that it would continue to examine PECO's rates to determine if they include charges related to the provision of generation service. After the Commission reiterated its desire in 2007 to ensure that default service costs were not embedded in distribution rates, PECO filed a base rate case in 2010 during which it further unbundled some cash working capital and transmission expenses. However, those efforts fell short of accomplishing the Commission's goals of a full unbundling of PECO's rates.

a. 1997 Restructuring Order

In its restructuring plan filed on April 1, 1997, PECO presented its cost-of-service allocation study and functionalized cost study by class-of-service and a detailed analysis of functional assignment of costs among the production (generation), transmission and distribution functions. Upon review of PECO's cost allocation methodology, the Commission found that it was deficient because it failed "to properly assign certain general costs to generation and allocated 100 percent of those costs to T&D."[33] Finding that "PECO has misallocated costs," the Commission observed that PECO had assigned the vast majority of A&G, overhead and general plant expense to its T&D rates. As noted by the Commission, "this assignment occurred without regard to whether there is a continuing generation component in that cost."[34] Specific accounts identified by the Commission as having been improperly assigned only to T&D included: Account 920 (A&G Salaries); Account 921 (Office Supplies and Expenses); Account 923 (Outside Services Employed); and Account 935 (Maintenance of General Plant).[35] Both the

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33 *1997 Restructuring Order* at 53.
34 *1997 Restructuring Order* at 53.
35 *1997 Restructuring Order* at 54.

Commission and OCA were concerned that the T&D rates were too high because of these improper cost allocations.[36]

The rationale offered by PECO's witness at that time was that if the costs could not be avoided as a result of the transition to competition and would still be incurred by the future EDC, they should be recovered through regulated distribution rates. As to the A&G expense allocation, PECO made an effort during the rebuttal phase to use "work centers" to separately track costs as being associated with production, transmission, distribution, corporate central services and corporate center. However, PECO continued to propose that these costs be examined to determine whether the same overall cost levels were still appropriate for PECO after all customers could choose their EGS. If the answer was yes, PECO asserted that these costs should be recovered through regulated distribution charges.[37]

In reviewing PECO's revised proposal, the Commission noted that PECO had "still failed to include other accounts in its allocation, or failed to properly allocate sums from accounts which were included."[38] Therefore, the Commission concluded that "PECO's allocations still improperly allocate costs to its T&D services rather than properly reflecting that a generation component exists in those costs."[39] The Commission also found that "PECO's responses to criticisms of its allocation are, at best, weak."[40] Rejecting PECO's revised proposal and "avoided cost" rationale, the Commission found that it must "ensure that there is an appropriate allocation of all costs among generation and T&D."[41] In reaching its determination, the Commission was persuaded by the OCA witness that "[i]t is simply incorrect to allocate these dollars entirely to T&D" because "[u]nbundling costs should produce results that should look

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36 *1997 Restructuring Order* at 53, 60.
37 *1997 Restructuring Order* at 55.
38 *1997 Restructuring Order* at 56.
39 *1997 Restructuring Order* at 54.
40 *1997 Restructuring Order* at 57.
41 *1997 Restructuring Order* at 57.

like what functional costs would be if PECO were to separate itself into functionally separate divisions. Clearly the generation division would require administrative and general services."[42]

As OCA's witness further noted at that time, A&G expenses comprised a substantial percentage of the costs they were challenging, and that costs "in these accounts are not easily identifiable with particular operating functions. They include salaries and office supplies for personnel in administrative functions such as human resources, legal, or accounting. These activities contribute to the generation function as well as distribution and transmission. Generation planners and marketers make use of these administrative functions and expenses."[43]

To address the shortcomings in PECO's proposal, the Commission adopted the methodology and adjustments that OCA had presented in surrebuttal testimony and reduced the T&D rate accordingly.[44] The Commission permitted PECO to recover the difference of $460 million through the competitive transition charge,[45] which was the mechanism that was used for the recovery of PECO's stranded costs and expired in 2010.[46]

The Commission also highlighted a concern regarding the level of A&G expenses, which it said were not clearly generation (energy production) or clearly T&D (wires). However, since no party had presented any competing evidence relating to those cost levels, the Commission accepted them. In doing so, the Commission stated: "[w]e note, however, that nothing precludes any person from later challenging PECO's T&D rates under any applicable section of the Public Utility Code."[47] Similarly, the Commission did not modify PECO's proposed allocations for uncollectibles, customer accounts, customer service and sales. Nonetheless, the Commission

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42 *1997 Restructuring Order* at 58, quoting OCA St. No. 5, p. 5.
43 *1997 Restructuring Order* at 60, quoting OCA St. No. 5, pp. 4-5.
44 *1997 Restructuring Order* at 59-61.
45 *1997 Restructuring Order* at 62.
46 *See Petition of PECO Energy Company for Approval of Its Default Service Program*, Docket No. P-2008-2062739 (Order entered June 2, 2009).
47 *1997 Restructuring Order* at 50.

stressed that as functions continue to be unbundled, PECO's rates may be reexamined to determine if they provide for charges which encompass generation or other unbundled services.[48]

b. 2010 and 2015 Base Rate Cases

Following the Commission's issuance of the 2007 Policy Statement, PECO's next base rate case was filed in 2010.[49] Based on Mr. Peterson's review of public documents available for that proceeding, he noted that PECO implemented a Transmission Service Cost Rider, which provides for recovery of transmission costs through the PTC, rather than through distribution charges. These costs include network service charges, regional transmission enhancement plan charges and any other load-serving entity transmission-related charges. Also during that case, the Commission approved Working Capital Riders, which reflect the working capital requirement associated with a portion of PECO's default generation supply and transmission costs. NRG St. No. 1 at 14. In addition, Mr. Peterson reviewed publicly available information from PECO's 2015 base rate proceeding and observed no further efforts to unbundle rates.[50] Therefore, the transmission costs paid to PJM and the cash working capital requirements for generation and transmission costs appear to be the only items unbundled by PECO following the issuance of the 2007 Policy Statement. NRG St. No. 1 at 14.

C. NRG Proposal to Reallocate Costs

1. Qualifications of Mr. Peterson

During the hearing on August 21, 2018, PECO challenged Mr. Peterson's qualifications to testify as an expert witness due to a lack of experience with respect to public utility

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48 *1997 Restructuring Order* at 61. NRG recognizes that the 1997 Restructuring Order was not implemented by PECO but was instead replaced by a joint settlement filed by the parties. However, the joint settlement did not disturb details regarding cost allocation and produced a system average shopping credit of 4.46 cents per kWh, which mirrored the result of the *1997 Restructuring Order*. *See* Order entered May 14, 1998.

49 *Pa. P.U.C. v. PECO Energy Company – Electric Division*, Docket No. R-2010-2161575 (Order entered December 21, 2010).

50 *Pa. P.U.C. v. PECO Energy Company – Electric Division*, Docket No. R-2015-2468981 (Order entered December 17, 2015).

ratemaking, and moved for a ruling to have him disqualified from testifying as an expert witness in this proceeding. Tr. 477-478. The ALJs denied the motion and noted that Mr. Peterson would be accepted as the expert presented, and that his testimony would be given due weight based on his level of expertise. Tr. 482.

The Commission adheres to the liberal standard of expert qualifications followed by the Pennsylvania Supreme Court: A person qualifies as an expert witness if, through education, occupation or practical experience, the witness has a reasonable pretension to specialized knowledge on the matter at issue.[51]

As a court-appointed expert witness in forensic accounting, Mr. Peterson is fully qualified to opine on PECO's allocation of indirect costs wholly to residential distribution service when it operates an entirely different business of providing default service to residential customers, and to propose a method for allocating such costs to residential default service. In evaluating Mr. Peterson's level of expertise, it is important to view his experience and background on the key issues addressed in his testimony relating to the proper allocation of indirect costs to different segments of a business. His lack of personal experience specific to public utility ratemaking does not in any way diminish his expert witness status as a forensic accountant, which PECO did not challenge. Tr. 481. Importantly, nothing about being a public utility shields PECO from following widely accepted accounting practices in the allocation of indirect costs to different functions of its business.

Mr. Peterson is a Principal of UHY Advisers, Inc. ("UHY") and leads the Fraud and Forensic Accounting Group in the Michigan offices. He specializes in providing fraud investigation, forensic accounting and expert services in both the private and government sectors.

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[51] *See PA PUC, et. al. v. City of Bethlehem*, Docket Nos. R-943124, et. al., Recommended Decision (Jan. 20, 1995), *citing Ruzzi v. Butler Petroleum Co.*, 588 A.2d 1 (1991); *Kuisis v. Baldwin-Lima-Hamilton Corp.*, 319 A.2d 914 (1974); *Re Philadelphia Suburban Water Co.* (Philadelphia Suburban I), 49 Pa. P.U.C. 354 (1975).

He also has extensive experience with accounting matters, audits of financial statements, and other attest engagements. NRG St. No. 1 at 1. As a cum laude graduate of Grand Valley State University, with a Bachelor of Arts degree in Accounting, Mr. Peterson is a licensed Certified Public Accountant in Michigan, a Certified Fraud Examiner and a Certified Internal Auditor.

Mr. Peterson's professional experience includes the provision of forensic accounting and expert witness services for litigation and alternate dispute resolution cases. He serves as a court-appointed forensic accountant and conducts examinations for asset misappropriations and fraudulent financial reporting. Other areas in which he has professional experience include internal investigations involving corruption and governance concerns; hidden asset discovery and recovery/damage mitigation for victims of fraud; assessment of financial internal controls; defense of professional malpractice claims for auditors and accountants; and defense of taxpayers in criminal investigations by the Internal Revenue Service. NRG St. No. 1 at 1. Additional information about his professional experience is included in NRG Exhibit CP-1.

Notably, Mr. Peterson has provided trial and deposition testimony in a number of proceedings, as follows:

- *VPH Pharmacy, Inc. and Deven Patel v. Vincent Howard* – Court-appointed expert in the Circuit Court for the County of Oakland, Michigan;
- *State of Oklahoma, ex. rel. John Doak, Insurance Commissioner, as receiver for Pegasus Insurance Company, Inc. v. Estate of William D. Thornell, Don Thornell, CPA, Inc., Diane Naler, and Diane Naler, CPA, P.C.* – District Court for the Northern District of Oklahoma;
- *G. Wesley Blankenship v. Superior Controls, Inc., a Michigan corporation, et al.* – District Court Eastern District of Michigan, Southern Division;
- *Amelia Queles v. Daimler Trucks North America LLC, a Delaware limited liability company, Detroit Diesel Corporation, and Freightliner, LLC, jointly and severally* – Circuit Court for County of Wayne, Michigan;

- *CUMIS Insurance Society, Inc. and CINCO Family Financial Center Credit Union v. Gary Condit and Condit & Associates, Inc. and GBQ Partners LLC and Linda Fite* – Court of Common Pleas, Hamilton County, Ohio;

- *Jenel M. Brockway v. Todd J. Brockway, and Regal Recyling, Inc. and Vern Brockway* – Circuit Court for County of Livingston, Michigan;

- *S.L.C. Meter Service, Inc. v. Neptune Technology Group, Inc., RIO Supply Michigan meter, et al.* – Commercial Arbitration, Atlanta, Georgia;

- *Sault Ste. Marie Tribe of Chippewa Indians v. Bernard Bouschor, et al.* – 50th Circuit Court for Chippewa County, Michigan; and

- *Glenn A. Sisk v. Elizabeth A. Sisk* – Arbitration, Wayne County, Michigan.

His testimony as an expert witness in those proceedings covered reports on fraud and forensic accounting examinations, internal audit investigations, and opinions on various accounting and auditing principles, standards and practices. NRG St. No. 1 at 3; NRG Exhibit CP-2.

Also, as an example of work performed in the government sector, Mr. Peterson described an engagement with the State of Michigan to provide accounting and financial reporting assistance to the Detroit Financial Review Commission ("DFRC"). The DFRC was created by State statute to provide financial oversight following the City of Detroit's exit from bankruptcy, which was the largest municipal bankruptcy in United States history – in excess of $18 billion. He served as a financial expert for the DFRC and provided an analytical cross-walk between the Emergency Manager's budget for 2015-2016 and budgets prepared by the City of Detroit for 2016-2019. NRG St. No. 1 at 2.

