Maillog No. 333746

ORDER NO. 92607

Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy	* * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND CASE NO. 9820

ORDER ON APPLICATION FOR ADJUSTMENTS TO RETAIL RATES

Before: Kumar P. Barve, Chair
Frederick H. Hoover, Jr., Commissioner
Bonnie A. Suchman, Commissioner
Odogwu Obi Linton, Commissioner
Ryan C. McLean, Commissioner

Issued: August 28, 2026

APPEARANCES

For Potomac Electric Power Company: Anne Bancroft; Douglas E. Micheel; Kimberly A. Curry; Matthew Segers; Taylor Beckham

For the Maryland Office of People's Counsel: Brock Miller; Jacob M. Ouslander; Michael F. Sammartino; Pauline G. Raisis; Ryan Hsu

For the Maryland Public Service Commission Staff: Chana S. Wilkerson; Harrison Scherr; Lloyd Spivak; Michael Dean; Ruthie Herman

For the Maryland Energy Administration: Bhaveeta K. Mody; David Shapiro; Gelane L. Diamond; Jeffrey C. Genzer; Kevin M. Kurzeja; Michele Honick; Nina Z. Wu; Sondra Simpson McLemore; Steven Talson; Thomas L. Rudebusch

For the Apartment and Office Building Association of Metropolitan Washington: Erin B. McAuliffe; Frann G. Francis; and Joshua M. Greenberg

For Montgomery County, Maryland: Diane Kilcoyne; Garrett Fitzgerald

For Prince George's County, Maryland: James McGee; Stephen J. Williams

For Chevy Chase Village, Town of Washington Grove, City of College Park, City of Gaithersburg, Section 3 of The Village of Chevy Chase, and the Village of North Chevy Chase: Suellen M. Ferguson

For the U.S. General Services Administration: Richard Owen Hughes

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I. INTRODUCTION AND EXECUTIVE SUMMARY

On October 14, 2025, Potomac Electric Power Company ("Pepco" or "the Company") filed an Application with the Commission seeking approval of distribution rates using a fully forecasted test year. In accordance with the requirements set forth in Order No. 91181,[1] Pepco also included record support for developing a revenue requirement using a traditional historic test year (Pepco's "TTYCF" or "Traditional Test Year Compliance Filing").

On October 15, 2025, the Commission suspended the proposed tariff revisions for an initial period of 270 days from November 13, 2025.[2] On April 14, 2026, Pepco filed a letter with the Commission, withdrawing its fully-forecasted test year application and stating that it is proceeding only with its traditional historic test year case.[3] In its correspondence, Pepco referenced the imminent passage of the Utility RELIEF Act, which prohibits the Commission from approving utility rate increases based on fully forecasted test years while the Commission considers the merits of using forecasted test years versus historical models.[4]

The Commission's statutory responsibility governing its rate-setting authority to set "just and reasonable" rates is codified at *Annotated Code of Maryland,* Public Utilities Article, ("PUA") §§ 4-101, 4-102 and 4-201. For a rate to be just and reasonable, the rate:

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[1] Order No. 91181 at 30, Case No. 9702, *Potomac Elec. Power Co.'s Application for Adjustments to its Retail Rates for the Distribution of Electric Energy,* (Jun. 10, 2024) ("Order No. 91181") ("The form of the Company's next rate case can be any of its choosing, so long as its application is accompanied by the requisite information needed to calculate a historic test year.").
[2] Order No. 91903.
[3] Maillog No. 328927.
[4] Utility RELIEF (Reducing Energy Load Inflation for Everyday Families) Act, HB 1532, SB 841 (2026), Md. Laws 2026, Ch. 353.

(1) cannot violate any provision of the PUA, (2) must "fully consider and be consistent with the public good," and (3) must "result in an operating income … that yields, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a reasonable return on the fair value of the public service company's property used and useful in providing service to the public."[5]

In considering the Company's proposed rate increase, the Commission was mindful of the burden that the increased electric utility rates place on customers, especially residential ratepayers. Numerous comments were received in this case regarding cost or affordability concerns that customers face with current utility bills. Additionally, these concerns are evident in actions the General Assembly has taken over the last two sessions including multiple credits to residential customers of money from the Strategic Energy Investment Fund and restrictions upon certain types of costs that utilities can recover from ratepayers.

