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October 28, 2009

VIA ELECTRONIC FILING
Dorothy Wideman
Commission Secretary
Public Service Commission
of the District of Columbia
1333 H Street, N.W.
Second Floor West Tower
Washington, D.C. 20005

Re: **Formal Case No. 1053 - Phase II, In the Matter of the Application of Potomac Electric Power Company To Increase Existing Retail Rates and Charges For Electric Distribution Service**

Dear Ms. Wideman:

Enclosed for filing in the above-referenced proceeding are an original and three (3) copies of Application of the Office of the People's Counsel for Reconsideration of Commission Order No. 15556.

If there are any questions regarding this matter, please contact me at (202) 727-3071.

Sincerely,

Brian O. Edmonds
Assistant People's Counsel

Enclosure

cc: Parties of record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE DISTRICT OF COLUMBIA

In the Matter of	§	
	§	
The Application of the	§	**Formal Case No. 1053**
Potomac Electric Power Company	§	**Phase II**
For Authority to Increase	§	**(Application for Reconsideration)**
Existing Retail Rates and Charges	§	
For Electric Distribution Service	§	

APPLICATION OF THE OFFICE OF THE PEOPLE'S COUNSEL
FOR RECONSIDERATION OF COMMISSON ORDER NO. 15556

Pursuant to D.C. Code § 34-604(b) and Rule 140.1 of the Public Service Commission of the District of Columbia's ("Commission" or "PSC") Rules of Practice and Procedure, 15 D.C.M.R. § 140.1 (2006), the Office of the People's Counsel for the District of Columbia ("OPC" or "Office"), the statutory representative of District of Columbia ratepayers and consumers,[1] respectfully files this application requesting that the Commission reconsider Order No. 15556.[2]

I. INTRODUCTION

The Commission has approved a rate mechanism – the Bill Stabilization Adjustment ("BSA") – that the Commission itself acknowledges will guarantee that the Potomac Electric Power Company ("PEPCO" or "Company") will recover its revenue requirement.[3] This is a fundamental change not only in the rate design for distribution service, but in the legal and regulatory relationship between PEPCO as a public utility and its ratepayers. PEPCO is the authorized monopoly supplier of distribution service in

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[1] D.C. Code § 34-804.

[2] *Formal Case No. 1053, In the Matter of the Application of the Potomac Electric Power Company For Authority to Increase Existing Retail Rates and Charges For the Electric Distribution Service*, Order No. 15556, rel. Sep. 28, 2009 ("Order No. 15556").

[3] Order No. 15556 ay ¶ 30 ("the BSA insulates Pepco from losing revenues . . . .").

the District of Columbia – it faces no competition in the sale of distribution service and ratepayers have no alternative suppliers to turn to for this essential service if they are dissatisfied with PEPCO. PEPCO is regulated by the Commission on a cost-of-service basis precisely because it is a monopoly. Traditionally, PEPCO has been insulated from the business risk of competition, *i.e.,* as an authorized monopoly supplier of distribution service it has no competitors, but it has borne the other business risks, such as a downturn in the economy, poor weather, and other factors that could affect its revenues. Prior to Order No. 15556, PEPCO had already disposed of all of its generating assets, and thus already was decoupled from the primary risk that most utilities have associated with increased efficiency – that of failure to recover the costs of their most expensive assets. PEPCO shareholders were assured that the Company would be permitted to charge rates set at a level to afford PEPCO (and its shareholders) the *opportunity* to recover its costs and earn a return on investment committed to public utility service. In other words, PEPCO was assured that its rates would be designed to recover costs plus its allowed return, but risk factors such as weather or economic downturn could result in the Company making fewer sales and therefore earning less than its authorized level of revenue. PEPCO was not guaranteed to recover all revenues and a return.

Implementation of the BSA fundamentally changes this regulatory paradigm. The BSA shifts **all** significant remaining business risk to District ratepayers. PEPCO will be guaranteed that it will recover its distribution service revenue requirement no matter how bad the economy is, no matter how bad the weather is, and no matter how poorly PEPCO performs or how unreliable its service is. To the typical consumer, the concept of guaranteeing a company its costs plus a profit before it performs would be absurd,

because, under such a scenario, the Company would have no incentive to perform well. Yet, that is precisely what the BSA that the Commission has approved does. PEPCO shareholders are insulated from all business risk, while ratepayers are exposed to all business risk, including the risk that PEPCO will not perform well.

Assuming *arguendo* such a radical change in favor of PEPCO and its shareholders was found to be warranted, one would expect that there would be significant if not overwhelming, countervailing benefits to the ratepayers in return for their shouldering all of the business risk of once borne by PEPCO shareholders. What do ratepayers get in return for bearing this risk under the BSA? Order No. 15556 is silent regarding any lasting benefits to District ratepayers. The Commission's apparent one-time reduction in PEPCO's rate of return on equity of 50 basis points to supposedly compensate ratepayers for being exposed on a potentially permanent basis to all of the risk of PEPCO's distribution business in the District does not balance the ledger. Absent from Order No. 15556 are any findings of facts or conclusions of law establishing that the BSA is just and reasonable and that ratepayers will enjoy identified benefits.