In addition, he has assisted the General Retirement Systems of the City of Detroit with an internal investigation, governance and internal control structure enhancements in periods following the City's bankruptcy. NRG St. No. 1 at 2. Mr. Peterson has also performed a forensic accounting investigation of the former director of the Macomb County Public Works Department ("Department"), at the request of its current director, Candice Miller (the former

U.S. Representative for Michigan and Michigan Secretary of State). A corruption probe by the Federal Bureau of Investigation of the former director is currently ongoing. NRG St. No. 1 at 2. As Mr. Peterson further explained during the hearing, this work involved a review of accounting issues with respect to internal controls over legal fees, specifically assessing if those legal fees had been properly allocated along with other indirect costs to various segments within the Department. Tr. 473.

Further, Mr. Peterson has done many cost allocations for many different companies across a wide variety of industries. As he explained, "[c]ost allocation studies are for an accountant the equivalent of a carpenter using a saw." Tr. 510. He offered several examples of these studies that he has performed. One involved cost allocation analysis for a large publicly traded company in the safety and security industry. For this multi-national corporation, Mr. Peterson reviewed cost allocations across the United States subsidiaries with respect to certain administrative costs, including legal, regulatory and executive offices. Tr. 511. Another study analyzed costs for a privately held sports apparel manufacturer with divisions or segments across the United States and several Latin American countries. Mr. Peterson assisted the company in allocating administrative costs across a variety of units. Tr. 512. The next example discussed by Mr. Peterson involved an automotive supplier with a tool-making injection molding operation. For that privately held company with operations in Michigan, Tennessee and South Carolina, Mr. Peterson analyzed how to share or allocate costs of a centralized administration that was being utilized at several different locations. Tr. 513. Mr. Peterson also described a cost allocation analysis performed for a design and engineering firm in the aerospace and automotive industry, where he used labor hours and machine hours as allocators because there are multiple ways to allocate indirect costs that are shared across functions. In the last example discussed by Mr. Peterson, two public school districts in Michigan brought him in to do some forensic accounting

on an existing shared services arrangement. Tr. 513-514. As Mr. Peterson explained, it is "a matter of assessing the situation and using the best professional judgment you have to come up with a reasonable approach to allocate those costs fairly." Tr. 513.

Moreover, although no requirement exists for an expert witness to be well-versed on all aspects of utility ratemaking, Mr. Peterson took measures to ensure that his testimony on cost allocation issues was presented in a manner that is consistent with utility ratemaking principles and reflects an understanding of electric restructuring in Pennsylvania. For example, Mr. Peterson explained that UHY was engaged by NRG on June 12, 2017 to perform an analysis of PECO's existing distribution and default service rates, based on information that was publicly available at that time. In performing that analysis, UHY subcontracted with Douglas Jester, 5 Lakes Energy, to provide energy industry expertise. NRG St. No. 1-SR (Rev) at 1-2. Following the review, UHY provided a study based on PECO's 2015 distribution rate case to NRG showing the results of our analysis in April 2018. The Utility Rate Study previously marked in this proceeding as NRG Exhibit CP-3 employed a similar analysis and produced similar results as that earlier study. Therefore, Mr. Peterson gained substantial familiarity with PECO's base rates and supporting data over the past year.

Mr. Peterson also relied on other UHY employees with public utility experience to assist him in preparing the prior study, as well as NRG Exhibit CP-3 and the testimony for this proceeding. He specifically identified former Judge Edward Plawecki, who helped him to understand regulatory and legal issues. Tr. 509. He further explained that Albert Allen worked on the project with him extensively, noting that Mr. Allen had been involved with a project for the Southeast Michigan Regional Energy Office. Mr. Allen's analysis in that project was used in determining rates by the Michigan Public Service Commission. Tr. 509. In addition, he noted that Brad Southern provided some services during the course of preparing the Utility Rate Study.

Prior to this project, Mr. Southern had worked with the City of Pontiac and Oakland County on the divestiture of a water and sewer system from a financially distressed municipal situation and the level of rates that would be needed to cover costs. Another project in which Mr. Southern was involved was a bankruptcy of the City of Detroit which owned the water and sewer system. UHY reviewed the costs of spinning off water and sewer operations and creating a regional authority, including projections based on the rates that would be needed to fund those operations. Tr. 510. Mr. Peterson also identified Rich Pinnock, who provided most of the in-depth research with finding publicly available information on PECO. Besides relying on these UHY employees, Mr. Peterson also sought the advice of counsel on matters relating to the background of electric restructuring and the provision of default service.

It is noteworthy that Mr. Peterson did not hold himself out as an expert witness on all issues related to the base rate proceeding. Indeed, with the many nuances that are involved in utility ratemaking, no witness in this proceeding was presented in such a manner. Rather, each witness – each of whom testified at one point for the first time in a utility rate proceeding – focused on his or her area of expertise as it fits into the larger picture of the base rate case.[52]

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[52] PECO's reliance on a single phrase used by Mr. Peterson in discussing the return it earns through distribution services is nothing but an attempt to divert the Commission from Mr. Peterson's key message, which is that it is not appropriate in any industry for a business to allocate all indirect costs to only one segment of its operations, while allocating no indirect costs to another segment. Moreover, this testimony was offered only as a theory as to PECO's motivation for allocating all indirect costs to distribution service, since PECO had claimed that it is not trying to maintain or attract more default service customers because it cannot earn profits from the pass thorough of electricity generation services. But less indirect costs allocated to distribution service means there would be less rate base and thus less return on profit included in the distribution revenue requirement. Indeed, Mr. Peterson's methodology included reallocation of reallocation of depreciation and amortization expenses related to Common Plant, General Plant and Intangible Assets; cost categories that impact the rate base assets upon which PECO earns a return. To the extent that the plant in service associated with these items are also allocated to default service, PECO's allowed return would be lower and PECO would not recover that return in its distribution rates. Thus, the more rate base allocated to default service the less return (i.e., profit) PECO has an opportunity to recover in its distribution revenue requirement. This certainly could be a motivation for PECO to fight so vehemently against the common sense relocation of indirect costs that Mr. Peterson is recommending.

In summary, based on Mr. Peterson's education, as well as his professional and practical experiences, Mr. Peterson has a reasonable pretension to specialized knowledge related to cost allocation. Specifically, as a court-appointed expert witness in forensic accounting, Mr. Peterson is fully qualified to opine on PECO's allocation of indirect costs wholly to residential distribution service when it operates an entirely different business of providing default service to residential customers. He has extensive experience performing cost allocation analysis for a variety of types of businesses, which fully qualifies him as an expert witness to address the proper allocation of indirect costs by PECO to different segments of its business.

2. NRG's Alternative Cost Allocation

a. PECO's Approach Is Flawed

Because PECO's approach of allocating zero indirect costs to residential default service is flawed, NRG has proposed an alternative approach that would result in a reasonable level of indirect costs being allocated to residential default service. Although PECO provides distribution services and default generation services to several customer classes, the focus of Mr. Peterson's testimony was on PECO's distribution and default service for the residential (Rate R) and residential heating (Rate RH) classes, which are referred to throughout his testimony as the "residential" classes, customers or services. NRG St. No. 1 at 15. As Mr. Peterson explained in response to the testimony of Mr. Clarence Johnson on behalf of OCA, however, his analysis could just as easily be applied to commercial and industrial customer classes with similar outcomes, if the Commission so desires. NRG St. No. 1-SR (Rev) at 41.

As a result of the analysis he performed of the costs that are allocated to residential distribution and residential default service, Mr. Peterson produced a Utility Rate Study ("Study") dated June 18, 2018, which is attached to NRG St. No. 1 as NRG Exhibit CP-3. This Study examines PECO's residential rate allocations between distribution service and default service

and contains the detail, calculations and schedules that he relied on and referred to in his testimony. It consists of: (i) a Narrative, which describes the purpose of the Study and summarizes the overall findings; (ii) Computations, which are set forth in Section I-Financial, Section II-Default Service (Price to Compare), and Section III-Distribution Service; and (iii) Appendices, which identify sources of information and additional support for the Study's findings. NRG St. No. 1 at 4.

It is undisputed in this proceeding that PECO allocates all indirect costs assigned to the residential customer classes to residential distribution service. Rather than considering whether certain costs would be incurred to provide residential default service or using a reasonable allocation method to allocate these costs to both distribution and default service, PECO simply ignores these widely accepted accounting principles routinely used by accountants for allocating indirect costs. While Mr. Cohn has a long employment history with PECO and is currently the Manager of Regulatory Strategy, he is not an accountant, a forensic account or a cost accountant, and has never examined cost allocation from any perspective other than that of a utility. Tr. 444-445. Perhaps for that reason, PECO's cost allocation analysis has fallen short by terminating the process at the customer class level without considering the need to allocate indirect costs within the residential classes as they relate to the provision of distribution service and default service. PECO's approach is also a departure from the way that other businesses and organizations routinely allocate indirect costs to the entity's various segments or functions.

i. PECO Allocates All Indirect Costs to Distribution Service

As explained by Mr. Peterson, "[a]lthough PECO provides a great deal of information about cost allocations between rate classes, details regarding the assignment of costs between distribution services and default generation services within the rate classes are not displayed in a specific schedule but must be derived from various portions of PECO's Cost of Service Study

("COSS")." NRG St. No. 1 at 15. Based on his analysis of PECO's COSS, Mr. Peterson found that the only costs allocated to default service are direct costs related to Production and Transmission. These expense categories include the cost of purchasing power to provide service, direct expenses related to the purchasing of the power, the development of PECO's procurement plan, and transmission charges incurred when purchasing electricity from outside parties (i.e. PJM Interconnection LLC). NRG St. No. 1 at 15; NRG Exhibit CP-5. Alan Cohn, testifying for PECO, confirmed that PECO does not allocate indirect costs within the residential rate classes as between distribution services and default generation services. Tr. 451-452, 456.

By way of further explanation, NRG Exhibit CP-5 is titled "Total Electric Division: PECO's Statement of Earnings (Before Interest and Income Taxes) Allocation to the Residential Class" and reflects the FPFTY 2019. This chart shows PECO's total expenses on lines 4 through 18, sets forth the total residential allocation in PECO's COSS for each of these expense items and specifies the allocations to residential default service and to residential distribution service, as taken directly from the COSS. A review of the columns labeled "Total Residential Default Service (Price to Compare)" and "Total Residential Distribution Service (All Customers)" under "Service Type" shows that the only categories of costs that were allocated to default service are Production Expense in the amount of $493.3 million and Transmission Expenses in the amount of $101 million. NRG St. No. 1 at 16.

NRG Exhibit CP-5 also identifies all of the expense categories that were allocated entirely to residential distribution services, including Distribution Operation, Distribution Maintenance, Customer Accounts, Customer Service, Sales, A&G, Intangible Plant, Transmission Plant, Distribution Plant, General Plant and Common Plant

Depreciation/Amortization. NRG St. No. 1 at 16.[53] Of the remaining expense categories that PECO allocated entirely to residential distribution services, Mr. Peterson examined the following amounts of indirect expenses, as shown on NRG Exhibit CP-5:

Expense Category	Amount Allocated Entirely to Residential Distribution Service ($)
Customer Service	10,857,163
Sales	793,507
A&G	136,051,164
Intangible Plant	12,689,664
General Plant	11,629,436
Common Plant	24,595,247
Total Pool	196,616,182

NRG St. No. 1 at 17.[54]

ii. From An Accounting Perspective, Indirect Expenses Must Be Allocated Across the Segments or Functions of the Business They Support

Mr. Peterson's basis for challenging PECO's allocations of indirect expenses is that they are "fully embedded in distribution rates" but "reasonably support residential default service." NRG St. No. 1 at 17. He added that "[i]ndeed it is illogical, from an accounting perspective, to allocate all of these indirect expenses to distribution service. Particularly given that PECO provides default service to approximately 66 percent of the residential population in its service area, a reasonable portion of indirect costs must necessarily support its operations for residential default service customers." NRG St. No. 1 at 17. This is the same point that OCA's witness

[53] Of these categories, Mr. Peterson did not challenge PECO's allocation of all costs for Distribution Operation, Distribution Maintenance, Outside Services related to Advanced Metering Infrastructure, Transmission Plant and Distribution Plant to distribution service because he viewed those costs as being incurred solely for the purpose of providing T&D services. Also, he accepted PECO's allocation of customer accounts expense since EGSs use PECO's utility consolidated billing services. However, he noted that if the billing and collection functions were to shift to EGSs for their customers, an allocation adjustment to PECO's costs in this regard may be necessary. NRG St. No. 1 at 23.