In making our determination, we note that several adjustments requested in this case were well past the test year. At a time when affordability is of paramount concern for customers, adjustments that attempt to mitigate monetary pressures on the utility due to the passage of time (referred to as regulatory lag) need to be carefully scrutinized as to their appropriateness.

The Commission has reviewed the evidence and testimony presented, including the comments received at the public hearings in reaching the decisions in this Order. Based on the record, the Commission authorizes Pepco to increase its electric distribution rates as provided in Table 1 below.

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[5] PUA § 4-101.

Table 1
Pepco Requested vs Authorized Revenue Requirement and Associated Bill Impacts

	Incremental Revenue Requirement	Residential Bill Impact ($/month)	Total Bill Impact - Montgomery County	Total Bill Impact - Prince George's County
Pepco Requested[6]	$119,876,000	$10.24	5.85%	5.79%
Commission Authorized	$50,946,000	$3.94	2.25%	2.23%

II. BACKGROUND

On October 14, 2025, Pepco filed its Application seeking authority for a base rate revenue increase of $133 million per year, along with supporting testimony, exhibits, and related tariff revisions with a proposed effective date of April 1, 2026. The Application included proposed tariff revisions and the direct testimony and exhibits of the following individuals: Robert T. Leming, Elizabeth M. Downs O'Donnell, Conor Nelson, David L. Vosvick, Amber M. Perry, Peter R. Blazunas, Lance C. Schafer, Samuel F. Williams, Taiwo O. Alo, Adrien M. McKenzie, John T. Coursey, and Sugandha Tuladhar.

The Commission docketed Pepco's Application as Case No. 9820 and issued Order No. 91903, which suspended the proposed new rates pursuant to PUA § 4-204(b)(2) for 270 days from their original effective date. That Order also set a deadline for the filing of petitions for intervention and scheduled a virtual prehearing conference.

[6] Nelson Surrebuttal Testimony at Schedule (CN-SR)-1 at 2 and Pepco Brief at 5.

On November 18, 2025, a prehearing conference was conducted; the Commission considered petitions to intervene and addressed other pending preliminary matters. Attorneys representing Pepco, Apartment and Office Building Association of Metropolitan Washington ("AOBA"), Maryland Office of People's Council ("OPC"), Montgomery County, Maryland ("Montgomery County"), Maryland Energy Administration ("MEA"), and the Commission's Technical Staff ("Staff") appeared at the pre-hearing conference.

On December 8, 2025, the Commission issued Order No. 92072, which set a procedural schedule for filing of testimony, hearings for cross-examination of witnesses, and filing of briefs and reply briefs. It also set forth procedures for discovery and directed the parties to arrange hearings for receipt of public comment.

On December 18, 2025, Pepco filed the Supplemental Direct Testimony of Conor Nelson, Peter R. Blazunas, and Lance C. Schafer. On January 6, 2026, Pepco filed an Errata to Direct Testimony for Robert T. Leming, Amber M. Perry, and Sugandha Tuladhar.

On January 30, 2026, the following parties made filings. Staff filed the Direct Testimony of Brandon Bowser, Lytangia Bunch, Oladipo Fadeyi, Alessendro Lee, Christopher Lo, David Hoppock, Drew McAuliffe, and Mark Rielly. OPC filed the Direct Testimony of Colin T. Fitzhenry, David J. Garrett, Ben Havumaki, Dustin M. J. Madsen, and Melissa Whited. MEA filed the Direct Testimony of Joyce Lombardi, Steven Kihm, and Nikhil Balakumar. AOBA filed the Direct Testimony of Bruce Oliver and Timothy Oliver.

On March 11, 2026, the following parties made filings. Pepco filed the public Rebuttal Testimony of Robert T. Leming, Conor Nelson, David L. Vosvick, Amber M. Perry, Peter R. Blazunas, Lance C. Schafer, Samuel F. Williams, Adrien M McKenzie, John T. Coursey, and Sugandha Tuladhar; and confidential filings for Elizabeth M. Downs O'Donnell and Taiwo O. Alo. Staff filed the Rebuttal Testimony of Brandon Bowser and David Hoppock. On April 6, 2026, Pepco filed the Supplemental Direct Testimony of Robert Leming, and Supplemental Rebuttal Testimony of Elizabeth M. Downs O'Donnell.