PEPCO's justification for the BSA was not that it would reduce its required return on equity, but rather that the BSA would align "the company's interests with those of customers to foster and enhance efficient use of energy."[4] In other words, PEPCO's justification for adoption of the BSA was that it would: (1) align the Company's interests with consumers; and (2) remove impediments to the success of energy efficiency and demand response programs in the District.[5] The Commission, however, has made no

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[4] *Formal Case No. 1053, In the Matter of the Application of Potomac Electric Power Company For Authority To Increase Existing Retail Rates and Charges for Electric Distribution Service*, Application of Potomac Electric Power Company at 12, filed Dec. 12, 2006 ("PEPCO Application").

[5] *Id.*

findings of fact or conclusions of law that the BSA will accomplish these stated goals. Moreover, the Commission has ignored, without explanation, OPC evidence that the BSA will not accomplish, and will actually impede the attainment of, these goals. The Commission has also utterly failed to come to grips with a reality that is patently obvious to even the most casual observer: by guaranteeing PEPCO recovery of its revenue requirement, the Commission has removed any incentive for PEPCO to plan, operate and maintain its distribution system in a reliable manner.

District ratepayers have no choice but to purchase distribution service from PEPCO. Their only protection from abuse is the Commission. The Commission is obligated to ensure that PEPCO's distribution service in the District of Columbia is safe, adequate, and reliable and that the rates and charges for that service are reasonable, just, and nondiscriminatory.[6] The Office submits that the Commission, by virtue of the errors specified herein, has failed to meet its statutory obligations to District ratepayers.

As explained more fully in Section IV, below, the Commission is obligated to make decisions in rate cases based upon substantial evidence of record, evaluation of all presentations and arguments, and detailed findings of fact and conclusions of law, and the Commission must explain fully and clearly the reasons for its decision. Order No. 15556 does not meet these requirements. The Office therefore requests the Commission reconsider Order No. 15556, consistent with the discussion below.

II. SUMMARY OF ERRORS

OPC seeks reconsideration of Order No. 15556 because of the following errors:

1. The Commission erred by approving the BSA without articulating fully and clearly any factual or reasoned basis for finding that the BSA

[6] *See*, D.C. Code § 1-204.93.

is just and reasonable;

2. The Commission erred in failing to find or to explain how the BSA will achieve its intended goals;

3. The Commission erred in approving the BSA while failing to consider the evidence of record that, as PEPCO is a wires-only company, it is already effectively "decoupled";

4. The Commission erred in failing to address evidence and arguments advanced by the Office that demonstrate that the BSA proposed by PEPCO will actually impede energy efficiency and conservation programs within the District;

5. The Commission erred by failing to consider evidence that the BSA will remove the economic incentive for PEPCO to properly maintain the reliability of its distribution system; and

6. The Commission erred in approving as just and reasonable the BSA which effects a fundamental change in rate design that shifts all business risk to ratepayers without regard for the likely impact of the BSA on the quality of service provided to District ratepayers.

In addition to the foregoing, the Commission should clarify that, during the operation of the BSA, the public will have access to sufficient data to verify the reasonableness of the BSA adjustment.

III. BACKGROUND

On December 12, 2006, PEPCO filed an application to increase its retail distribution service rates for the District of Columbia by $50.4 million.[7] In its application, PEPCO requested, among other things, authorization to implement what it referred to as the Bill Stabilization Adjustment, a rate mechanism that would permit the Company to periodically readjust its distribution rates based on changes in average

[7] *Formal Case No. 1053,* PEPCO Application.

revenue per customer, regardless of the cause of such changes. According to PEPCO, the stated purpose of the BSA would "allow[] a better alignment of the company's interests with those of customers to foster and enhance efficient use of energy."[8]

On January 30, 2008, the Commission issued its Opinion and Order on PEPCO's rate increase and found that it "agreed with the BSA mechanism, in concept."[9] The Commission, however, did not approve PEPCO's proposed BSA, but instead established this Phase II of Formal Case No. 1053 to "address whether and how the BSA can be implemented consistent with the relevant statutory requirements regarding utility rate changes."[10]

On September 28, 2009, the Commission issued Order No. 15556, which approved the BSA to become effective on November 1, 2009. According to the Commission, the BSA is "intended to account for changes in usage due to variations in weather, customer response to price increases or energy-efficiency programs."[11] Stated differently, the BSA will shift essentially all business risk currently faced by PEPCO shareholders to District ratepayers. As discussed herein, the Commission has approved this shift without regard for the likely impact of the BSA on the quality of service provided to District ratepayers. Worse yet, the Commission has approved the BSA in order to "solve" a problem – PEPCO's purported disincentive to promote energy efficiency and conservation programs – that has never been demonstrated or found to actually exist.

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[8] *Id.* at 12.

[9] *Id.* (*citing Formal Case No. 1053, In the Matter of the Application of the Potomac Electric Power Company For Authority to Increase Existing Retail Rates and Charges For the Electric Distribution Service*, Order No. 14712 at ¶ 351 (January 30, 2008)).

[10] *Id.*

[11] *Formal Case No. 1053*, Order No. 15556 at ¶ 2.