[54] More details about the expense items that fall under each of these categories are set forth in NRG St. No. 1 at 19.

made during PECO's 1997 restructuring proceeding with which the Commission agreed – "[i]t is simply incorrect to allocate these dollars entirely to T&D."[55]

As Mr. Peterson explained, allocation of shared costs to different businesses or business units is not a novel concept. Companies consistently allocate indirect expenses across business units and cost centers. Indirect costs are costs which cannot be identified with a particular service or product, including overhead costs, such as administrative and general expenses. NRG St. No. 1-SR (Rev) at 23-24. "While indirect costs cannot, by their nature, be attributed directly to certain aspects of PECO's operation," Mr. Peterson emphasized that "a reasonable level of administrative expenses are necessary to support any business' operations." NRG St. No. 1-SR (Rev) at 39. It is noteworthy that even the Commission itself incurs indirect costs that cannot be assigned to specific industries for purposes of assessing regulatory entities to support its budget. As a result, those indirect costs are allocated to all industries.[56] Mr. Peterson testified that the "concept is the same for any business or organization." NRG St. No. 1-SR (Rev) at 39. Fully allocated costs are the sum of direct costs plus an appropriate share of indirect costs. NRG St. No. 1-SR (Rev) at 23. Neither Mr. Cohn for PECO nor Mr. Johnson for OCA disputed these basic accounting principles.

As support for his views as to the proper allocation of these indirect expenses, Mr. Peterson described the "concept of full absorption costing, which is a term of art in financial accounting that refers to the assignment of all reasonable costs to an activity. Full absorption costing typically involves allocations of common costs between activities." NRG St. No. 1 at 18. Stated differently, the concept of full absorption costing is a guiding principle justifying cost allocation, not a specific methodology used for allocation. Following this guideline, all reasonable costs associated with a product or activity should be allocated, including indirect

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55 *1997 Restructuring Order* at 57, quoting OCA St. No. 4, p. 5.

56 66 Pa. C.S. § 510(b)(1)-(2).

costs, which Mr. Peterson has also described as common or shared costs. NRG St. No. 1-SR (Rev) at 26-27.

Explaining that a "single universal convention for cost allocations does not exist," Mr. Peterson testified that "numerous cost allocation methods are commonly used and widely accepted to determine the entire cost of an activity." NRG St. No. 1 at 18. In simple terms, cost allocations are the methods or ratios used to apportion costs. He identified common cost allocation drivers as including revenues, number of customers, and labor hours. As he noted, "[j]udgment is required to determine the reasonableness of a cost allocation methodology for a given activity." NRG St. No. 1 at 18.

Mr. Peterson further testified that in his experience, "nearly every business with complex operations incurs indirect expenses of the type" he has identified as "needing to be reallocated to default service." NRG St. No. 1-SR (Rev) at 20. As he explained, it "is common and prudent business practice to allocate all reasonable costs to any business or business unit so that management can better understand the implications of running that line of business. From an accounting perspective, it is appropriate to allocate indirect costs across all segments or divisions of a business' operations. Indeed, it is illogical for a business to allocate all indirect expenses to one portion of its operations while allocating no indirect expenses to another segment or division of its operations." NRG St. No. 1-SR (Rev) at 20.

In an attempt to justify the assignment of all indirect costs to distribution service, Mr. Cohn referred to the testimony of PECO witness Jiang Ding as explaining how each of the costs "was properly functionalized and assigned to distribution customers." PECO Statement No. 9-R at 14. However, a review of Ms. Ding's testimony does not support the allocation of these indirect costs wholly to distribution service. Rather, Ms. Ding's testimony explains how expenses were functionalized, classified and allocated among rate classes. PECO Statement No.

6 at 14-25. This testimony provides no explanation for why all indirect costs were assigned to distribution service within the residential rate class. To the contrary, Ms. Ding's testimony is silent as to the rationale for ignoring the default side of the business during this functionalization, classification and allocation process. NRG St. No. 1-SR at 23.

Mr. Cohn also testified that PECO has applied full absorption costing in its COSS to fully allocate fixed and variable costs to its electric distribution customers across the distribution rate classes. PECO Statement No. 9-R at 19-20. However, as explained by Mr. Peterson, PECO has ignored in its COSS the separate function of providing default generation service to customers who are not receiving generation service from EGS in the retail market. While PECO may have applied full absorption costing in its COSS to fully allocate fixed and variable costs to its electric distribution customers across the distribution rate classes, PECO must go further in its allocation process and apply these principles to distribution *and* default service within the residential rate class. NRG St. No. 1-SR (Rev) at 26.

iii. The Effect of Allocating No Indirect Costs to Default Service Is That Customers Cannot Make Meaningful Comparisons

The practical effect of PECO's practice of allocating no indirect costs to default service is that customers who are shopping for electric generation service in PECO's territory are being presented with offers from EGSs with which they cannot make apples-to-apples comparisons to PECO's PTC. If a customer chooses an EGS to provide generation supply service, the EGS sets the price that is paid and includes that price in a contract to which the customer agrees.[57] Also, the electric shopping website administered by the Commission encourages customers to review the PTCs of the EDCs when shopping for a new supplier.[58] However, this is an unfair and misleading comparison when an EDC recovers certain costs through its distribution charges that

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57 52 Pa. Code § 54.4(b)(10).

58 http://www.papowerswitch.com/

are incurred to provide default generation service. It also creates a framework where customers are not able to "compare prices and services on a uniform basis,"[59] or in other words, to make apples-to-apples comparisons.[60] NRG St. No. 1 at 32. In the *Fixed Means Fixed Order*, the Commission stressed the importance of providing information to consumers so that they can make accurate and fair comparisons to make informed shopping decisions.

Since an EGS is not providing distribution service, it has no other way of recovering costs from customers and therefore its prices must necessarily reflect all costs incurred to provide competitive generation service. NRG St. No. 1 at 33. In fact, the Commission has recognized that although the primary price signal provided to consumers is the EDC's PTC, the PTC is "often not correlated to wholesale energy markets and may move in directions opposite that of wholesale energy market trends" due to "reconciliation and the mix of contracts that EDCs use to establish the PTC."[61] Not only does this present challenges to EGSs in operating in the retail market, the Commission has observed that it can also "inhibit consumers' ability to make informed decisions due to the receipt of false or misleading price signals."[62] As a result of these improper price signals and the mis-information Mr. Peterson highlighted in this proceeding, consumers are left with an apples-to-cucumber comparison that is not consistent with the Competition Act or the Commission's objectives of creating a robust, competitive market.[63]

Permitting PECO to continue operating with an artificially low PTC also enables it to attract and retain default service customers. NRG St. No. 1 at 6. Mr. Cohn testified that because PECO makes no profit from providing default service, it is not an area in which PECO seeks to "compete" with EGSs. PECO Statement No. 9-R at 9-10. As Mr. Peterson pointed out,

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59 66 Pa. C.S. § 2807(d)(2); 52 Pa. Code § 54.1.

60 *Guidelines for Use of Fixed Price Labels for Products With a Pass-Through Clause*, Docket No. M-2013-2362961 (Order entered November 14, 2013) ("*Fixed Means Fixed Order*"), at 28-29.

61 *RMI End State Order* at 12.

62 *RMI End State Order* at 12.

63 *See generally RMI End State Order.*

however, if PECO is not seeking to compete with EGSs to provide generation service, it would seem that PECO would be indifferent to NRG's proposals to ensure that the PTC more accurately reflects the costs of providing default service. NRG St. No. 1-SR (Rev) at 18. He also explained that providing default service positions PECO to provide additional services for which it can seek ratepayer funding that not only includes recovery of costs but the potential to earn a return on investment. For example, by offering a pre-pay product or a microgrid pilot, PECO has the opportunity to recover the costs of the program from all ratepayers. To make such proposals palatable, PECO is incentivized to both deepen and continue to build its long-term relationship with customers and to position itself as "the energy company." Therefore, portraying itself as the dominant provider of generation service (through default service) enables PECO to continue down the path of offering more and more ancillary services for which it can seek ratepayer recovery plus a return on investment. NRG St. No. 1-SR (Rev) at 18.

iv. Review of PECO's Current Price to Compare Confirms Failure to Include All Required Costs

PECO's PTC methodology is shown in NRG Exhibit CP-13. The list of components that are included in the PTC further demonstrates that indirect expenses incurred to operate a business have been omitted from PECO's methodology. As Mr. Peterson discussed, a functionally separate division of PECO providing default service would necessarily incur expenses that are not shown in this methodology, such as A&G expenses and costs for communications, accounting and finance, regulatory, human resources and IT infrastructure. NRG St. No. 1 at 35.

The administrative cost factor in PECO's PTC is very narrow and only reflects "the costs of the auction or Request for Proposal (RFP) monitor, consultants providing guidance on the development of the procurement plan, legal fees incurred gaining approval of the plan, and any

other costs associated with designing and implementing a procurement plan."[64] The administrative cost factor was 0.00 cents per kWh from June through August 2017. Historically, it has been higher at 0.04 cents per kWh from June through August 2013 and 0.01 cents per kWh from December 2015 through February 2016. However, in all instances, the administrative cost factor did not account for a significant portion of the PTC. NRG St. No. 1 at 35.

The elements of PECO's current PTC are set forth in NRG Exhibit CP-20 (Rev). The current PTC includes 0.005 cents per kWh for administrative costs, which total only $118,314.[65] As Mr. Peterson testified, "[t]he significance of a total of $118,314 in administrative costs in the current PTC to support a business that provides default service to over one million customers is that it single-handedly shows the absurdity of PECO's misallocations as between distribution and default service. PECO forecasts annual A&G costs of over $136 million for the residential rate class; $118,314 is less than 1 percent of the forecasted amount." NRG St. No. 1-SR (Rev) at 8. Astonishingly, PECO's current PTC reflects *negative* administrative and general ("A&G") expenses related to default service. NRG Exhibit CP-20 (Rev). While Mr. Cohn acknowledged this negative expense category, he offered no explanation for this absurd result. Tr. 446. It would not be possible to run any business, let alone a business that is selling 8.6 billion kWh of electricity and generating hundreds of millions of dollars, with negative A&G expenses.

Section 69.1808(a)(4) of the Commission's Policy Statement is very clear in identifying the administrative costs that should be included in the PTC. Indicating that the PTC "should be designed to recover all generation, transmission and other related costs of default service," this provision specifies those cost elements as including "[a]dministrative costs, including billing,

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64 See NRG Exhibit CP-3 at N-11 (PECO's PTC Sample Calculation Methodology for June-August 2017, page 3). Source: https://www.peco.com/SiteCollectionDocuments/Residential.pdf

65 This calculation is shown on Attachment III-1(a) and is derived by adding together the amounts of $71,977 (Supply bidding & Contracting), $25,398 (Administrative and General Expenses related to Supply management costs), and $32,630 (Litigation), and then subtracting from that total the amount of $11,691 (Administrative and General Expenses related to Default Service). Tr. 447-448.

collection, education, regulatory, litigation, tariff filings, working capital, information system and associated administrative and general expenses related to default service."[66] Yet, according to Mr. Cohn, PECO only includes "administrative costs that are associated with the wholesale power supply contracts," while not including administrative costs more broadly related to the provision of default service. PECO Statement No. 9-R at 6.

By only including administrative costs that are directly associated with the procurement of wholesale power supply, PECO is inappropriately viewing the provision of default service as entailing only the procurement of energy for non-shopping customers. However, as evidenced by PECO's most recent default service proceeding, default service is broader than the procurement of energy.[67] NRG St. No. 1-SR (Rev) at 7. For instance, as the default service provider, PECO implements retail market enhancements such as the Standard Offer Program. While PECO presented Cross Examination Exhibit 1 to show that some retail market enhancement costs may be recovered through the PTC, the fact remains that PECO indicated in testimony in this proceeding that no such costs are currently included in the PTC and that the PTC shows only $118,314 in administrative costs currently being recovered. PECO Statement No. 9-R at 7; NRG Exhibit CP-20 (Rev); Tr. 447.

Further, as Mr. Peterson explained, in serving default service customers, PECO necessarily incurs administrative costs in connection with numerous aspects of its business. Beyond procuring default service supply, PECO needs to rely on numerous resources to make default service available to consumers. NRG St. No. 1-SR (Rev) at 7. Mr. Peterson provided additional details in support of his statement as follows:

> For example, supporting default service requires a call center infrastructure and employees to maintain appropriate customer service. An information technology

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66 52 Pa. Code § 69.1808(a)(4) (emphasis added).

67 *Petition of PECO Energy Company for Approval of its Default Service Program for the Period from June 1, 2017 through May 31, 2021*, Docket No. P-2016-2534980 (Order entered December 8, 2016).