On April 14, 2026, April 17, 2026, and May 27, 2026, the Commission held Public Comment Hearings for the purpose of soliciting public comments. Written comments were also solicited from the public.

On April 16, 2026, the following parties made filings. Pepco filed the Surrebuttal Testimony of Conor Nelson, David L. Vosvick, Peter R. Blazunas, and John T. Coursey. Staff filed the Surrebuttal Testimony of Brandon Bowser, Lytangia Bunch, Odalipo Fadeyi, David Hoppock, Alessendro Lee, Christopher Lo, Drew McAuliffe, and Mark Rielly. OPC filed the Surrebuttal Testimony of Colin T. Fitzhenry, David J. Garrett, Ben Havumaki, Dustin M. J. Madsen, and Melissa Whited. MEA filed the Surrebuttal Testimony of Joyce Lombardi, Steven Kihm, and Nikhil Balakumar. On April 21, 2026, AOBA filed the Surrebuttal Testimony of Bruce Oliver.

On April 23, 2026, Staff filed the Supplemental Surrebuttal Testimony of Brandon Bowser, Alessendro Lee, and Christopher Lo. On April 28, 2026, AOBA filed the Supplemental Surrebuttal Testimony of Bruce Oliver. On May 1, 2026, OPC filed the Revised Direct Testimony and Revised Surrebuttal Testimony of Dustin M. J. Madsen, and the Revised Direct and Revised Surrebuttal Testimony of Colin T. Fitzhenry.

On April 27-30, 2026, evidentiary hearings were held. On June 17, 2026, Pepco, Staff, OPC, MEA, and AOBA filed Initial Briefs. On July 1, 2026, Pepco, Staff, OPC, MEA, AOBA filed Reply Briefs.

III. DISCUSSION AND FINDINGS

A. Revenue Requirement and Adjustments

1. Pepco's historic test year revenue request

In its Application, Pepco requested the Commission approve rates premised on a traditional test year (a "TTY" or "Traditional Test Year") ending September 30, 2025. In the initial filing, Pepco included nine months of actual data and three months of forecasted data,[7] but over the course of the case, Pepco updated its requested revenue requirements multiple times for actual data. Pepco's final incremental requested revenue requirement is $119.9 million based on a rate base of $3.2 billion and an operating income of $165.9 million with a rate of return ("ROR") of 7.85%.[8]

The table below identifies each party's recommended rate base, operating income, and recommended revenue requirement previously summarized on the Comparison Chart filed by Staff in the docket (attached to this Order as Appendix B) but updated to be premised upon Pepco's previously authorized ROR.[9] Using that previously authorized ROR, the table shows the parties each recommended revenue increases in a range of $26.0 million to $87.7 million.

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[7] AOBA raised concerns about Pepco's compliance with the Commission's directive in Order No. 91181 to include "the requisite information needed to calculate a historic test year," given that Pepco initially filed with a historic test year that included forecasted data, rather than twelve months of historic data. B. Oliver Direct Testimony at 6-8. The Commission accepts Pepco's filing as consistent with general practice in historic test year cases to update with actuals subsequent to the initial filing.
[8] Nelson Surrebuttal Testimony at schedule (CN-SR)-1 at 1.
[9] *See* Revised Staff's Post Hearing Revenue Requirement Comparison Chart, filed May 21, 2026, Maillog No. 330372.

Table 2:
Proposed Revenue Requirement Increase by Party Using Previously Authorized ROR (Per Staff's Comparison Chart)

	Pepco	Staff	OPC	AOBA	MEA
Rate Base	$ 3,207,684	$ 3,155,481	$ 3,037,658	$ 2,785,798	$ 3,067,359
Rate of Return	7.13%	7.13%	7.13%	7.13%	7.13%
Required Income	$228,708	$224,986	$216,585	$ 198,627	$ 218,703
Adjusted Operating Income	$ 165,913	$ 172,307	$ 177,008	$ 180,035	$ 165,950
Operating Income Deficiency	$ 62,795	$ 52,679	$ 39,577	$ 18,592	$ 52,753
Incremental Revenue Requirement[10]	$ 87,737	$ 73,603	$ 55,297	$ 25,983	$ 73,721

Once the parties' proposed rates of return are then incorporated, the parties' proposed revenue increases are in the range of $14.98 million to $119.9 million (see Table 3 below).