IV. COMMISSION'S OBLIGATION IN MAKING A DETERMINATION BASED ON SUBSTANTIAL RECORD EVIDENCE IN A RATEMAKING PROCEEDING

PEPCO bears the sole burden of proof in establishing that the Company's proposed BSA is just and reasonable.[12] The D.C. Court of Appeals has indicated that, "[i]ncluded in that burden is a responsibility to develop a record sufficiently complete to support a Commission order in their favor on any contested issue."[13]

The Commission has the responsibility of ensuring that utility service in the District of Columbia is safe, adequate, and reliable and that the rates and charges for utility service are reasonable, just, and nondiscriminatory.[14] The D.C. Court of Appeals has indicated, "A utility rate cannot be deemed 'reasonable' simply because an expert agency says it is. . . . the Commission . . . has the burden of showing fully and clearly why it has taken the particular ratemaking action. Absent such comprehensive explanation, judicial review of the Commission's substantive decisions cannot be completed and the rate order finally approved – or set aside."[15] As the D.C. Court of Appeals held in deciding how to allocate the financial gain from the sale of land by a public utility:

> The Commission, as decision-maker, must evaluate all the presentations and then fashion the most just and reasonable order, including a determination of the land-gains issue. The Commission, however, cannot validly do so without furnishing detailed findings of fact and conclusions of law

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[12] D.C. Code § 2-509(b); *see also, Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d 71, 77 (D.C. 1978).

[13] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 77.

[14] D.C. Code § 1-204.93.

[15] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 75; *accord, e.g., D.C. Telephone Answering Serv. Comm. v. Public Serv. Comm'n*, 476 A.2d 1113, 1119 (D.C. 1984); *see* D.C. Code § 2-509 (e).

> sufficient to demonstrate that the overall rate determination is "in accordance with the reliable, probative, and substantial evidence."[16]

The law requires that the Commission's factual findings be based upon substantial record evidence.[17] The findings of fact shall consist of a concise statement of the conclusions upon each contested issue of fact.[18] As the Court has held, "This 'substantial evidence' test is not directed solely at the quantity of evidentiary support for an administrative determination. Equally important is the preceding language of [D.C. Code § 2-509(e)], '*in accordance with* . . . .' [Emphasis added.] There 'must be a *demonstration* in the findings of a 'rational connection between facts found and the choice made'.' Thus, as applied to ratemaking, there must be enough evidence, rationally related to the rate order (through clearly articulated criteria), to justify the Commission's decision."[19] When describing the quantity of evidentiary support requirement, the Court has held that "'substantial evidence' is 'more than a mere scintilla'; it is 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.'"[20]

In addition, "the Commission must indicate 'fully and carefully the methods by which, and the purposes for which, it has chosen to act. . . .'"[21] To satisfy this requirement, the Commission must state on the record the criteria governing its decision

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[16] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 77 (internal citations omitted); *accord* D.C. Code § 2-509(e); *Chesapeake & Potomac Tel. Co. v. Pub. Serv. Comm'n,* 339 A.2d 710, 714.

[17] *See, e.g., Office of People's Counsel v. Pub. Serv. Comm'n*, 571 A.2d 206, 209 (D.C. 1990) (quoting *Atlantic Tel. Co. v. Public Service Comm'n*, 390 A.2d 439, 441 (D.C. 1978)).

[18] D.C. Code § 2-509(e).

[19] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 77 (citations omitted).

[20] *Id.* at n. 6 (internal citations omitted).

[21] *Washington Gas Light Co. v. Pub. Serv. Comm'n*, 450 A.2d 1187, 1193 (D.C. 1982) (quoting *In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968)).

and must explain how its particular decision applies these criteria to the facts of the case.[22] In describing the criteria governing a rate determination, the Commission must balance both consumer and shareholder interests. The D.C. Court of Appeals has stated, "'[the] consumer interest cannot be disregarded in determining what a 'just and reasonable' rate . . . . is and the rate itself cannot be 'exorbitant.' Equitable factors from the ratepayer perspective, therefore, are equally a part of the just and reasonable rate calculus. "[23] Moreover, the Commission must "fully and clearly explain its decision" and demonstrate "'a rational connection between the facts found and the choices made;"[24] and is not permitted to rely on "factual misstatements that lack evidentiary support in the record."[25]

Regarding the Commission's duty to explain clearly how its criteria are satisfied by the rate order, i.e., how it arrived at the particular result, the Supreme Court has noted, "Judicial review of the Commission's orders will . . . function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act . . . ."[26] "The methodology must be disclosed for the bearing it may have on that overall judgment. Absent precise explanation of methodology as applied to the facts of the case, there is no way for a court

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[22] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 75, supplemental opinion and dissent, 404 A.2d 541 (D.C. 1979), cert. denied, sub nom *Potomac Electric Power Co. v. Pub. Serv. Comm'n*, 444 U.S. 926 (1979).

[23] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 76 (citations omitted).

[24] *Office of the People's Counsel*, 979 A.2d at 726 (*citing Potomac Elec. Power Co. v. Pub. Serv. Comm'n*, 661 A.2d 131, 135 (D.C. 1995)).

[25] *Id* at 727.

[26] *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968).

to tell whether the Commission, however expert, has been arbitrary or unreasonable."[27] The Commission's findings of fact cannot be upheld on appellate review if they are "unreasonable, arbitrary, or capricious."[28]

As the Court indicated in *Washington Public Interest Org.*, the Supreme Court's requirement that the Commission create reasonably precise ratemaking criteria and explain with clarity how the facts relate to each in support of the overall rate order, "is inherent in the Commission's responsibilities under the District of Columbia Administrative Procedure Act, by which a rate order also must be tested."[29]

OPC submits that the Commission has not met these legal requirements and Order No. 15556, therefore, must be reconsidered and modified consistent with the discussion below.