> infrastructure is necessary to support these aspects of PECO's business and this infrastructure requires appropriately trained personnel to maintain and upgrade it. Costs are incurred to maintain and operate office space for the employees supporting default service. These employees are supported through a corporate structure addressing administrative and human resources issues that incurs costs. These employees also need access to office supplies and other accounting and auditing services. Administrative costs are incurred to communicate with default service customers including, but not limited to, expenses related to printing and postage. Working capital (e.g. the cost of money) must also be available to support the purchase of default service supply for customers in advance and receive payment from those customers at a later date.[68] Costs related to outside and inside legal personnel are needed to comply with the regulatory rules and requirements related to default service. In short, a business that projects over $637 million in annual default service revenues could not operate without incurring administrative costs of the type and magnitude that I have identified.

NRG St. No. 1-SR (Rev) at 7-8.

Notably, the current PTC includes zero costs for Education, Regulatory and Information System. NRG Exhibit CP-20 (Rev); Tr.446. This means that PECO is supposedly operating a business upon which over one million residential customers rely for generation supply service without incurring any IT costs. It is unfathomable to accept the notion that PECO incurs no IT costs to provide essential electricity services to two-thirds of its residential distribution customers.

As to the inclusion of zero IT costs in the current PTC, Mr. Cohn testified that only when IT costs relate specifically to implementation of the default service plan have they been included in the PTC. PECO Statement No. 9-R at 6. That standard is not consistent with the Policy Statement, which identifies IT costs for inclusion in the PTC and does not limit the inclusion of such costs to only IT upgrades necessary to implement the default service plan. Rather, the Policy Statement indicates that IT costs "related to default service" should be included in the PTC. As Mr. Peterson testified, IT costs are an integral part of the ability of PECO to provide

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[68] Mr. Peterson recognized that PECO's PTC already contains a component for working capital. However, he noted that the amount currently in the PTC is only $813,535. NRG CP-20 (PECO Responses to NRG-III-1 and NRG-III-2).

default service. Therefore, it is his view that a reasonable portion of PECO's IT costs should be included in the PTC since it would be impossible for PECO to provide default service to over one million customers without incurring IT costs. NRG St. No. 1-SR (Rev) at 11.

With respect to regulatory costs and litigation costs, Mr. Cohn's Rebuttal Testimony indicated that only those costs "associated with PECO's default service plans are recovered through the PTC," and identifies no other regulatory and litigation costs associated with the provision of default service. PECO Statement No. 9-R at 6. Since PECO would necessarily incur some level of regulatory costs and additional litigation costs associated with the provision of default service that are not reflected in the PTC, Mr. Peterson opined that it is necessary to allocate a reasonable portion of those indirect costs to default service. NRG St. No. 1-SR (Rev) at 9.

By including only regulatory costs and litigation costs that are associated with PECO's default service plans in its current PTC, PECO is overlooking the fact that it incurs other regulatory and litigation costs related to the provision of default service. For instance, PECO files comments with the Commission related to proposed retail market enhancements, including comments urging the Commission to keep EDCs in the default service role[69] and opposing an EGS proposal to implement supplier consolidated billing.[70] Both sets of comments related specifically to PECO's functions as a default service provider.

PECO also filed a prepay petition and a microgrid petition, both of which have the potential to affect default service customers in terms of the specific service offered by PECO as well as by negatively impacting the competitive choices available in the PECO service territory. The Administrative Law Judge concluded in her Recommended Decision regarding PECO's

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69 *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (PECO Comments filed December 10, 2012).

70 *Petition of NRG Energy, Inc. for Implementation of Electric Generation Supplier Consolidated Billing*, Docket No. P-2016-2579249 (PECO Comments and Answer filed January 23, 2017).

proposed prepay pilot, that PECO's proposed pilot would present "an impediment for generation suppliers to have direct access to retail customers" and would be "contrary to the public policy declarations of the Electric Competition Act."[71] Though PECO ultimately withdrew its microgrid proposal,[72] the pilot would have permitted PECO to utilize ratepayer funding to build generation in competition with private developers crowding out competition and creating customer misperceptions regarding the service provided by the EDC in contrast with competitive suppliers. These are just two examples of proposals offered by PECO which would have a direct impact on the competitive market and the provision of default service to customers. Yet, no costs for these activities are reflected in its PTC for default service.

According to Mr. Cohn's Rebuttal Testimony, "[c]osts associated with educating customers about retail market enhancements not paid for by EGSs may be included in the PTC." PECO Statement No. 9-R at 7. Currently, however, PECO's current PTC includes no education costs. NRG Exhibit CP-20 (Rev). Again, the Policy Statement clearly provides that education costs should be, not may be (as Mr. Cohn suggested), recovered through the PTC. Whether education costs are directly related to a retail market enhancement is not the standard that PECO should employ. Education activities can take many forms including call center representatives responding to inquiries about electric choice, for which those representatives need to be trained. In addition, PECO engages in extensive education, awareness and marketing activities in connection with their energy efficiency and conservation ("EE&C") programs[73] – all of which give PECO an opportunity to educate consumers about default service. Therefore, it is

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71 *PECO Energy Company's Pilot Plan for an Advance Payments Program Submitted Pursuant to 52 Pa. Code § 56.17*, Docket No. P-2016-2573023 (Petition filed on October 26, 2016; Recommended Decision served February 12, 2018 at 77-78).

72 *Petition of PECO Energy Company for: (1) Approval of its Microgrid Integrated Technology Pilot Plan and (2) Issuance of a Declaratory Order Regarding the Recover of Microgrid Costs*, Docket No. P-2016-2546452 (Petition filed May 18, 2016) (Initial Decision Granting the Joint Petition for Leave to Withdraw dated November 22, 2016).

73 *See* NRG Exhibit CP-22 (PECO Response to NRG-III-8).

unreasonable for PECO to include no education costs in the PTC. NRG St. No. 1-SR (Rev) at 11-12.

It is also noteworthy that PECO uses an Energy Acquisition team ("EA"), consisting of nineteen employees, who perform functions necessary to support electric and gas customer choice. Yet, PECO does not allocate these costs to default service. Rather, these costs are recovered through distribution rates because PECO views these services as part of delivering energy to both shopping and default service customers. Tr. 440-441. While PECO may find it more convenient to combine these tasks of allocating system throughput among suppliers and acquiring default service supply, the acquisition of energy supplies is clearly allocable to default supply service under traditional ratemaking principles of cost causation. The fact that PECO allocates none of the EA costs to default service is further evidence of its lopsided approach of allocating a disproportionate amount of costs to distribution service.

b. NRG's Proposal Properly Allocates Indirect Costs

i. PECO Should Allocate Indirect Costs in a Way That Resembles the Costs It Would Incur if It Operated a Separate Default Service Division

Consistent with the approach taken by the Commission in the *1997 Restructuring Order*, NRG proposes to reallocate indirect expenses in a way that more accurately reflects the costs that PECO incurs to support all of PECO's residential operations, including both default service and distribution service. Similar to the views expressed by OCA in 1997, as endorsed by the Commission, and consistent with the concept of full absorption costing, Mr. Peterson opined that "PECO's expenses should be allocated in a way that resembles the costs that PECO would incur if it operated a separate default service division. PECO's expenses to operate such a division would necessarily include indirect costs of the type I am identifying in this testimony." NRG St. No. 1 at 18.

Using PECO's actual indirect expenses for specified cost categories that any business would need to incur and widely-accepted allocators to reallocate these shared or common costs across PECO's two business lines, Mr. Peterson allocated these costs between distribution and default service. As Mr. Peterson testified, "[t]o determine if costs should be allocated to certain business units, one only has to consider whether the business could sustain itself with its current cost structure if it were operated on a stand-alone basis. Clearly, PECO's default service business could not operate for even a single day under its current cost structure if it were operated on a stand-alone basis." NRG St. No. 1-SR (Rev) at 17.

Through his reallocation process, Mr. Peterson arrived at a reasonable amount of costs that should be properly allocated to default service rather than having all such costs assigned to distribution service. While Mr. Peterson acknowledged that no universal solution exists to precisely allocate indirect costs that are by their nature not attributable to a particular segment of the business, it is clear that assigning all indirect costs to distribution service, as PECO does, "has no basis in logic or reality." NRG St. No. 1-SR (Rev) at 17. As to the level of indirect costs that should be allocated to default service, the one answer that is clearly wrong is "zero."

Notably, Mr. Cohn did not refute Mr. Peterson's assertion that PECO would incur indirect costs of the type identified by Mr. Peterson if it operated a functionally separate default service division. Rather, he generally opposed the notion of a functionally separate division, clinging to the view that the separate functions of providing distribution service and providing default service are not different. PECO Statement No. 9-R at 10-12. Indeed, Mr. Cohn testified in this proceeding that if PECO stopped providing default service, its current cost structure would not change, echoing the claims of the PECO witness in 1997 whose views were rejected by the Commission. Tr. 456. The notion that PECO's current cost structure would not change if it ceased supplying 8.6 billion kWh of electricity to over one million customers (generating

projected revenue of $637 million) is so irrational as to demonstrate the depth of PECO's commitment to continuing its misallocation of indirect costs to distribution service, regardless of what its motivations might be.

Mr. Cohn also testified that no other electric utility in the United States treats the provision of default service as a separate operating division for purposes of cost allocation. PECO Statement No. 9-R at 11. However, as Mr. Peterson noted, Pennsylvania is widely recognized as a national leader for retail electric choice.[74] Indeed, the only state that is consistently ranked above Pennsylvania for its success with electric choice is Texas, where default service does not exist. Therefore, he observed that it was not surprising that Pennsylvania would be the first state to move toward a cost allocation approach that is designed to ensure that the costs of providing default service are more accurately reflected in the PTC, so that customers can make more meaningful price comparisons and EGSs can compete on a more level playing field. Even twenty years ago, when electric choice was in its infancy, the Commission took the view that proper unbundling should produce results that "look like what functional costs would be if PECO were to separate itself into functionally separate divisions."[75]

Mr. Cohn further claimed that the language in the Commission's *1997 Restructuring Order*, which supports NRG's position in this case, is not as valid as it was twenty years ago because at that time, PECO had both generation operations and distribution operations. PECO Statement No. 9-R at 12. Disagreeing with Mr. Cohn, Mr. Peterson explained that the issue is exactly the same today as in 1997 when the Commission found "that PECO's allocation of

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[74] ABACCUS 2015: Annual Baseline Assessment of Choice in Canada and the United States (Published July 28, 2015): http://defgllc.com/publication/abaccus-2015-annual-baseline-assessment-of-choice-in-canada-and-the-united-states/

[75] *1997 Restructuring Order* at 57-58.

General and Administrative costs requires significant adjustment."[76] NRG St. No. 1-SR (Rev) at 21.

Importantly, just as PECO was providing separate generation services and distribution services twenty years ago, it is still today providing separate generation services and distribution services. The fact that PECO no longer generates electricity has no bearing on the separate nature of the generation services that it provides. Rather than generating and selling electricity to all of its distribution customers, it now sells electricity – that it procures through the wholesale market – to distribution customers who do not receive generation services from an EGS. This change in PECO's business model that occurred as a result of restructuring in 1997 is of no consequence to the proper allocation of indirect costs between distribution service and default service today. NRG St. No. 1-SR (Rev) at 21-22. It is noteworthy that in issuing its Policy Statement in 2007, a decade after restructuring, the Commission still held the same views that it did in 1997 about the need to properly allocate costs between separate functions.[77] Then again just five years ago, the Commission stressed the importance of PTCs reflecting the costs of providing default service, noting that it strives to address these issues as they arise in distribution rate cases.[78]

Mr. Cohn further stated that "all PECO customers – whether they receive electric generation supply from EGSs or from PECO – are distribution customers, and responsibility for distribution business costs should not vary based upon receipt of default service." PECO Statement No. 9-R at 14. Just as the Commission rejected the "avoided cost" theory in 1997, it should do so here as well. While Mr. Peterson recognized that all PECO customers are

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76 *1997 Restructuring Order* at 57.
77 *Policy Statement Order* at 6.
78 *RMI End State Order* at 21.

distribution customers, he noted that not all distribution customers receive default service from PECO. As he explained:

> In fact, about one-third of PECO's distribution customers receive generation service from EGSs in the competitive market. Clearly, distribution services and default services are two separate functions. For instance, PECO's rates for distribution service are being established in this base rate proceeding, whereas the terms and conditions for PECO's default service were adjudicated in a separate default service proceeding. Any business providing distinctly different services necessarily incurs indirect costs such as the administrative costs that are the subject of my testimony for all lines of its operations. Yet, because all indirect costs are being allocated to distribution service, PECO distribution customers who are receiving default service from EGSs are subsidizing the default service that PECO is providing to the remaining two-thirds of its distribution customers.