[10] After applying a conversion factor of 1.3972.

Table 3:
Proposed Revenue Requirement Increase by Party Using Each Parties Proposed ROR (Per Staff's Comparison Chart)[11]

	Pepco	Staff	OPC	AOBA	MEA
Rate Base	$3,207,684	$3,155,481	$3,037,658	$2,785,798	$3,067,359
Rate of Return	7.85%	7.28%	6.18%	7.24%	7.07%
Required Income	$251,803	$229,719	$187,727	$201,604	$216,862
Adjusted Operating Income	$165,913	$172,307	$177,008	$180,035	$165,950
Operating Income Deficiency	$85,890	$57,412	$10,719	$21,569	$50,912
Incremental Revenue Requirement[12]	$120,006	$80,216	$14,977	$30,142	$71,149

For the reasons set forth in the remainder of this Order, the Commission authorizes a revenue requirement increase of $50.9 million based on a rate base of approximately $2,994,612,000, operating income of approximately $179,748,000, and ROR of 7.22%.

2. Pepco's Ratemaking Adjustments

As part of its Application, Pepco requested a number of pre- and post-test year Ratemaking Adjustments ("RMAs") to modify the historic test year revenue requirement. Certain RMAs are disputed by the parties. Those that are not disputed are accepted, unless stated otherwise herein.

[11] Does not match exactly with the comparison chart due to rounding.
[12] After applying a conversion factor of 1.3972.

a. RMA 1—Annualization of Test Year Reliability Plant Closings

OPC proposed modifications to RMA 1 to reflect the disallowance of certain costs in order to avoid creating a separate RMA.[13] AOBA also raised concerns that RMA 1 included costs for the White Flint project, to which AOBA objects.[14] Those proposals and projects are discussed below, but RMA 1 is otherwise undisputed and is accepted.

b. RMAs 2, 3, and 4 - Inclusion of Post Test Year Reliability Closings

<u>*Pepco*</u>

Pepco proposed three RMAs for post-test year reliability closings, respectively covering the periods of October 2025 through March 2026 (RMA 2), April 2026 through July 2026 (RMA 3), and August 2026 and July 2027 (RMA 4).[15] Pepco witness Nelson testified that these RMAs relate to construction work in progress and reflect the known and measurable costs of projects that were placed into service after the test year or are forecast to be placed into service during the rate-effective period of this proceeding.

<u>*OPC*</u>

OPC witness Madsen argued that the Commission should disallow the costs reflected in RMAs 3 and 4 because they were not known and measurable and thus are unmatched to the revenues and other costs reflected in rates.[16] On brief, OPC argued further that RMA 4 includes plant that is unlikely to have been placed into service prior to the time

[13] Madsen Revised Clean Surrebuttal Testimony at 27.
[14] B. Oliver Direct Testimony at 24-27.
[15] Nelson Direct Testimony at 11-14.
[16] Madsen Revised Clean Surrebuttal Testimony at 27-28.

of the hearing, and that the record does not identify which specific plant additions from RMA 3 might have gone into service by the time of the hearing beginning May 1, 2026.[17] OPC also points to five recent historic test year Pepco rate cases where the Commission rejected adjustments reflecting post-hearing reliability plant additions for failing to meet the known and measurable standard.[18] Mr. Madsen recommended revisions to RMA 2 to ensure it reflected known and measurable costs as of April 27, 2026.[19]

AOBA

AOBA witness Bruce Oliver recommended that the Commission reject RMAs 2, 3, and 4, arguing that they do not represent known and measurable costs and that Pepco has not established that its forecasts are reliable.[20] AOBA also argued that Pepco has not established the prudency of the capital costs included in these RMAs, both as to planning decisions, execution, and as to the overall costs incurred.[21]