V. DISCUSSION

A. THE COMMISSION ERRED BY FAILING TO ARTICULATE FULLY AND CLEARLY A FACTUAL OR REASONED BASIS FOR FINDING THAT THE BSA IS JUST AND REASONABLE.

The Commission is charged with ensuring that the rates and services provided by public utilities in the District of Columbia are reasonable, just and non-discriminatory.[30] In Order No. 15042, the Commission explicitly found "that the BSA is a rate"[31] and subsequently "deferred final judgment on Pepco's proposed Bill Stabilization Adjustment...and opened a second phase of the proceeding to consider the issue

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[27] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 76-77.

[28] D.C. Code § 34-606.

[29] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 77 (citations omitted).

[30] DC Code § 34-1101(a).

[31] *Formal Case No. 1053*, Order No. 15042 at ¶ 19, rel. Aug. 21, 2008.

further."[32] The Commission also expressly acknowledged in Order No. 15556 that Phase II of Formal Case No. 1053 was to address "whether and how the BSA can be implemented consistent with the relevant statutory requirements regarding utility rate changes."[33] The Commission's legal obligations in ruling on a rate change are well established (*see* Section III, *supra.)*, principal of which is the obligation to furnish "detailed findings of fact and conclusions of law sufficient to demonstrate that the overall rate determination is 'in accordance with the reliable, probative, and substantial evidence.'" [34] Notwithstanding its legal obligations, the Commission has approved the BSA without making the findings of fact and conclusions of law with respect to the reasonableness of the BSA that are necessary to sustain the PSC's order.

While the Commission makes the cursory conclusion that "[b]ased on the evidence presented, the Commission concludes that the BSA methodology and the components thereof are just and reasonable," this finding is unsupported in Order No. 15556 or the record and cannot withstand judicial scrutiny. The Commission must "fully and clearly explain its decision" and demonstrate "'a rational connection between the facts found and the choices made.'"[35] This requirement is even more important when the effect of the order is to impose an entirely new form of service obligation and incentives. The Commission has failed to provide this analysis in Order No. 15556 and its approval of the BSA is therefore unsustainable. As discussed below, at no point in Order No. 15556 does the Commission find or explain how the BSA will produce the benefits that

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[32] *Formal Case No. 1053*, Order No. 15187 at ¶ 2, rel. Feb. 12, 2009.

[33] *Formal Case No. 1053*, Order No. 15556 at ¶ 2

[34] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 77; D.C. Code § 2-509(e); *Chesapeake & Potomac Tel. Co. v. Public Service Comm'n*, 339 A.2d 710, 714.

[35] *Office of the People's Counsel*, 979 A.2d at 726 (*citing* Potomac *Elec. Power Co. v. Pub. Serv. Comm'n*, 661 A.2d 131, 135 (D.C. 1995)).

are the sole basis of and justification for its adoption. Nor does the Commission meaningfully consider or respond to several arguments raised by OPC demonstrating significant flaws with PEPCO's proposed decoupling mechanism including its shift of significant business risk to District ratepayers and its impact on PEPCO's demonstrably poor quality of service within the District.

1. The Commission erred in failing to find or to explain how the BSA will achieve its intended goals.

The BSA is a fundamental change in rate design for distribution service; an attempt to eliminate all volumetric risk from the Company's recovery of its authorized revenue requirement. PEPCO's justification for the BSA is that it will "allow [] a better alignment of the company's interests with those of customers to foster and enhance efficient use of energy"[36] and "remove [] the disincentive that the Company would otherwise face in its distribution business from encouraging conservation programs."[37] Despite the fact that these purported public policy aims were the chief arguments provided by PEPCO as support for its fundamental change in distribution service rate design, Order No. 15556 fails to make any finding of fact that the BSA will actually achieve this stated purpose and remove the disincentives that the Commission appears to believe PEPCO may have to promote the energy efficiency and conservation programs in the District.

Order No. 15556 discusses the merits of decoupling *in concept* and notes that decoupling can "further public policy goals of encouraging the development of energy efficiency or to make a utility indifferent with respect to encouraging reduced energy

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[36] *Formal Case No. 1053,* PEPCO Application at 12.

[37] Exhibit PEPCO (A) at 4:1-3.

consumption initiatives,"[38] but Order No. 15556 does not find that the actual rate proposal before the Commission – the BSA – will achieve these goals or even explain how the BSA may achieve those goals. Nor, as discussed below, does the Commission address OPC arguments and evidence that demonstrate that the BSA will not produce theses results and will likely have other, negative impacts on District ratepayers.

2. The Commission erred in approving the BSA while failing to consider the evidence of record that, PEPCO – as the wires-only company in the District – is already effectively "decoupled."