NRG St. No. 1-SR at 24. Importantly, for ratemaking purposes, the Commission follows cost causation principles, not avoided cost principles.[79] NRG's attempt to reasonably allocate the indirect costs to the separate distribution and default service functions is aligned with cost causation principles. By contrast, PECO's allocation of all indirect costs to one segment of its business reflects no attempt to follow such principles.

While PECO does not currently provide default service through a separate operating division, the provision of distribution service and default service are wholly separate functions that should be treated as such for purposes of allocating common or shared costs. NRG St. No. 1-SR (Rev) at 19. As noted by Mr. Peterson, distribution service involves the delivery of electricity to retail customers, while default service entails the provision of electric generation service to customers who have not chosen an EGS. The Commission has similarly explained the differences in these functions as follows:[80]

> The Competition Act deregulated electricity generation and provided all customers in Pennsylvania with the opportunity to choose their electricity generation supplier (EGS). 66 Pa. C.S. 2806 (a). The EDC is responsible for delivering the electricity to those customers who choose to buy from an EGS.

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79 *See Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa. Cmwlth. 2006) (cost of service is the polestar for ratemaking).

80 *Implementation of Act 129 of October 15, 2008; Default Service And Retail Electric Markets*, Docket No. L-2009-2095604, Final Rulemaking Order at 2 (Oct. 4, 2011) (emphasis added).

> Additionally, the EDC is responsible for both acquiring and delivering electricity for those customers who do not shop or buy their electricity from an EGS or where an EGS fails to provide the promised electricity.
>
> **When an EDC acquires electricity for customers not served by an EGS, the EDC is functioning as the "default service provider" (DSP).**

In addition, an EDC's distribution rates are established in a general rate case proceeding, whereas its default service rates are established in a separate default service proceeding.[81]

Observing that independent functions must be performed for each of these services, which are separate and distinct, Mr. Peterson explained that "both lines of the business necessarily must rely on shared or common services, such as information technology, regulatory costs and litigation costs. In order to ensure that each business line supports the costs that are incurred for these shared or common services, it is necessary to allocate these costs to both lines of the business." NRG St. No. 1-SR (Rev) at 19-20.

Mr. Peterson further explained that a functionally separate default service division would necessarily incur costs associated with administrative salaries, office supplies, property insurance, regulatory commission fees and other A&G expenses. NRG St. No. 1 at 20. Similarly, the expenses that fall under the category of outside services employed within A&G expenses, including executive, financial, human resources, legal, real estate, etc., are all "common business expenses that are critical to day-to-day operations." NRG St. No. 1 at 20-21. Mr. Peterson unequivocally concluded that "[i]f PECO had a separate division providing default service, it would necessarily incur costs in all of these areas." NRG St. No. 1 at 21.

ii. The Indirect Expenses Reallocated By NRG Relate to the Provision of Default Service

As to each indirect expense category that Mr. Peterson examined for reallocation, he addressed how they relate to the provision of default service and would be incurred by a

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81 *See* 66 Pa.C.S. §§ 1308, 2807(e).

functionally separate division furnishing only this service to customers. The total expenses that that Mr. Peterson deemed necessary to reallocate total $196,616,182, which is the sum of the amounts shown in NRG Exhibit CP-5 for Customer Service Expenses, Sales Expenses, A&G Expenses, Intangible Plant Expense, General Plant Expense and Common Plant Depreciation/Amortization in the column labeled "PECO Energy Company Total Residential Class." NRG St. No. 1 at 19-23. Of the total indirect expenses that he deemed necessary to reallocate, he identified $101,951,549, which is currently allocated entirely to distribution service, and should be attributed to default service. This represents approximately 51.5 percent of the total pool of indirect expenses. NRG St. No. 1 at 24.

Of note, A&G Expenses, which total $136 million and account for the largest portion of the total $196 million in indirect costs examined by Mr. Peterson in this proceeding, include among other things administrative salaries, office supplies and expense, outside services employed, property insurance, injuries and damages, employee pensions and benefits, regulatory commission fees and maintenance of general plant. NRG St. No. 1 at 19. Again, this mirrors the situation that OCA highlighted in 1997 and that the Commission took measures to rectify. Mr. Peterson explained that by proposing to allocate all indirect A&G expenses to distribution services, "PECO seeks to recover costs from all customers that are incurred to support default service." NRG St. No. 1 at 20. He added that, as a result, "EGS customers who do not buy electricity from PECO pay the full distribution charges but receive no benefit from the portion of A&G expenses that support default service." NRG St. No. 1 at 20. He also noted that "a functionally separate default service division would necessarily incur costs associated with administrative salaries, office suppliers, property insurance, regulatory commission fees and other A&G expenses." NRG St. No. 1 at 20.

Within the pool of residential A&G expenses reviewed by Mr. Peterson, it is likewise noteworthy that Outside Services Employed in the amount of $56.0 million is the single largest expense. NRG St. No. 1 at 20; NRG Exhibit CP-6. Data provided in FERC reports reveals the nature of some of the expenses in this category.[82] Outside services could include: business center, communication, executive, financial, human resources, information technology, legal government, legal, real estate, security, supply, utilities, advertising, promotional, public relations, and other services. It may also include regulatory and government affairs, AMI deployment and information technology, project management office compliance and program administration costs. NRG St. No. 1 at 20-21. Clearly, the costs "that are encompassed by the category Outside Services Employed are common business expenses that are critical to day-to-day operations. If PECO had a separate division providing default service, it would necessarily incur costs in all of these areas." NRG St. No. 1 at 21.

In addition, Mr. Peterson discussed the appropriateness of allocating the cost categories of common plant, general plants and intangible plant in connection with depreciation and amortization expense to default service. As he explained, PECO describes Common Plant as facilities, such as PECO's headquarters office building in Philadelphia, that are used to provide both electric and gas service. General Plant is described in PECO's filing as including primarily structures and improvements relating to administrative activities, tools, and communications equipment, as well as other miscellaneous assets. Intangible Plant, according to PECO, represents the costs of franchises and consents and other intangible assets.[83]

The FERC descriptions are similar but more detailed as follows:[84]

> Common Plant - If the utility is engaged in more than one utility service, such as electric, gas, and water, and any of its utility plant is used in common for several

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82 PECO Attachment SDR-OM-16(a).

83 PECO Statement Nos. 4 and 6.

84 CFR, Title 18, Chapter 1, Subchapter C, Part 101, Uniform System of Accounts.

> utility services or for other purposes to such an extent and in such manner that it is impracticable to segregate it by utility services currently in the accounts, such as property, with the approval of the Commission, may be designated and classified as common utility plant.
>
> General Plant – Land and land rights, Structures and improvements, Office furniture and equipment, Transportation equipment, Stores equipment, Tools, shop and garage equipment, Laboratory equipment, Power operated equipment, Communication equipment, Miscellaneous equipment, Other tangible property, Asset retirement costs for general plant.
>
> Intangible Plant – Organization, franchises and consents, miscellaneous intangible plant, which includes the cost of patent rights, licenses, privileges, and other intangible property necessary or valuable in the conduct of utility operations and not specifically chargeable to any other account.

Having reviewed these descriptions, Mr. Peterson concluded that as "with any business with Common Plant, General Plant and Intangible Plant, PECO would incur these Depreciation and Amortization Expenses if it were operating a separate default service division." NRG St. No. 1 at 22.

Mr. Peterson also provided explanation for the inclusion of Customer Service Expenses, which cover customer assistance, information advertisement and miscellaneous customer service. "A functionally separate division of PECO providing default service would necessarily incur some level of costs to provide customer services. Therefore, it is not appropriate to allocate all of these costs to distribution services." NRG St. No. 1 at 22. Similarly, with respect to Sales Expenses, which include demonstrating and selling costs for PECO's services and products, Mr. Peterson noted that "providing residential default service entails sales expenses, such that it is unreasonable to allocate all of these costs to distribution services." NRG St. No. 1 at 22. Indeed, he explained that "while PECO allocates no advertising or market costs to default service, it engages in messaging that is intended to retain customers on default service." NRG St. No. 1 at 22.

Mr. Cohn attempted to dispute Mr. Peterson's assertion regarding any efforts undertaken by PECO to retain customers on default service by pointing to the messaging referenced by Mr. Peterson as relating to PECO's EE&C program, which is available to all customers, including those who take service from EGSs. PECO Statement No. 9-R at 19. However, as noted by Mr. Peterson, the fact remains that "[a]ny educational activities in which PECO engages to make consumers aware of its EE&C program necessarily promotes its brand name." NRG St. No. 1-SR (Rev) at 36. Residential electricity consumers viewing information on a billboard about the EE&C program certainly have no basis for distinguishing between educational or marketing activities that are related to the EE&C program versus PECO's default supply service. NRG Cross Examination Exhibit 1. Similarly, if consumers visit the website referenced in Mr. Peterson's testimony, and they are prompted to call 1-888-5-PECO-SAVE, they have no way of differentiating that message from one promoting default service. Tr. 459. Also, during the hearings, Mr. Cohn confirmed that the PECO displays crown lights on the top of its building in Philadelphia, which are used to interact with residents and businesses in the City. Tr. 459; 461-462. Such activities, regardless of their purpose, elevate PECO's brand in consumers' minds and are at least part of the reason that two thirds of its customers continue to take default service rather than shopping for electricity.

Also, it is noteworthy that some of these expenses are specifically listed in the Commission's 2007 Policy Statement as costs that should be recovered through the PTC for default service, such as A&G expenses associated with providing default service and expenses incurred for regulatory and litigation activities. In short, as concluded by Mr. Peterson, despite the Commission's prior efforts to unbundle EDC rates, PECO's distribution charges continue to include certain indirect costs associated with providing residential default service. NRG St. No. 1 at 18.

iii. A Reasonable Level of Indirect Costs, Rather Than Zero Costs, Should Be Allocated to Default Service

To address the fact that PECO is improperly allocating all of the identified indirect expenses to distribution service, Mr. Peterson reallocated the indirect expenses in each of these categories in a way that more accurately reflects the costs that PECO incurs to support all of PECO's residential operations, both default service and distribution service. The total expenses that he deemed necessary to consider for reallocation the total $196,616,182, which is the sum of the amounts shown in NRG Exhibit CP-5 for Customer Service Expenses, Sales Expenses, A&G Expenses, Intangible Plant Expense, General Plant Expense and Common Plant Depreciation/Amortization in the column labeled "PECO Energy Company Total Residential Class." NRG St. No. 1 at 23-24. Of the total indirect expenses that Mr. Peterson examined for reallocation, he recommended that $101,951,549, which is currently allocated entirely to distribution service, should be attributed to default service. This represents approximately 51.5 percent of the total pool of indirect expenses. NRG St. No. 1 at 24.

Mr. Peterson arrived at this recommended level of $101,951,549 by considering three alternative methods for computing the amount of indirect expenses to be reallocated to PECO's default service. Allocation Method A allocates costs to "generation" or default service on the basis of residential default service revenues divided by total residential revenues. Allocation Method B allocates these costs on the basis of residential default service customers divided by total residential customers. Allocation Method C allocates these costs on the basis of a hybrid of Allocation Methods A and B. The results of the three allocation methods are shown in NRG Exhibit CP-7.[85] NRG St. No. 1 at 24-25.

[85] Although these schedules are included in NRG Exhibit CP-3, labeled as Charts 1.2 and 1.3, Mr. Peterson reproduced them as NRG Exhibit CP-7 for ease of reference.

As explained by Mr. Peterson, NRG Exhibit CP-7 consists of two different schedules. The first one is labeled "Default Service: PECO's Statement of Earnings – Summary of Residential Customer Cass and Recast Allocation Methods." In the first column, this schedule shows PECO's allocations of costs to default service, which are recovered through the PTC. The remaining three columns show the results of each of my three allocation methods, under which some portion of Customer Service Expenses, Sales Expenses, A&G Expenses, Intangible Plant Expense, General Plant Expense and Common Plant Depreciation/Amortization are allocated to default service. NRG St. No. 1 at 24-25.

Additionally, the second schedule in NRG Exhibit CP-7 is labeled "Distribution Service: PECO's Statement of Earnings – Summary of Residential Customer Class and Recast Allocation Methods." In the first column, this schedule shows PECO's allocation of costs to distribution service, which are recovered through distribution charges. The remaining three columns show the results of each of his three allocation methods, under which a smaller portion of Customer Service Expenses, Sales Expenses, A&G Expenses, Intangible Plant Expense, General Plant Expense and Common Plant Depreciation/Amortization are allocated to distribution service. NRG St. No. 1 at 25.