Staff

Staff recommended allowing RMA 2, which had been revised to only include actual plant closings.[22] Staff argued against the inclusion of RMAs 3 and 4 because the costs were not projected to be in service prior to the end of evidentiary hearings. Staff witness Rielly noted previous Commission decisions to reject post-hearing reliability additions.[23]

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[17] OPC Brief at 18.
[18] *Id*. at 19-20, *citing* Case Nos. 9602, 9443, 9418, 9336, and 9311.
[19] Madsen Revised Clean Direct Testimony at 14.
[20] B. Oliver Direct Testimony at 25-28.
[21] B. Oliver Surrebuttal Testimony at 23.
[22] Staff Brief at 12-13; Hearing Transcript ("Hr'g. Tr.") Volume 5 at 1345-1348.
[23] Rielly Direct Testimony at 14-15, *citing* Case Nos. 9602, 9443, and 9418.

Staff witness Rielly also testified that, in response to Staff Data Request No. 54, Pepco revised RMAs 3 and 4 (concerning non-revenue producing projects that did not go into service during the test period) on April 8, 2026 and Pepco would need to issue a revised TTY revenue requirement.[24] Mr. Rielly testified that the amounts in RMAs 3 and 4 are also not known and measurable. He testified that a cost activity must have happened or there must be substantial evidence that an activity will occur and be supported by contracted, legal, or other enforceable obligations, and also have quantitative effects that are measurable with reasonable certainty and accuracy. Mr. Rielly testified that RMAs 3 and 4 did not meet these requirements and thus Staff recommended those components be removed. He testified that this reduced the rate base by $19,306,000 and $39,865,000, respectively, with a corresponding adjustment to depreciation expense.

Mr. Rielly also testified that Staff is concerned with the adequacy of Pepco's internal controls to accurately identify and allocate the Maryland portion of joint Pepco DC-MD projects, for which Pepco failed to provide the Maryland allocation amounts for eight individual projects.[25]

Pepco Rebuttal

Pepco witness Nelson argued that the Commission has routinely approved adjustments placed into service between the end of the test period and the date of the evidentiary hearings, including Case Nos. 9602, 9443, and 9418.[26] Mr. Nelson testified that these amounts are known and measurable and in-service.[27] He testified that the timeline on

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[24] Rielly Surrebuttal Testimony at 3-4.
[25] *Id*. at 2.
[26] Nelson Rebuttal Testimony at 23.
[27] *Id*. at 23-24.

which Pepco provided updates to data in this case is similar to those of prior proceedings, with all data from October through February 2026 being provided more than a month prior to submission of the parties' surrebuttal testimony.

Regarding plant closings from April 2026 through July 2027, Mr. Nelson testified that those projects provide reliability benefits while rates approved in this proceeding are in effect.[28] He testified that, although the Commission has not previously approved post-test year reliability RMAs in the past in which the actual plant additions were not provided to the parties prior to the evidentiary hearings, timing alone should not alter the result. Mr. Nelson stated that Pepco would be willing to true-up any variances between projected amounts and actual amounts via a compliance filing and adjustment to rates after the final order in this proceeding. He argued that the Commission has approved other post-hearing adjustments when necessary to align rates with conditions during rate-effective periods, such as annualized wage increases in Case No. 9418.

COMMISSION DECISION

The inclusion of post-test period reliability expenses is an exception to the rule of allowing recovery of reliability investments only from within the historic test period.[29] That exception was adopted in Case No. 9418 as an attempt to incentivize Pepco to make accelerated reliability infrastructure investments during a period of poor reliability performance.[30] Although permitting such late RMAs may act to reduce regulatory lag, it also goes against the traditional test year model (where expenses and revenues are drawn

[28] Nelson Rebuttal Testimony at 25-26.
[29] Case No. 9418, *In the Matter of the Application of Potomac Elec. Power Co. for Adjustments to its Retail Rates for the Distribution of Electric Energy*, Order No. 87884 at 35.
[30] *Id*.