OPC has consistently argued in this proceeding that implementation of a "decoupling" mechanism is not necessary because of the nature of PEPCO's operations within the District as a wires-only company that makes no energy sales.[39] In both Phase I and Phase II of this proceeding, the Office presented evidence that PEPCO was, in effect, already decoupled because it makes no energy sales that can be depressed by the success of energy efficiency and demand response programs. Unlike the traditional vertically-integrated utility, PEPCO has already shunted off the major part of the traditional risk for electric companies; that it will not recover enough to pay for the generating assets. But it is that risk that has led to the national consideration of alternative decoupled rates. The Office also pointed out that, far from better aligning "the Company's interests with those of customers to foster and enhance efficient use of energy," at best the BSA would make PEPCO indifferent to energy conservation and energy efficiency measures,[40] an argument with which the Commission apparently agrees,[41] yet the Commission failed even to

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[38] *Formal Case No. 1053,* Order No. 15556 at ¶ 24.

[39] *Formal Case No. 1053, Phase II,* Initial Post-Hearing Brief of the Office of the People's Counsel at 3, filed May 29, 2009 ("OPC Initial Post-Hearing Brief").

[40] *Id.* at 3-4.

[41] *Formal Case No. 1053,* Order No. 15556 at ¶ 24.

discuss the fact that one of PEPCO's principal justifications for the BSA was demonstrably false. If PEPCO is already decoupled, then the basis upon which PEPCO proposed the BSA – and the presumptive reason that the Commission approved it – is completely undermined If, contrary to its own conclusion, the Commission nevertheless presumes that decoupling is necessary to align PEPCO's interests with energy efficiency and conservation programs, it must so state, make the necessary findings of fact, and reconcile the inconsistencies between that presumption and its own conclusion that the BSA makes PEPCO indifferent. The Commission has failed to take any of these essential steps.[42]

3. The Commission erred in failing to address Office evidence and arguments that demonstrate that the BSA proposed by PEPCO will actually impede energy efficiency and conservation programs within the District.

Order No. 15556 fails to address the Office's factual demonstration that implementation of the BSA would actually be detrimental to the goal of promoting energy efficiency and conservation programs within the District. OPC witness Larkin testified[43] that such programs could be harmed by implementation of the BSA because the BSA would produce an *upward* BSA adjustment to the bills of those customers who reduce their energy usage.[44] The effect of the BSA in this case would be to mute the price signal for those customers and dampen the incentive for those customers to reduce their energy consumption. In failing to consider this demonstration, the Commission has

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[42] *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) ("Judicial review of the Commission's orders will . . . function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act . . . .").

[43] *See Formal Case No. 1053*, OPC Initial Post-Hearing Brief at 50 (*citing* Phase I Exhibit OPC (H) at 17).

[44] *Id.*

once again failed to meet its statutory obligation to ensure that the BSA is just, reasonable and non-discriminatory. On reconsideration, the Commission must provide findings of fact, based upon evidence of record to justify its decision to approve the BSA.[45] More specifically, the Commission must articulate the problem it is trying to solve and explain how the BSA, as proposed by PEPCO, will solve that problem.

4. The Commission erred by failing to consider evidence that the BSA will remove the economic incentive for PEPCO to properly maintain the reliability of its distribution system.

The record in Phase I and Phase II of this proceeding is replete with evidence demonstrating the significant deterioration of PEPCO's distribution system that has occurred over the past decade. PEPCO itself acknowledged that "reliability expectations of customers, the D.C. Council and the Commission are not being met,"[46] and the Commission has found that "PEPCO's reliability when more recently compared to other utilities indicates that the Company's reliability as measured by SAIDI and CAIDI [47] is at or near the bottom."[48] The Commission ignored this evidence and its own findings in Order No. 15152 and approved the BSA without making any findings of fact with respect to the impact of the BSA on PEPCO reliability, *i.e.*, that the BSA will not result in further deterioration of PEPCO's reliability of service in the District, and without imposing any meaningful reliability standards in conjunction with the adoption of the BSA. Put another

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[45] *See, e.g., Office of People's Counsel v. Pub. Serv. Comm'n*, 571 A.2d 206, 209 (D.C. 1990) (quoting *Atlantic Tel. Co. v. Public Service Comm'n*, 390 A.2d 439, 441 (D.C. 1978)).

[46] *Formal Case No. 1053,* OPC Cross Examination Exhibit 60 (seventh page of ten).

[47] SAIDI [System Average Interruption Frequency Index] is calculated by dividing the number of customer interruption minutes by the number of customers served. CAIDI [Customer Average Interruption Duration Index] is derived by dividing the total number of customer minutes of interruption by the number of customers affected by interruptions. OPC Cross Examination Exhibit 54 at pp. 8-16 of 20.

[48] *Formal Case No. 766, In the Matter of the Commission's Fuel Adjustment Clause and Review Program*, Order No. 15152 at ¶ 60, rel. Jan. 6, 2009 ("Order No. 15152").

way, the Commission has approved the BSA mechanism that will guarantee PEPCO recovery of its authorized revenue requirement irrespective of the quality of the Company's service at a time of unquestionably poor and declining service quality and reliability by PEPCO, and in the face of evidence that the BSA could make PEPCO service quality and reliability worse in the future, without making any findings of facts concerning the BSA's impact on reliability. In substance, the approval of the BSA removes the slight connection remaining between service and profit, making PEPCO indifferent to service and to customer satisfaction.

