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## CONSUMER ADVISORY

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### PEPCO FORMAL CASE No. 1076 RATE INCREASE REQUEST

On May 22, 2009, the Potomac Electric Power Company (PEPCO) filed a request for authority to increase existing distribution service rates and charges for electric service in the District of Columbia by \$51.7 million. According to PEPCO, the request represents an increase of approximately 13.9% in PEPCO's distribution revenues and a 6.1% **total** bill increase for a typical residential customer using 750kWh per month. The requested rates are designed to collect \$425 million in total distribution revenues. Under PEPCO's proposal, the monthly **distribution** bill increases from \$13.82 to \$20.26, an increase of \$6.44 or **46.5%** for a typical residential customer using 750kWh per month.

PEPCO is seeking a \$77.4 million increase in rate base is composed of: (1) \$30.8 million of construction; (2) \$20.6 million in additions to Prepaid Pension assets; (3) \$6.4 of unamortized expenses; and (4) \$19.4 million in changes to deferred taxes, accumulated depreciation and accumulated amortization.

#### Rate Case Summary

	Formal Case No. 1053 Order No. 14712 (1/30/08)	Formal Case No. 1076 Application
Revenue Increase	\$28,286,000	\$51,704,000
Return on Equity	10.00%	11.50% w/o BSA; 11.25% w/BSA
Rate of Return	7.96%	8.88%
Capital Structure	Long-Term Debt 53.45% Common Equity 46.55%	Long-Term Debt 46.18% Common Equity 53.82%

#### PEPCO's Goals

PEPCO has two main goals: (1) further shift business risk to ratepayers; and (2) increase its return on equity. PEPCO proposes to shift business risk by: (1) proposing to capitalize and amortize expenses that were incurred in the test year or prior to the test year for Credit Facility costs (\$143,000), Customer Education costs (\$2,483,000), Blueprint/AMI costs (\$759,000), and rate case costs (\$3,043,000) and (2) implementing a surcharge and deferred regulatory asset mechanism to recover its pension, Other Post-Employment Benefits (OPEB) and uncollectible expenses.<sup>1</sup> These three costs represent \$15.6 million (pension and OPEB are \$13.1 million) or

<sup>1</sup> The Company would recover the three-year average of these costs through a surcharge and be permitted to defer for future recovery or refund the difference between the average and the actual incurred amounts. The claimed justification for this unique treatment is the volatility of the costs. The effect of this proposal would be to essentially guarantee PEPCO recovery of these costs, thus effectively shifting all business risk associated with these costs to ratepayers, materially impairing ratepayer protection against excessive costs by subjecting the deferred costs to only an after-the-fact prudence review, and allowing PEPCO to earn a return on the deferred amounts even though those expenditures have never been determined to be just and reasonable.

16.8% of PEPCO's D.C. adjusted operation and maintenance expenses for the 2008 test year. PEPCO's losses in its pension investments during 2008 and 2009 are the major reason for the increases in its pension and OPEB expenses. PEPCO has a defined benefit plan that promises a monthly check to the employee at retirement based on a set formula.

### **Pension and OPEB**

In addition to the pension and OPEB expense costs for the test period, PEPCO has included \$44,151,000 in rate base for the test year to compensate for its "Prepaid Pension and OPEB." The annual cost of this prepaid asset in this case at PEPCO's proposed 11.5% ROE is \$5,583,000. OPC opposed the inclusion of this asset in Formal Case No. 1053, but the Commission ruled in PEPCO's favor. In that case the rate base amount was only \$23,294,000 and the annual cost to ratepayers was \$2,621,000. This prepaid pension asset represents amounts paid into the pension fund that are in excess of the amounts charged to expense and further increase the cost to ratepayers of the Company's pension program.