from the same time period, an approach known as the "matching principle") and in the cases of RMAs 3 and 4 are not known and measurable adjustments.[31] Additionally, the inclusion of such costs also reduces the amount of time for parties to review and respond to new projects. Subsequent to Case No. 9418, the Commission found that, in light of Pepco's improved reliability performance, the justification for this reliability exception was lessened.[32] Moreover, the Commission has not historically favored post-test year adjustments that do not meet the standard of known and measurable, nor has it generally authorized more than three months of post-year reliability adjustments.[33]

Consistent with that practice, the Commission finds that RMAs 2, 3, and 4 should not be included for any projects placed in service after January 31, 2026. While this is longer than the three months the Commission has previously cited as permissible, these costs were known and measurable by the time the Company filed rebuttal testimony such that parties were able to address these plant additions within their surrebuttal filings. At the same time, the Commission cautions that post-test year reliability adjustments are not guaranteed and will continue to be reviewed on a case-by-case basis to determine whether they are necessary to incentivize reliability improvements going forward. The Commission notes that Pepco's reliability is good and that Staff witness Lo observed, in the case of at least one project included in Pepco's proposed RMA 2, Pepco has "excellent"

[31] Case No. 9311, *In the Matter of the Application of Potomac Elec. Power Co. for an Increase in its Retail Rates for the Distribution of Electric Energy*, Order No. 85724 at 14-15. The Commission rejected a RMA for costs 12 months beyond the test year noting parties' comments that it "does not represent plant additions that are currently used and useful and is inconsistent with the matching principle" and that "the Company has not even typically been able to accurately estimate future costs."
[32] *Id*. at 63.
[33] Case No. 9418, Order No. 87884 at 35-36. *See also* Case No. 9704, Order No. 90943 at 18.

SAIFI/SAIDI reliability metrics, even as it continues doing reliability work.[34] Pepco itself highlighted testimony from OPC that Pepco "has had the best [reliability metrics] in Maryland for a number of years."[35] This calls into question the need to continue consideration of lengthy post-test year adjustments.

c. RMA 9—July 2023 Major Storm Costs

Pepco

Pepco requested an RMA that amortizes over five years the incremental operations and maintenance ("O&M") storm preparation costs incurred for a July 2023 storm, including increased staffing and costs related to mutual assistance and contractor crews.[36] Pepco witness Nelson testified that these costs were never reviewed for prudency, have never been recovered, were not litigated in any prior rate case, and could not have been included in Pepco's rates because the costs were incurred outside of the schedule for developing rates in prior rate cases.[37]

AOBA

AOBA witness Bruce Oliver argued that the Commission should reject Pepco's request for a regulatory asset for July 2023 major storm costs.[38] Mr. B. Oliver testified that Pepco failed to address that the July 2023 storm event was a product of two separate storms on successive days. He pointed to testimony from Pepco witness Alo[39] that the peak level

[34] Lo Direct Testimony at 42, discussing ITN 70898 as it is specified in Pepco witness Alo's Direct Testimony.
[35] Pepco Brief at 2.
[36] Nelson Direct Testimony at 17.
[37] Nelson Rebuttal Testimony at 27.
[38] B. Oliver Surrebuttal Testimony at 6-9.
[39] Alo Direct Testimony Part 2 at 5.

of outages experienced during that two-day period impacted 29,625 customers, less than half the number of sustained customer outages required to classify it as a Major Storm Event under Code of Maryland Regulations ("COMAR") 20.50.01.03B(32). Mr. B. Oliver testified that Pepco's 2023 Annual Performance Report, filed in Case No. 9353, also identified separate thunderstorms on July 28, 2023 and July 29, 2023, which impacted 13,238 and 49,989 customers, respectively. He testified that neither storm met the 10 percent threshold for sustained customer outages. Mr. B. Oliver argued that Pepco's attempt to merge these storms together is an effort to gain special rate treatment for minor storm costs.

Mr. B. Oliver argued that Pepco witnesses Nelson and Alo failed to provide support for the prudence of the costs for the July 2023 storm event. He testified that Pepco records, including Mr. Nelson's workpapers produced in this case, showed expenditures from the storm were still accruing through June 2024. He argued that Pepco failed to explain why expenses from the storms were being incurred so long after the event.