The Commission's only discussion of the persistent service outages that have plagued PEPCO's customers for years pertains to the calculation of the BSA adjustment and not as part of an analysis of the reasonableness of the BSA itself. As discussed in the Office's Initial and Reply Briefs in this proceeding, the BSA proposed by PEPCO will remove all economic incentive for the Company to improve the reliability of its distribution system because the Company would no longer be at risk for revenues lost during service interruptions and outages.[49] Removing the slight economic incentive that the Company had to reduce outages is an important fact because PEPCO's more than a decade decline in reliability shows that it is immune to other stimuli – political, regulatory and consumer – that might encourage the Company to improve upon its dismal reliability performance.

Without meaningful criteria and enforceable penalties, the BSA does not simply decouple PEPCO's revenues from the amount of distribution service provided; rather, as OPC witness Larkin noted, the BSA decouples PEPCO's revenues from its

[49] *Formal Case No. 1053,* OPC Initial Post-Hearing Brief at 11-15; Post-Hearing Reply Brief of the Office of the People's Counsel at 3-7, filed June 12, 2009.

performance.[50] Mr. Larkin therefore proposed that the Commission: (1) adopt concrete reliability criteria and enforceable penalties for poor reliability performance if the BSA was adopted;[51] and (2) determine test year kWhs lost as included in test year revenues and then excluding any excess over that in the periodic base month, to ensure the same level of reliability associated with the approved rates.[52] The Commission notes the existence of these evidentiary demonstrations by OPC in Order No. 15556,[53] but addresses only the latter, concluding that "[c]alculating the revenue effects for every outage would be impractical due to the burden, time required to do so, and the insignificance (comparatively speaking) of the resulting dollar amount."[54] The Commission completely ignored the first recommendation, that the Commission adopt concrete reliability criteria and enforceable penalties for poor reliability performance.[55] There would be no administrative burden or difficult calculations with such a mechanism.

The Commission misstates the issue raised by the Office as a "concern over the BSA mechanism's ability to compensate customers during an extended outage was raised."[56] The Office's overriding concern has been keenly focused throughout this proceeding on remedying the already poor and continual decline in the quality of service provided by PEPCO that figures to deteriorate even further with the BSA in place.

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[50] Exhibit OPC (A) at 9:21-23.

[51] Exhibit OPC (A) at 3:7-10.

[52] Exhibit OPC (A) at 8:3-14.

[53] *Formal Case No. 1053*, Order No. 15556 at ¶ 41.

[54] *Formal Case No. 1053*, Order No. 15556 at ¶ 42.

[55] There could be no question that Mr. Larkin's' recommendations were distinct, as he testified: "I emphasize that this proposal to exclude or include outages which exceed the total kWh which were not billed during the test-year due to outages is intended as an adjunct to, not a substitute for, enforceable reliability standards that should be imposed as a condition to any approval of the BSA." Exhibit OPC (A) at 8:16-19.

[56] *Formal Case No. 1053*, Order No., 15556 at ¶ 42.

The Commission notes that PEPCO addressed extended outages "in the proposed BSA calculation by proposing a threshold outage of 10,000 customers for 24 hours before the BSA is adjusted for extended outages."[57] This too is not responsive to the Office's reliability concerns in this proceeding. As the Office demonstrated in this proceeding, these major outages are precisely the types of outages that are likely to be caused by severe weather event that cannot be avoided by improved maintenance and planning efforts by the utility.[58] Adopting such a BSA adjustment does nothing to provide an incentive for PEPCO to improve its worsening distribution service reliability and outage restoration performance for what have become its normal pattern of outages – the occurrences that most directly affect the lives and welfare of District consumers. The Commission commits plain error in Order No. 15556 by failing to address these arguments and ignoring the overarching question of the impact of the BSA on PEPCO's reliability.

B. THE COMMISSION ERRED IN APPROVING AS JUST AND REASONABLE THE BSA WHICH EFFECTS A FUNDAMENTAL CHANGE IN RATE DESIGN THAT SHIFTS ALL BUSINESS RISK TO RATEPAYERS WITHOUT COMMENSURATE OFFSETTING BENEFITS TO RATEPAYERS

PEPCO's distribution service is regulated because PEPCO is the authorized monopoly supplier of that essential service in the District. The Commission's obligation to ensure that rates are just and reasonable[59] necessarily involves a determination of whether the costs and risks to ratepayers are not outweighed by the benefits enjoyed by ratepayers. "'[The] consumer interest cannot be disregarded in determining what a 'just

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[57] *Formal Case No. 1053,* Order No. 15556 at ¶ 42.

[58] *See Formal Case No. 1053,* OPC Initial Post-Hearing Brief at 15.

[59] D.C. Code § 1-204.93 ("The charge made by any such public utility for any facility or services furnished, or rendered, or to be furnished or rendered, shall be reasonable, just, and nondiscriminatory.").

and reasonable' rate . . . . is and the rate itself cannot be 'exorbitant.' Equitable factors from the ratepayer perspective, therefore, are equally a part of the just and reasonable rate calculus. "[60] The Commission has utterly failed in this obligation.