(a) Allocation Method A

Under Allocation Method A, Mr. Peterson used residential sales revenues of both default service and distribution service. Per PECO's filing in this proceeding, residential default service revenues for the FPFTY 2019 are $636.9 million, or approximately 43 percent of the total projected residential sales of $1.5 billion. Mr. Peterson considered the percentage of residential sales as a method of reallocating costs attributable to default service because this is a commonly used and widely accepted methodology for financial allocations. As he explained, this

methodology reallocates approximately $84.5 million of indirect expense currently allocated to residential distribution service to residential default service. NRG St. No. 1 at 25.

In order to understand the impact of allocating this expense to PECO's PTC, Mr. Peterson converted the dollar amount to the equivalent cents per kWh. PECO estimates the budgeted residential kWh used by default service customers to be 8.56 million for the FPFTY 2019.[86] To be consistent with the other line items on PECO's PTC, he adjusted the rate per kWh for the gross receipts tax ("GRT") of 5.90 percent. He then converted the tax adjusted amount from dollars to cents. Using this allocation methodology, Mr. Peterson determined that PECO's PTC is understated by approximately 1.05 cents per kWh. This calculation is summarized below, with additional details provided in NRG Exhibit CP-9.[87]

Allocation Methodology A - Percentage of Revenues		
Total Residential Expenses to be Allocated	$	196,616,182
Allocation Factor		43%
Total Expenses Allocated to Residential Default Service	$	84,544,958
÷ Total annual kWh's for Default Residential Customers		8,585,439,745
Increase in Allocation to Default Service per kWh	$	0.009847
÷ Adjusted for Gross Receipts Tax Factor (1 - GRT Rate) @ 5.90%		94.10%
Recast Expenses to Residential Default Service ($ per kWh)	$	0.010465
Total Recast Expenses to Residential Default Service (¢ per kWh, Rounded)	**¢**	**1.05**

NRG St. No. 1 at 25-26.

Mr. Cohn objected to the use of default service revenue as an allocator because it would result in $61 million of $136 million in administrative expenses currently allocated to residential distribution service customers being reallocated to residential default service customers, while default service revenues are driven by wholesale supplier costs. Further, in response to Mr. Peterson's testimony regarding the need for administrative employees to maintain the levels of

86 NRG Exhibit CP-8 (PECO Response to NRG-II-2).

87 Although this schedule is included in NRG Exhibit CP-3, labeled as Chart 2.1(A), Mr. Peterson reproduced it as NRG Exhibit CP-9 for ease of reference.

revenue achieved by both default service and distribution service operating divisions, Mr. Cohn stated that PECO is not seeking to maintain the default service revenue levels and that virtually all of the revenue received from default service customers is passed to wholesale suppliers under contract with PECO. PECO Statement No. 9-R at 15-16.

Allocating common or shared costs to separate functions performed by an entity on the basis of revenues is a commonly used and widely accepted accounting methodology. In fact, PECO uses revenue as an allocation factor for its common plant (facilities that are used to provide both electric and gas service) and in other areas. These are expenses that occur despite fluctuations in the level of customers that are receiving default service. For example, Mr. Peterson reallocated administrative salaries based on the percentage of revenues method because a portion of administrative salaries must be incurred to support PECO's default service operations. PECO projects that it will sell over one billion kilowatt hours of electricity to its default service customers. Managing nothing more than the finances and cash flow issues associated with this business would require support from the cost categories he has identified. NRG St. No. 1-SR (Rev) at 27-28.

Mr. Cohn also objected to using default service revenues as an allocator because these amounts are dependent on the price of power without any established causation between the price of default service power and the costs Mr. Peterson seeks to reallocate. In addition, he suggested that default service revenue is a poor cost allocator for administrative expenses generally and that NRG's analysis is inconsistent with principles of cost allocation discussed by Ms. Ding. PECO Statement No. 9-R at 16-17.

Certainly, allocating no indirect costs to distribution service is inconsistent with principles of cost causation. While there is no universal way to allocate indirect costs, it is reasonable to use widely-accepted accounting methodologies for allocating them. And NRG's

approach is far more acceptable than PECO's method of allocating no indirect costs to default service, which the Commission found was an unacceptable practice over twenty years ago in the *1997 Restructuring Order*. As to Mr. Cohn's claim that Ms. Ding's approach of allocating most A&G and outside services by labor is appropriate, Mr. Peterson did not disagree with the allocation of costs on the basis of labor as between customer classes. But since Ms. Ding did not take the additional step of allocating costs as between distribution service and default service within the residential classes, and labor information is not available at that level, it is necessary to rely on other typical allocation factors, of which revenue is one. NRG St. No. 1-SR (Rev) at 28.

Mr. Cohn further testified that Mr. Peterson's analysis does not properly reflect the fact that some of PECO's transmission expense is collected from customers on a non-bypassable basis. PECO Statement No. 9-R at 15, footnote 10. In response to NRG-III-7, PECO has identified $53.9 million as the amount of non-bypassable transmission expense that it projects will be collected from residential customers in the fully projected future test year. Because the revenues associated with these transmission expenses should be removed from both the numerator and the denominator (in calculating the percent of revenues that are attributable to default service), Mr. Peterson testified that the impact of removing $53.9 million is minimal. Specifically, he has calculated that the removal of this amount from his calculations would result in a proposed increase to the PTC in the amount of 1.22 cents per kWh, rather than my recommended increase of 1.25 cents per kWh. NRG St. No. 1-SR (Rev) at 29.

However, this issue did not affect Mr. Peterson's overall proposal. As he noted, PECO has access to all of the details of its cost of service study and this is the only potential error Mr. Cohn identified. If NRG had similar access to the details of PECO's cost of service study, Mr. Peterson expressed no doubt that other expense items would be identified as being more properly

allocated to default service or being more heavily allocated to default service than occurs through the revenue allocation method. NRG St. No. 1-SR (Rev) at 30.

(b) Allocation Method B

Under Allocation Method B, Mr. Peterson used the number of residential customers. Using actual 2017 EDC to EGS customer levels,[88] he estimated that approximately 66 percent of PECO's total residential customers will also be default service customers in 2019 (1.02 million/1.56 million). He considered the percentage of residential customers as a method for reallocating costs attributable to default service because this is another commonly used and widely accepted methodology for financial allocations. Indeed, the Direct Testimony of Jiang Ding, Principal Regulatory and Rate Specialist at PECO, indicates that she classified certain costs in the Cost of Service Study by the number of customers being served. Allocation by customers is needed to allocate expenses which are not incurred as a function of usage on the customer's part. Ms. Ding explained as follows:

> Customer-related costs are the expenditures made to attach a customer to the distribution system, to meter usage and to maintain the customer's account. Customer costs are a function of the number of costs served and continue to be incurred whether or not a customer uses any electricity. This classification includes capital costs associated with poles, wires, services and meters and operating expenses incurred for customer service, field service, billing, and accounting and related activities.[89]

As explained by Mr. Peterson, this methodology reallocates approximately $129.8 million of expense currently allocated to residential distribution service to residential default service. As in Allocation Method A, he went through the same steps to derive the equivalent cents per kWh rate for this allocation methodology. Using this approach, he determined that

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88 NRG Exhibit CP-10 (PECO Response to NRG-I-7).

89 PECO Statement No. 6 at 12.

PECO's PTC is understated by approximately 1.61 cents per kWh. This calculation is summarized below, with additional detail set forth in NRG Exhibit CP-11.[90]

Allocation Methodology B - Percentage of Customers		
Total Residential Expenses to be Allocated	$	196,616,182
Allocation Factor		66%
Total Expenses Allocated to Residential Default Service	$	129,766,680
÷ Total annual kWh's for Default Residential Customers		8,585,439,745
Increase in Allocation to Default Service per kWh	$	0.015115
÷ Adjusted for Gross Receipts Tax Factor (1 - GRT Rate) @ 5.90%		94.10%
Recast Expenses to Residential Default Service ($ per kWh)	$	0.016062
Total Recast Expenses to Residential Default Service (¢ per kWh, Rounded)	**¢**	**1.61**

NRG St. No. 1 at 27-28.

For expenses that cannot be directly correlated to revenue generation, Mr. Peterson testified that it is appropriate to allocate the costs using the percentage of customers method. These expense items are either not directly related to revenues or are directly attributable to the number of customers served. Therefore, allocating these expenses in this way accurately reflects the Company's default service to distribution customer mix. For example, customer assistance expense is incurred based on the need to serve the customer base and is commonly tracked by customer call volume. How often customers call is not directly correlated to increases or decreases in revenue. However, the number of customer calls received is reasonably a function of how many customers are being served. NRG St. No. 1-SR (Rev) at 32.

Despite confirming that the number of customers is used for allocating costs and that he provided identical testimony to that of Ms. Ding quoted above in 2015 (Tr. 455457), Mr. Cohn opposed using the number of default service customers as an allocator. His concern is that "if all customers became default service customers, large amounts of PECO distribution system costs" would need to be recovered from those customers, or if all of PECO's customers elected

[90] Although this schedule is included in NRG Exhibit CP-3, labeled as Chart 2.1(B), Mr. Peterson reproduced it as NRG Exhibit CP-11 for ease of reference.

to receive generation service from EGSs, PECO would not recover any of the expenses that NRG has proposed to reallocate from distribution service to default service. PECO Statement No. 9-R at 17.

However, both of Mr. Cohn's hypothetical scenarios are speculative and have no basis in the record that is being established here. If such extreme results were to occur, they would likely develop over a long period of time and both PECO and the Commission would have an opportunity to address those scenarios in order to assure appropriate cost recovery. For instance, if PECO is required by the Commission in this proceeding to reallocate a reasonable portion of indirect expenses from distribution service to default service, using the allocators that Mr. Peterson has recommended, PECO could address changes to revenues and customer numbers when it resets its PTC on a quarterly basis. NRG St. No. 1-SR at 30-31.

As to the first scenario, if all residential customers became default service customers, PECO would recover all of its costs. PECO itself has said that all of its residential customers are distribution customers. In that scenario, all of its customers would be both distribution and default service customers. Therefore, it would not matter what they are called or whether the costs are recovered through the PTC or the distribution charges. NRG St. No. 1-SR at 31.

With respect to the second scenario, where all customers are receiving generation service from EGSs in the competitive market, Mr. Peterson noted that roughly two-thirds of PECO's distribution customers receive default service, which has been the case for several years, as confirmed by Mr. Cohn. Tr. 457. Any noticeable change in the percentage would likely occur over a relatively lengthy period of time. Indeed, if all of these customers began taking service from EGSs, NRG questions whether PECO's default service would continue to be necessary. In that instance, the Commission could determine PECO's true distribution costs and authorize recovery of them through distribution charges. It is important to keep in mind that Mr.

Peterson's analysis is based on the facts as they exist today and are projected through the FPFTY – in the same way as other data is being used in this proceeding. Nothing would prevent PECO and the Commission from using the same allocators in addressing a different set of facts in the future through the PTC reconciliation process and in future distribution rate cases. NRG St. No. 1-SR at 31. Other mechanisms such as automatic adjustment clauses could also be used.[91]

(c) Allocation Method C

Explaining that ultimately, reallocating costs based on revenues is appropriate for some expenses, while allocating expenses based on the number of customers is appropriate for others, Mr. Peterson he proposed implementing a hybrid of the two allocation methods based on what is deemed most appropriate for each expense line. This hybrid is referred to in his testimony as Allocation Method C. NRG St. No. 1 at 28.

In determining the types of costs that it is appropriate to allocate on the basis of revenues, Mr. Peterson considered the percentage of revenues method for reallocating expenses that are needed in order to support revenue generation. These are expenses that occur despite fluctuations in the level of customers that are receiving default service. For example, he reallocated administrative salaries based on the percentage of revenues method because a portion of administrative salaries must be incurred to support PECO's default service operations. Because administrative employees are clearly needed to maintain the levels of revenue achieved by both default service and distribution service operating divisions, Mr. Peterson noted his belief that percentage of revenues is an appropriate way to allocate these costs. NRG St. No. 1 at 28-29.

For expenses that cannot be directly correlated to revenue generation, Mr. Peterson expressed the opinion that it is appropriate to allocate the costs using the percentage of customers

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[91] 66 Pa.C.S. § 1307(a).

method. Explaining that these expense items are either not directly related to revenues or are directly attributable to the number of customers served, he opined that it is appropriate to allocate these expenses in a way that accurately reflects the Company's default to distribution customer mix. For example, customer assistance expense is incurred based on the need to serve the customer base and is commonly tracked by customer call volume. How often customers call is not directly correlated to increases or decreases in revenue. However, the number of customer calls received is reasonably a function of how many customers are being served. NRG St. No. 1 at 29.