Mr. B. Oliver testified that Pepco failed to demonstrate the prudency of increased expenditures on call center representatives and damage assessors in advance of these storms. He testified that the Commission has noted concerns with Pepco's downed wire response performance and abandoned call performance rate during the same event period.

COMMISSION DECISION

The Commission finds that the record sufficiently establishes that the July 2023 storm event, stretching over multiple days, was a single extraordinary event for purposes of recovery and therefore should receive regulatory asset treatment. Pepco met the requirements for Major Outage Event Reporting set forth in COMAR 20.50.12.13 and filed with the Commission on September 5, 2023 a Major Outage Event Report for the period starting July 28, 2023 and ending August 1, 2023.[40] The Commission also established that this multi-day storm event was a Major Outage Event when it ordered a corrective action plan to address Pepco's performance during the event in Order No. 91307.[41]

The Commission accepts that Pepco’s expenditures both before and after the event itself are the sort of expenditures that might reasonably be expected to be incurred in responding to such emergency storm events. The Commission notes the concerns raised regarding Pepco’s downed wire performance and abandoned call performance rate during the relevant period. The Commission will continue to monitor Pepco’s performance going forward but is not persuaded that these issues create a genuine issue as to prudency of the expenditures. RMA 9 is approved as requested.[42]

d. RMA 10—Current Rate Case Expenses

Pepco

In RMA 10, Pepco requested an adjustment to recover the incremental costs associated with this rate case to be amortized over a three-year period.[43]

OPC

OPC witness Madsen testified that, while the Commission directed Pepco to provide the requisite information to calculate a historic test year, the Commission did not direct Pepco to file a forecasted test year and supporting testimony.[44] Mr. Madsen argued

[40] Maillog No. 304877.
[41] Maillog No. 312076 at 37.
[42] *See* B. Oliver Rebuttal Testimony at 8-9.
[43] Nelson Direct Testimony at 17.
[44] Madsen Revised Clean Surrebuttal Testimony at 11-12.

it is therefore improper for customers to bear the cost of Pepco's decision to prepare an alternative ratemaking proposal. He also testified that this recommendation took into consideration the fact that Pepco failed to provide actual and forecast rate case costs for its TTYCF.

On brief, OPC argued that Pepco unreasonably failed to make any effort to demonstrate what portion of its rate case expenses were attributable to the historic test year, versus the forecasted test year, and thus all rate case expenses should be disallowed.[45] OPC also argued that Pepco's proposal for a single-year forecasted rate case without reconciliation was an attempt to bypass the Commission's pending review of forecasted test-year ratemaking lessons learned, and customers should not be forced to pay for Pepco's attempt to propose a new policy.[46] OPC also argued that Pepco should not be allowed to earn a return on any rate case expenses, arguing that rate case expenses are not eligible to earn a ROR.[47]

AOBA

AOBA witness Bruce Oliver also challenged Pepco's request for recovery of rate case expenses.[48] Mr. B. Oliver argued that Pepco failed to provide evidence to support its claim that the estimated current rate case costs are informed by actual incurred costs in litigating prior cases. He argued that the fact that Pepco has contracted for vendor services does not render those costs necessary, reasonable, or prudent. He further argued that costs

[45] OPC Brief at 42-44.
[46] *Id*. at 43-44.
[47] *Id*. at 47-48.
[48] B. Oliver Surrebuttal Testimony at 10-13.

incurred to support an inflated revenue increase request or the presentation of unduly complex ratemaking alternatives should not be viewed as ratepayer costs.

Mr. B. Oliver also argued that costs for the use of outside consultants to perform work normally performed by in-house personnel, without justification, must not be accepted without scrutiny. He challenged testimony by Pepco witness Nelson in which Pepco argued such consultant costs were prudently incurred given workforce constraints, arguing that Mr. Nelson provided no insight regarding the nature of those constraints or their causes, whether outside consulting services were competitively bid, or why the use of outside consulting services was more cost-effective than hiring or retaining in-house personnel. Mr. B. Oliver noted that a number of Pepco's outside witnesses in this case are former Pepco employees.