The Commission's adoption of the BSA represents a fundamental change from the long-standing traditional regulatory paradigm in which a regulated public utility is entitled to no more than an opportunity to recover its costs and earn a return on investment. In *Bluefield Water Works & Improvement Co.*,[61] the Supreme Court held:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.[62]

The Court was careful to state that the public utility's rate must *permit,* not guarantee, the public utility to earn its return on investment. Thus, the ratemaking process is designed to provide the regulated entity with an opportunity – not the right or even an assurance – to recover profits commensurate with the risks it undertakes as a business entity. The Court made it clear that a return is not guaranteed, but rather dependent upon other factors; *i.e.*, "efficient and economical management"[63] by the utility.

Nor is there any statutory right for a regulated entity to recover its revenue requirement. As the Supreme Court explained in *Federal Power Commission v. Hope*

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[60] *Washington Pub. Interest Org. v. Pub. Serv. Comm'n*, 393 A.2d at 76 (citations omitted).

[61] 262 U.S. 679 (1923).

[62] *Id.* at 692.

[63] *Id.* at 693.

Natural Gas Co.:[64]

> The rate-making process under the [Natural Gas] Act, *i.e.*, the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. . . . From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

This is the same "just and reasonable" standard that this Commission administers under the D.C. Code.[65]

The Office has, through both phases of this proceeding, argued and factually demonstrated that the BSA was unreasonable because it would not merely protect PEPCO from the consequences of energy efficiency and demand response programs, but rather would insulate PEPCO from virtually all of its business risk.[66] For example, the evidence of record confirms that, had the BSA been in effect for 2008, PEPCO would have received an additional $11.4 million from ratepayers[67] despite the fact that in 2008 PEPCO did not implement any new energy efficiency or demand side management

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[64] 320 U.S. 591, 603 (1944) (footnotes omitted) (emphasis supplied). *See also, e.g.*, *Ellwood City, et al. v. FERC*, 731 F.2d 959, 967 (D.C. Cir. 1984) ("The Commission is required to set a rate of return commensurate with other enterprises of comparable risk and sufficient to assure that enough capital is attracted to the utility to enable it to meet the public's needs.") (citations omitted).

[65] *Washington Gas Light Co. v. Pub. Serv. Comm'n*, 450 A.2d 1187, 1193-94 (DC. App. 1982), *citing Washington Pub. Interest Organization v. Pub. Serv. Comm'n*, 393 A.2d 71, 75 (D.C. App. 1978), *cert. denied*, 444 U.S. 926 (1979) (holding the *Hope Natural Gas Co.* standard applicable the Public Service Commission); *accord Metropolitan Washington Board of Trade v. Pub. Serv. Comm'n*, 432 A.2d 343, 351 (D.C. App. 1981).

[66] *See Formal Case No. 1053*, OPC Initial Post-Hearing Brief at 27-30, 43-47 (reproducing OPC's Initial Post-Hearing Brief from Phase I of Formal Case No. 1053).

[67] OPC Cross Examination Exhibit 65.

programs.[68] In Paragraph 30 of Order No. 15556, the Commission confirms that the Office's argument is correct and finds that the effect of the BSA will be to shift the Company's business risk to District ratepayers:

> This benefit to the Company and its shareholders requires a concomitant benefit to the ratepayers who are essentially guaranteeing that the Company will collect its revenue requirement as determined in its last base rate case.[69]

This statement, while technically inaccurate[70], confirms that the Commission has approved a rate mechanism that will essentially guarantee a 100% recovery of PEPCO's revenue requirement by shifting virtually all of PEPCO's business risk to District ratepayers. PEPCO has a statutory right to seek a rate increase and the Company can file for new rates whenever it deems it necessary to do so. The Commission is obligated to grant PEPCO rates that assure PEPCO an opportunity to earn a reasonable rate of return.[71] As such, the BSA, by design, will shift all of PEPCO's business risk to District ratepayer.

The Commission acknowledges in Order No. 15556 that the adoption of a decoupling mechanism requires the Commission to "balance [the interests of] customers, the utility and its shareholder"[72] because "the utility reaps such benefits as reduced risk, less regulatory lag, and revenue stability...."[73] The Commission then finds that a 50

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[68] Exhibit OPC (A) at 20: 9-12; Tr. at 42: 1-9

[69] *Formal Case No. 1053*, Order No. 15556 at ¶ 30.

[70] The statement at Paragraph 30 of Order No. 15556 quoted above is inaccurate and should be clarified on reconsideration. The BSA, by itself, will not guarantee that PEPCO will collect its revenue requirement, it will "only" guarantee that PEPCO will recover its revenue requirement as determined in the last base rate case. The Company will not be authorized to recover new or additional costs incurred since its previous rate case unless the Company files a new rate case and obtains Commission approval for the recovery of those costs. The Commission should clarify this statement on reconsideration.

[71] *See Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[72] *Formal Case No. 1053*, Order No. 15556 at ¶ 25.

[73] *Id.* at ¶ 26.

basis point reduction in ROE in connection with the approval of the BSA "balances the ledger by providing a benefit to consumers in exchange for the benefit to the Company and shareholders of reaping lowered business risk."[74] This conclusion is flawed and incorrect.

First, the BSA does not merely reduce the Company's business risk; it eliminates all significant business risk from PEPCO and imposes it on ratepayers. As noted above, this is a fundamental change in rate theory – a legal monopolist being guaranteed recovery of its revenue requirement, and therefore its return on investment – with all business risk shifted to the captive customers of the monopolist. The Commission has made no effort to evaluate the magnitude and likely consequences of the risks to which ratepayers are now to be subjected. The failure to consider the implications of its BSA approval decisions on ratepayers is the essence of a lack of reasoned decision-making.