Utilizing these concepts for each line item, he reallocated compensation, outside services, and regulatory expenses based on percentage of revenue. Also, he reallocated customer service, sales, maintenance, insurance, damages, and depreciation & amortization expenses based on the number of customers. NRG St. No. 1 at 29.

The results of Allocation Method C is that it reallocates approximately $101.2 million of expense currently allocated to residential distribution service to residential default service. Following the same steps as above to derive a cent per kWh rate, Mr. Peterson determined that PECO's PTC is understated by approximately 1.25 cents per kWh under Allocation Method C.

This calculation is summarized below and additional detail is set forth in NRG Exhibit CP-12.[92]

Allocation Methodology C - Hybrid: Revenues and Customers		
Total Residential Expenses to be Allocated	$	196,616,182
Allocation Factor		51%
Total Expenses Allocated to Residential Default Service	$	101,191,549
÷ Total annual kWh's for Default Residential Customers		8,585,439,745
Increase in Allocation to Default Service per kWh	$	0.011786
÷ Adjusted for Gross Receipts Tax Factor (1 - GRT Rate) @ 5.90%		94.10%
Recast Expenses to Residential Default Service ($ per kWh)	$	0.012525
Total Recast Expenses to Residential Default Service (¢ per kWh, Rounded)	**¢**	**1.25**

NRG St. No. 1 at 30.

Mr. Cohn criticized Mr. Peterson's hybrid allocation method that uses both default service revenues and the number of default service customers, depending on the expense category, on the basis that "both are improper allocators for costs that PECO will continue to incur regardless of the level of shopping by distribution system customers." PECO Statement No. 9-R at 18.

This argument confuses the concepts of avoidable costs and the practice of appropriately allocating costs. Ratemaking in Pennsylvania is based on cost causation principles, not on the basis of avoided costs.[93] Moreover, cost accounting principles that call for common or shared costs to be allocated cross multiple operating divisions or business lines support the use of reasonable allocators to accomplish this goal. Both of the allocators Mr. Peterson has proposed to use – revenues and number of customers – are widely accepted conventions for this purpose. Also, he did not accept it as a foregone conclusion that PECO will continue to incur all of the indirect expenses he has identified "regardless of the level of shopping by distribution system customers." PECO Statement No. 9-R at 18. To the contrary, if the level of shopping by

92 Although this schedule is included in NRG Exhibit CP-3, labeled as Chart 2.1(C), I am reproducing it as NRG Exhibit CP-12 for ease of reference.

93 *See Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa. Cmwlth. 2006) (cost of service is the polestar for ratemaking).

distribution system customers substantially increases to the point that PECO's default service business is minimal or non-existence, Mr. Peterson would expect PECO's overall costs to decrease. NRG St. No. 1-SR (Rev) at 34-35.

(d) Other Allocation Methods

Both Mr. Cohn and Mr. Johnson noted that the allocator adopted by the Commission in 1997 to address the administrative expense of PECO's generation and distribution operations was the number of employees working generation and distribution operations, rather than revenues, customers or a hybrid. PECO Statement No 9-R at 12; OCA Statement No. 3R at 7. Yet, neither witness disputed that revenues and number of customers are both widely utilized allocators. While Mr. Peterson acknowledged that labor is an allocator that is used for cost allocation purposes, he explained that PECO does not have a specified number of employees working in generation and distribution operations. Further, PECO has indicated that it does not track the amount of time that is being spent by its employees working on default service and distribution service. NRG Exhibit CP-19 (PECO Response to NRG-III-6); Tr. 454. Without information on employee headcounts, he selected two widely recognized allocators for common expenses – customers and revenues. And, he went further to examine each individual cost category and determine which of those allocators was better suited for the particular expense. NRG St. No. 1-SR (Rev) at 22-23. In the absence of labor information, Mr. Peterson's method of using common allocators is far superior to PECO's approach which simply declines to allocate any indirect costs to default service.

3. Effects of NRG's Proposal

a. Distribution Charges Should Be Decreased

Reallocating expenses to default service would reduce the distribution charges paid by customers on their monthly bills since they would be recovered by PECO through the PTC. The

distribution charge is broken into fixed and variable (per kWh) elements on each customer's bill, with the fixed portion labeled as "Customer Charge" and the variable portion labeled as "Distribution Charges." Because of the manner in which PECO derives the fixed Customer Charge, Mr. Peterson recommended that PECO adjust the variable Distribution Charges to reflect the reallocation of expenses from distribution service to default service. NRG St. No. 1 at 37.

In adjusting the variable Distribution Charge, Mr. Peterson derived a reduction of the distribution charge per bill and calculated this amount to be .76 cents per kWh using Allocation Method C, which is described above and is shown in NRG Exhibit CP-17.[94] This amount was calculated by dividing the total reallocated expense for each methodology by the total number of residential and residential heating bills (approximately 18.7 million for the FPFTY 2019). Under proposed Allocation Method C (hybrid), he further determined that my proposed adjustment to the variable distribution charge would result in an estimated reduction, on average, of $5.41 per monthly bill or $64.89 on an annual basis. This calculation is shown below and can be seen in greater detail in NRG Exhibit CP-18.[95]

Analysis of Reallocated Distribution Service Expenses			
	Allocation Method		
	A - % of Revenues	B - # of Customers	C - Hybrid
Total Distribution Service Expenses Reallocated to Price To Compare	$84,544,958	$129,766,680	$101,191,549
÷ Number of Bills (Annual)	18,714,403	18,714,403	18,714,403
Reduction to Distribution Service Revenue per Bill (Monthly)	**$4.52**	**$6.93**	**$5.41**
Annual Reduction to Distribution Service Revenue per Customer	**$54.21**	**$83.21**	**$64.89**

NRG St. No. 1 at 39.

94 Although this schedule is included in NRG Exhibit CP-3, labeled as Chart 3.2, he reproduced it as NRG Exhibit CP-17 for ease of reference.

95 Although this schedule is included in NRG Exhibit CP-3, labeled as Chart 3.1, he reproduced it as NRG Exhibit CP-18 for ease of reference.

The table below shows the effect of a reduction in the distribution charge in the amount of .76 for customers using 500, 750, 1000 and 2000 kWh per month.[96]

Average Customer Usage	Distribution Charge Reduction
500 kWh	$3.82
750 kWh	$5.73
1000 kWh	$7.64
2000 kWh	$15.29

NRG St. No. 1 at 40. This reduction would result in a fairer allocation between distribution service and default service. By lowering the distribution charges that are paid by both shopping and default service customers, shopping customers would no longer be subsidizing non-shopping customers through the payment of indirect expenses that are incurred by PECO in providing default service to those non-shopping customers.

b. PTC Should Be Increased

Importantly, NRG is not proposing that PECO be denied recovery of the amount of $101 million that Mr. Peterson has identified as being misallocated to distribution service. Rather, as he explained, "similar to the way that the riders were developed during the 2010 distribution rate case to capture the transmission service charges and the cash working capital requirements," he proposed that PECO recover this amount through the PTC for default service. NRG St. No. 1 at 31. Specifically, Mr. Peterson recommended that PECO be directed to adjust its PTC at the next quarterly adjustment following the issuance of an order in this proceeding to reflect the reallocation of these costs from distribution service to default service.

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[96] NRG is aware that the Commission's regulations require EGSs to show prices in marketing materials for average customers with usage levels of 500, 1000 and 2000 kwh per month. 52 Pa. Code § 54.7.

The effect of this recommendation is to reallocate approximately $101 million from residential distribution services to residential default service and increase PECO's PTC for residential default service by 1.25 cents per kWh. This proposal is consistent with the Commission's regulations requiring an EDC's PTC to recover all default service costs that are incurred to serve customers.[97] Further, in prohibiting EDCs from recovering default service costs through the distribution rate, the Commission's regulations require that costs recovered through the distribution rate be reallocated to the default service rate, with the distribution rate reduced accordingly.[98]

Reviewing the PTC for June 2017 through August 2017, which was 7.11 cents per kWh, the effect on the PTC of adding 1.25 cents per kWh would be to increase it by 15 percent to 8.36 cents per kWh. Through Mr. Peterson's analysis, he observed that the Company's residential costs, number of annual residential customers served, and annual residential kilowatt hours used in its operating area are relatively stable for the years 2014 through 2017. Accordingly, he opined that the 1.25 cent per kWh increase is also applicable to PECO's current residential default service rate of 7.15 cents per kWh, which would rise by 14.9 percent to 8.40 cents per kWh. NRG St. No. 1 at 33-34.

Mr. Peterson recognized that 1.25 cents may seem like a slight difference in price – merely a penny give or take – and it is when talking about most products. However, in relative terms, it means that PECO's PTC is understated by 15 percent. That kind of price differential is fundamentally misleading to consumers when they are looking at prices on www.papowerswitch.com and deprives them of the information that is needed to compare prices and services on an accurate and fair basis. As consumers shop for generation supply, they are constantly reminded of the price and when this price is inaccurate by nearly 15 percent, many

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97 52 Pa. Code § 54.187(e) (emphasis supplied).
98 52 Pa. Code § 54.187(e).

may choose not to make the switch. In short, PECO's default service customers are not being provided adequate information that is needed to enable them to make informed choices regarding the purchase of electricity services. Stated differently, they are unable to make apples-to-apples comparisons. NRG St. No. 1 at 34.

Another factor identified by Mr. Peterson that demonstrates the importance of increasing PECO's PTC relates to costs recovered by PECO for its EE&C programs. During his review of PECO's COSS, he determined that $88.7 million of projected customer assistance costs for its EE&C programs were removed from PECO's cost projections for the FPFTY 2019 through an elimination adjustment since EE&C costs are recovered through a surcharge mechanism pursuant to Act 129.[99] NRG Exhibit CP-14 shows that of PECO's $99.8 million in customer assistance expenses, only $11 million has been allocated to distribution services.[100] NRG St. No. 1 at 36.

The $88.7 million of customer assistance costs excluded from PECO's cost projections includes $10.8 million is allocated to Education, Awareness, and Marketing expenses.[101] These items may include advertising and other marketing activities that are branded using PECO's name. As a result, PECO may be able to unfairly promote its brand name, and thereby its residential default service, under the guise of marketing the EE&C program. NRG St. No. 1 at 36-37; NRG Exhibit CP-14.

The significance of PECO's removal of $88.7 million from customer assistance expenses in its COSS in this proceeding is that this amount represents costs that PECO recovers through a surcharge on all customers, while some of these costs support PECO's default service operations. If these costs had remained in the COSS as being entirely allocated to distribution services, Mr.

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99 66 Pa.C.S. §§2806.1 and 2806.2.

100 Although this schedule is included in NRG Exhibit CP-3, labeled as Appendix B, I am reproducing it as NRG Exhibit CP-14 for ease of reference.

101 NRG Exhibit CP-15 (PECO Response to NRG-I-1).

Peterson's recommended reallocation of costs to default service would have been much larger. NRG St. No. 1 at 36. Although Mr. Peterson did not propose any adjustments to account for these costs, NRG points this issue out as a way of emphasizing the importance of the Commission directing the adjustment of PECO's PTC for default service to reflect a reasonable portion of its indirect expenses so that it more accurately presents information that allows customers to make fairer comparisons between PECO's PTC and the prices charged by EGSs for competitive generation service. NRG St. No. 1 at 37.

The outcome of implementing these recommendations is that the information received by residential customers will allow for more meaningful comparisons between PECO's PTC and the prices offered by EGSs. While the result will still not be a perfect apples-to-apples comparison, these adjustments would permit customers to compare prices and services on a more uniform basis and enhance their ability to make informed choices regarding the purchase of electricity services. NRG St. No. 1 at 7.

V. CONCLUSION

WHEREFORE, NRG Energy, Inc. respectfully requests that the Commission direct PECO Energy Company to reallocate its indirect expenses, to reflect the level of rate relief that is awarded in this proceeding, in the manner recommended by NRG in this proceeding.

Respectfully submitted,

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Date: September 7, 2018

Appendix A

Proposed Findings of Fact

NRG Energy, Inc.
Proposed Findings of Fact

1. NRG Energy, Inc. ("NRG") has five affiliate companies that are licensed by the Commission as electric generation suppliers ("EGSs"} to provide electricity or electric generation supply services to retail customers throughout Pennsylvania. These EGSs, which include Reliant Energy Northeast LLC d/b/a NRG Home and NRG Business, Green Mountain Energy Company, Energy Plus Holdings LLC, Independence Energy Group d/b/a Cirro Energy and XOOM Energy Pennsylvania, LLC, serve customers in PECO's distribution service territory. NRG St. No. 1 at 3; NRG St. No. 1-SR (Rev) at 1.