### **PEPCO's Construction Budget**

PEPCO proposes a 2009 construction budget of \$126.8 million (\$112.8 million for distribution, \$12.1 million for transmission, and \$1.9 million for other), not including the Blueprint/AMI and Mid-Atlantic Power Pathway transmission costs. This is a portion of the overall PEPCO construction budget of \$260.4 million.

Distribution Budget Areas	General Scope of Work	PEPCO's Investment 2006-2008	PEPCO's 2009 Budget
Customer Driven	Projects required by customers, including connecting them to the distribution system and work performed at the direction of the D.C. Government such as plant relocations	\$40.7 million in 2006 \$37.3 million in 2007 \$63.2 million in 2008  TOTAL: \$141.2 million	\$38.5 million
Reliability	Projects to increase electric reliability along with emergency and planned work to replace and upgrade components of the electric distribution system	\$20.0 million in 2006 \$20.3 million in 2007 \$43.0 million in 2008  TOTAL: \$83.3 million	\$54.4 million
Load	Projects related to electric capacity and system load	\$87.1 million in 2006 \$118.4 million in 2007 \$124.3 million in 2008 TOTAL: \$329.8 million	\$19.9 million

Source: Direct Testimony of PHI Senior Vice President for Asset Management and Planning William M. Gausman Table 3 at 6.

### **Depreciation**

PEPCO has prepared a new depreciation study and the calculations of depreciation expense incorporate those new depreciation rates. The new rates increase test period expense by \$5.8 million.

### **PHI Service Company**

PEPCO indicates that, in two years, expenses have increased by \$10.7 million to \$87.9 million. PEPCO also proposes test period adjustments totaling an additional \$5.1 million. The \$93 million included as test year O&M expense is 20.5% higher than the O&M expenses in the last rate proceeding. A substantial part of the increase comes from the PHI Service Company.

In the 2008 rate case order, the D.C. PSC directed PEPCO to procure the services of a contractor to conduct an independent audit of PHI Service Company costs allocated to PEPCO-

D.C and to file a benchmarking or industry study of the PHI service Company costs to support their reasonableness. The study prepared by The Hackett Group concluded that PHI Service Company's costs are in-line with its peers and therefore reasonable. Given the significant portion of PHI Service Company costs being shifted to PEPCO's D.C. utility, these costs will be examined carefully.

**Formal Case No. 1076 Distribution Rate Changes for Residential Classes**

<u>Rate Schedule</u>	<u>Current Rates</u>		<u>Proposed Rates</u>	
	Summer	Winter	Summer	Winter
Residential - Standard (R)				
Customer Charge	\$ 2.00	\$ 2.00	\$ 2.93	\$ 2.93
First 400 kWh	\$ 0.00945	\$ 0.00945	\$ 0.01385	\$ 0.01385
In Excess of 400 kWh	\$ 0.02796	\$ 0.01942	\$ 0.04098	\$ 0.02846
Residential - All Electric (AE)				
Customer Charge	\$ 2.00	\$ 2.00	\$ 3.10	\$ 3.10
First 400 kWh	\$ 0.00945	\$ 0.00945	\$ 0.01467	\$ 0.01467
In Excess of 400 kWh	\$ 0.02796	\$ 0.01552	\$ 0.04339	\$ 0.02408
Residential Time-of-Use (RTM)				
Customer Charge	\$ 9.09	\$ 9.09	\$ 11.17	\$ 11.17
kWh Charge	\$ 0.03717	\$ 0.03717	\$ 0.04566	\$ 0.04566

**Formal Case No. 1076 Distribution Rate Impact for Residential Classes**

<u>Rate Schedule</u>	<u>Average Monthly Usage</u>	<u>Monthly Increase Distribution Bill Only</u>		<u>Monthly Increase for SOS Customers Total Bill</u>	
		<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Residential – Standard (R)	641	5.26	29.3	5.26	6.0
Residential – All Electric (AE) 786		7.59	34.7	7.59	6.9
Residential Time-of-Use (RTM)	4,047	36.44	18.1	36.44	5.4