Second, the Commission has failed in any way to justify its apparent conclusion that a 50 basis point reduction in ROE compensates ratepayers for the increased risk. As noted above, the Commission has not evaluated the magnitude or implications for ratepayers of the risk shifted to them. Nor has the Commission attempted to calibrate its potentially one-time downward adjustment to ROE in this proceeding with what appears to be a long-term shift of PEPCO business risk to District consumers. While PEPCO's ROE will be reset in its next base rate case (which, as the Commission is aware, has already been filed), the BSA is likely to impact rates on a much more protracted basis.

The Commission also cannot put on the ratepayers' side of the "ledger" any supposed benefit from improved energy efficiency and conservation programs in the District. As discussed above, the Commission has failed to make any finding of fact that

[74] *Id.* at ¶ 30.

the BSA will actually achieve its ostensible (or any other legitimate) purpose or to consider arguments that the BSA will actually deter energy efficiency and conservation programs in the District. The BSA is a concrete and verifiable benefit to the Company and its shareholders provided at the expense of District ratepayers. District consumers should not receive only speculative benefits from a mechanism that the Commission has failed to find will even deliver any actual value to energy efficiency and conservation programs.

Finally, even if one assumes that the 50 basis point ROE reduction is an appropriate reflection of the additional risk that ratepayers will bear under the BSA, the Commission has failed to make any meaningful attempt to quantify and compensate ratepayers for the detrimental impact of the BSA on reliability in the District. As discussed in section IV.A.3 above, the likely impact of the BSA is a further degradation of the quality of service that District ratepayers receive from PEPCO. Order No. 15556 ignores and removes these significant concerns from the BSA "ledger."

C. THE COMMISSION SHOULD CLARIFY THAT THE PUBLIC WILL HAVE ACCESS TO SUFFICIENT DATA TO VERIFY THE REASONABLENESS OF THE BSA ADJUSTMENT.

The Commission states in Order No. 15556 that its goal with respect to the BSA reporting requirements is to ensure that "the Commission and interested parties will be able to assess the success of the BSA; verify the accuracy of the adjustments; and ensure that certain standards are still being met in light of the BSA's implementation...."[75] In order to meet these goals, Order No. 15556 requires that PEPCO file with the Commission "the information contained in Exhibit (A)-4 for each customer class each

[75] *Id.* at ¶ 57.

month... [and] the workpapers supporting any estimated lost revenues caused by major outages...."[76] The Commission states that the data provided will permit interested parties to "compute the BSA."[77]

The Office agrees with the Commission that, if the BSA is implemented, interested parties must have access to the documents and data necessary to verify and calculate the BSA. Order No. 15556 implies, however, that the Commission and the public will only receive workpapers associated with the computation of lost outage revenue and no workpapers underlying the inputs to the summary sheet demonstrating the calculation of the BSA. To the extent that this is the Commission's intent, Order No. 15556 is insufficient. In order to achieve the Commission's stated goals for the BSA reporting requirements, the public must have access to the workpapers and materials underlying the figures that are reported on Exhibit (A)-4 so that they can test and verify the inputs to the BSA and not merely certify that the BSA arithmetic was properly calculated. The Commission should therefore require that PEPCO file all necessary BSA calculation supporting documents with the Commission. The Commission should further clarify that the Office and the public will have access to and the right to review all of the documents filed with the Commission pursuant to the directives in Order No. 15556. In the absence of such a clarification, the Office seeks reconsideration of the Commission's denial of this data as an arbitrary and capricious decision inconsistent with the Commission's stated goals for the reporting requirements adopted in Order No. 15556.

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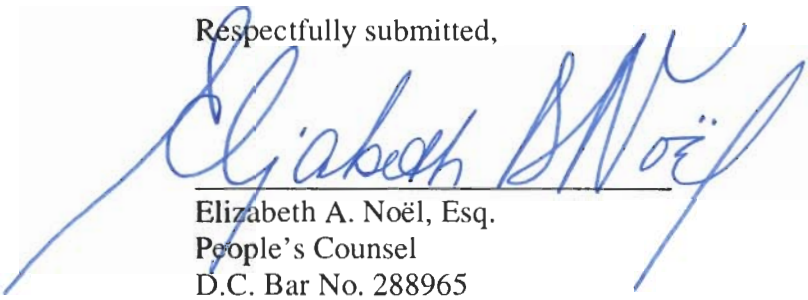
[76] *Id.* at ¶ 58.

[77] *Id.*

V. CONCLUSION

For the reasons stated above, the Commission should reconsider Order No. 15556 and reject PEPCO's BSA as unjust and unreasonable.

Respectfully submitted,



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Dated: October 28, 2009

CERTIFICATE OF SERVICE

Formal Case No. 1053 - Phase II, In the Matter of the Application of Potomac Electric Power Company To Increase Existing Retail Rates and Charges For Electric Distribution Service

I hereby certify that on this 28th day of October, 2009, a copy of the Application of the Office of the People's Counsel for Reconsideration of Commission Order No. 15556 was served on the following parties of record by hand delivery, first class mail, postage prepaid, or electronic mail:

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