2. PECO Energy Company ("PECO") is the default service provider for two-thirds, or over one million, of its residential distribution customers. NRG St. No. 1 at 17; NRG Exhibit CP-3 at N7.

3. PECO projects that it will sell 8.6 billion kilowatt hours of electricity to its residential default service customers during the Fully Projected Future Test Year. NRG St. No. 1-SR (Rev) at 27; NRG Exhibit CP-3 at N6.

4. PECO projects that it will generate revenue in the amount of $637 million from its residential default service business during the FPFTY. NRG St. No. 1 at 25; NRG Exhibit CP-5.

5. In its Cost of Service Study ("COSS"), PECO allocated no indirect costs to residential default service. NRG St. No. 1 at 15-17; NRG Exhibit CP-5; Tr. 451-452, 456.

6. PECO's current price to compare ("PTC") includes zero costs for the categories of information technology, education and regulatory. NRG Exhibit CP-20 (Rev); Tr. 446.

7. PECO would necessarily incur some level of IT, education and regulatory costs to provide default service. NRG St. No. 1-SR (Rev) at 9, 11.

8. PECO's administrative cost factor in its current PTC reflects only the costs of the auction or Request for Proposal monitor, consultants providing guidance on the development of the procurement plan, legal fees incurred gaining approval of the plan, and any other costs associated with designing and implementing a procurement plan. NRG St. No. 1 at 35; NRG Exhibit CP-3 at N11.

9. PECO's current PTC includes administrative costs of 0.005 cents per kWh, which amounts to $118,314, which is less than 1 percent of PECO's forecasted annual Administrative & General (A&G) costs of over $136 million for the residential rate class. NRG St. No. 1-SR (Rev) at 8; NRG Exhibit CP-20 (Rev); Tr. 447-448.

10. PECO's current PTC reflects negative A&G expenses related to default service. NRG Exhibit CP-20 (Rev); Tr. 446.

11. PECO's current PTC only reflects regulatory and litigation costs associated with PECO's default service plans. PECO Statement No. 9-R at 6.

12. Providing default service entails more than the procurement of wholesale power supply. NRG St. No. 1-SR (Rev) at 7-8.

13. PECO's indirect expenses should be allocated in a way that reflects the costs that would be incurred to operate a separate default service division. NRG St. No. 1 at 18.

14. PECO's functions of providing distribution service and default service are separate and distinct. NRG St. No. 1-SR (Rev) at 21-22, 24.

15. Both lines of PECO's business – distribution service and default service – must rely on shared or common services, such as information technology, regulatory and litigation costs. In order to ensure that each business line supports the costs that are incurred for these shared or

common services, it is necessary to allocate these costs to both lines of the business. NRG St. No. 1-SR (Rev) at 19-20.

16. A functionally separate default service division would necessarily incur costs associated with administrative salaries, office supplies, property insurance, regulatory commission fees and other A&G expenses. Similarly, the expenses that fall under the category of outside services employed within A&G expenses, including executive, financial, human resources, legal, real estate, etc., are all common business expenses that are critical to day-to-day operations. NRG St. No. 1 at 20-21.

17. Allocation of shared costs to different businesses or business units is not a novel concept. Companies consistently allocate indirect expenses across business units and cost centers. Indirect costs are costs which cannot be identified with a particular service or product, which includes but is not limited to overhead costs, including A&G expenses. NRG St. No. 1-SR (Rev) at 23-24.

18. A reasonable level of administrative expenses are necessary to support any business' operations. NRG St. No. 1-SR (Rev) at 39.

19. The concept of full absorption costing is a term of art in financial accounting that refers to the assignment of all reasonable costs to an activity. Full absorption costing typically involves allocations of common costs between activities. NRG St. No. 1 at 18. Under this concept, all reasonable costs associated with a product or activity should be allocated, including indirect costs. NRG St. No. 1-SR (Rev) at 26-27.

20. A single universal convention for cost allocations does not exist. Rather, numerous cost allocation methods are commonly used and widely accepted to determine the entire cost of an

activity. Common allocation driver include revenues, number of customers and labor hours. NRG St. No. 1 at 18.

21. The practical effect of PECO's practice of allocating no indirect costs to default service is that customers who are shopping for electric generation service in PECO's territory are being presented with offers from EGSs to which they cannot make apples-to-apples comparisons with PECO's PTC. NRG St. No. 1 at 32.

22. Of PECO's total amount of $196,616,182 in indirect costs associated with serving the residential classes for the FPFTY, the amount of $101,951,549 should be reallocated from residential distribution service to residential default service. NRG. St. No. 1 at 23-25, 28-30; NRG Exhibit CP-5.

23. PECO is recovering a disproportionally high amount of costs through residential distribution charges, which should be reduced to reflect the reallocation of indirect costs from distribution service to default service. Reallocating $101 million would reduce the residential distribution charge, on average, by .76 cents per kWh. NRG St. No. 1 at 37; NRG Exhibit CP-17.

24. The result of reallocating $101 million from residential distribution service to residential default service would be an increase in PECO's PTC from 7.15 cents per kWh to 8.40 cents per kWh, or approximately 15 percent NRG St. No. 1 at 33-34.

25. The outcome of these reallocations is that the information received by residential customers will allow for more meaningful comparisons between PECO's PTC and the prices offered by EGSs. While the result will still not be a perfect apples-to-apples comparison, these adjustments would permit customers to compare prices and services on a more uniform basis and enhance their ability to make informed choices regarding the purchase of electricity services. NRG St. No. 1 at 7.

26. As a court-appointed expert witness in forensic accounting, NRG's witness, Chris Peterson, is fully qualified to opine on PECO's allocation of indirect costs wholly to residential distribution service when it operates an entirely different business of providing default service to residential customers, and to propose an approach for allocating indirect costs to residential default service using commonly utilized allocators. NRG St. No. 1 at 1-3; NRG St. No. 1-SR (Rev) at 1-2; NRG Exhibit CP-1; NRG Exhibit CP-2; Tr. 473, 510-513.

Appendix B

Proposed Conclusions of Law

NRG Energy, Inc.
Proposed Conclusions of Law

1. As the party requesting the distribution rate increase, PECO Energy Company ("PECO") has the burden of proving the justness and reasonableness of every element of its requested rate increase. 66 Pa.C.S. § 315; *Lower Frederick Twp. v. Pa. P.U.C.*, 48 Pa. Commw. 222, 226-27, 409 A.2 505, 507 (1980) (citations omitted).

2. Under Pennsylvania law, no similar burden is placed on a party proposing an adjustment to a utility base rate filing. *PUC v. Appalachian Utilities, Inc.*, Docket No. R-2015-2478098 et al., Opinion and Order entered March 10, 2016 adopting the Recommended Decision dated February 19, 2016, at 19, 2016 Pa. PUC LEXIS 62.

3. The party proposing an adjustment to a ratemaking claim bears the burden only of presenting evidence or analysis tending to demonstrate the reasonableness of the adjustment. *See, e.g., PUC v. PECO*, Docket No. R-891364, et al., Opinion and Order entered May 16, 1990, 1990 Pa. PUC LEXIS 15; *PUC v. Breezewood Telephone Company*, Docket No. R-901666, Opinion and Order entered January 31, 1991, 1991 Pa. PUC LEXIS 45.

4. The electric market in Pennsylvania was restructured following the enactment of the Electric Competition and Choice Act in 1996. 66 Pa.C.S. §§ 2801-2812.

5. PECO's rates were unbundled to show separate charges for transmission, distribution and generation services. *See, e.g., Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code*, Docket No. R-00973953 (Order entered December 23, 1997) ("*1997 Restructuring Order*").

6. Following a review of PECO's restructuring plan, the Commission found that PECO had misallocated costs by assigning the vast majority of Administrative & General ("A&G") costs, overhead and general plant expense to transmission and distribution ("T&D")

rates, without regard to whether there is a continuing generation component in that cost. *1997 Restructuring Order* at 53.

7. In 1997, the Commission found that PECO's unbundling should produce results that resemble the functional costs that would be incurred if it provided generation services through a functionally separate division. *1997 Restructuring Order* at 58.

8. In 1997, the Commission recognized that a full unbundling of PECO's rates had not been accomplished and noted the ability of any person to later challenge PECO's T&D rates so that they could be reexamined to determine if they encompass generation charges. *1997 Restructuring Order* at 50, 61.

9. Ten years after PECO's restructuring proceeding, the Commission expressed concerns about generation costs being improperly allocated or embedded in EDC distribution rates. *Default Service and Retail Electric Markets, Docket No. M-00072009 (Final Policy Statement entered May 10, 2007), 37 Pa. B. 5019 ("Policy Statement Order"),* at 8-9.

10. The price to compare ("PTC") that is charged by default service providers for default service must "be designed to recover all default service costs, including generation, transmission and other default service cost elements, incurred in serving the average member of a customer class." 52 Pa. Code § 54.187(e).

11. EDCs are prohibited from recovering default service costs through the distribution rate. When this occurs, the costs are required to be reallocated from the distribution rate to the default service rate. 52 Pa. Code § 54.187(e).

12. By allocating all indirect costs associated with serving residential customers to residential distribution service, PECO is in violation of 52 Pa. Code § 54.187(e).

13. The Commission's Default Service and Retail Electric Markets-Policy Statement adopted on May 10, 2007 lists the default service cost elements that should be included in a PTC. These elements entail the costs for providing generation service, such as wholesale energy, capacity, ancillary, transmission and congestion costs, as well as applicable taxes and costs for alternative energy portfolio standard compliance. They also include supply management costs (i.e., bidding, contracting, hedging, scheduling and forecasting services), and A&G expenses related to those activities. In addition, the Policy Statement identifies several administrative costs for inclusion in the PTC, including billing, collection, education, regulatory, litigation, tariff filings, working capital, information system, and associated A&G expenses related to default service. 52 Pa. Code § 69.1808 (a). The Policy Statement also states that "EDC rates should be scrutinized for any generation related costs that remain embedded in distribution rates." 52 Pa. Code § 69.1808 (b).

14. Following issuance of the 2007 Policy Statement, PECO filed its 2010 base rate case through which it unbundled transmission costs and working capital requirements, but did not unbundle the remaining elements identified by the 2007 Policy Statement. NRG St. No. 1 at 14.

15. In 2013, during the retail markets investigation, the Commission noted its agreement with the need for a further unbundling of commodity costs from distribution rates and indicated a desire to address these issues as they arise in distribution cases. *Investigation of Pennsylvania's Retail Electricity Market: End State of Default Service*, Docket No. I-2011-2237952 (Order entered February 15, 2013) ("*RMI End State Order*"), at 21.

16. Customers are required to receive information that allows them to compare prices and services on a uniform basis. 66 Pa. C.S. § 2807(d)(2); 52 Pa. Code § 54.1.

17. Under PECO's approach of allocating all indirect costs to residential distribution service, PECO is inflating its distribution charges and creating an artificially low PTC, which deprives customers of receiving information that allows them to compare prices and services on a uniform basis. Customers are unable to make apples-to-apples comparisons. *See Guidelines for Use of Fixed Price Labels for Products With a Pass-Through Clause*, Docket No. M-2013-2362961 (Order entered November 14, 2013) ("*Fixed Means Fixed Order*"), at 28-29.

18. PECO's PTC does not reflect all of the cost elements listed by the Commission's Policy Statement. 52 Pa. Code § 69.1808.

19. PECO has failed to carry its burden of proof in establishing that its allocation of all indirect costs associated with serving residential customers to residential distribution service is just and reasonable or in the public interest.

Appendix C

Proposed Ordering Paragraphs

NRG Energy, Inc.
Proposed Ordering Paragraphs

1. That PECO Energy Company ("PECO") is directed to modify its allocation of indirect expenses for the residential classes, using Allocation Method C that was recommended by the witness for NRG Energy, Inc., using the final revenue requirement approved by this Order, so that a proportionate amount of indirect expenses are reallocated from residential distribution service to residential default service.

2. That PECO is directed to reduce residential distribution charges to reflect the reallocation process ordered by Ordering Paragraph No. 1.

3. That PECO is directed to increase the price to compare for residential default service to reflect the reallocation process ordered by Ordering Paragraph No. 1 no later than its next quarterly adjustment.