Mr. B. Oliver also argued that allowing Pepco to submit additional invoices that could increase its claimed total current rate case costs before hearings without reasonable opportunity for the parties to explore the basis for those costs and address those costs in written testimony is inconsistent with sound ratemaking practice. He also objected to Pepco producing, in response to data requests, invoices that Pepco already had and could have produced in its original rate case application. Mr. B. Oliver also objected that Pepco's rate case costs documentation did not include costs for certain consultants who made contributions to the filing.

AOBA recommended the Commission either deny recovery of rate case costs or limit recovery to the proportional amount of the revenue requirement awarded in the case against the revenue requirement proposed by Pepco.[49] AOBA argued that the proportional

[49] AOBA Brief at 39-40.

adjustment would better incentivize Pepco to control the amount of the requested revenue.[50]

Staff

Staff witness Rielly initially testified that he opposed Pepco's RMA 10 because it proposed to allow a return on rate case expenses incurred after the start of evidentiary hearings.[51] Mr. Rielly testified that anticipated rate case expenses are not known and measurable and should be recovered in a future rate case, at which time the amounts will be known. At the same time, he testified that Pepco had provided support for its actual rate case expenses in response to Staff's data requests and that the Commission has consistently allowed recovery of reasonable rate case expenses for expert witnesses.[52]

On brief, Staff stated that after the filing of witness Rielly's surrebuttal testimony, Pepco ultimately provided invoices that supported actual rate case expenses, and Staff's post-hearing revenue requirement reflected an adjustment consistent with Pepco's rate case expenses.[53]

While ultimately recommending recovery of rate case expenses, Staff recommended that Pepco should not be allowed to earn a return on the unrecovered balance of costs, arguing that such treatment is inconsistent with prior Commission practice.[54]

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[50] *Id*. at 40.
[51] Rielly Surrebuttal Testimony at 4-5.
[52] *Id*. at 5-6.
[53] Staff Brief at 13.
[54] Staff Reply Brief at 7-10.

Pepco rebuttal

Pepco witness Nelson argued that RMA 10 reflects anticipated rate case expenses that will be incurred prior to the Commission issuing an order in this proceeding based on executed contracts with external vendors and costs incurred to litigate similar previous base rate cases, with costs deferred to a regulatory asset once the Commission issues an order in this proceeding.[55] Mr. Nelson testified that Pepco incurred the actual rate case costs provided through discovery and that all costs would be incurred before they would be deferred to a regulatory asset. He further testified that Pepco provided invoices supporting incurred rate case expenses in discovery.[56] He testified that Pepco would incur incremental costs after the evidentiary hearings. Mr. Nelson testified that Pepco's estimated costs reflect a fulsome and reasonable estimate of the cost to prepare and litigate this proceeding, grounded in executed contracts with vendors and informed by actual incurred costs in litigating prior cases. He argued that if the Commission declined to permit these costs to be recovered in this proceeding, Pepco should be eligible for recovery in a future proceeding.

Mr. Nelson also argued that this case required a more detailed filing because it involved multiple contested issues and new requirements that needed to be addressed.[57] He argued that the use of outside experts was common in cases of this complexity and allowed Pepco to maintain consistency in order to promote efficiency, comparability, and a clear evidentiary record. He further argued that the Commission in Order No. 91181 authorized Pepco to file a rate case in any form of its choosing, so long as its application is

[55] Nelson Rebuttal Testimony at 28-29.
[56] *Id*. at 31.
[57] *Id*. at 30-31.

accompanied by the requisite information needed to calculate a historic test year. Mr. Nelson further argued that many costs support the overall proceeding and cannot be precisely assigned to only the historic or forecasted test year filing.

COMMISSION DECISION

The Commission has historically permitted utilities to recover reasonable and prudently incurred costs of bringing rate cases. That has included permitting the cost of hiring outside expert consultants. The Commission finds credible Staff's review of Pepco's rate case expenses and recommendation to permit recovery thereof. The Commission appreciates that the unusual nature of this case, which originally featured both forecasted and historic test years, may have resulted in increased rate case expenses as a result. Given that the Commission approved forecasted rates in both of Pepco's last two rate cases and did not prohibit it from filing for forecasted rates in this rate case, the Commission does not find Pepco's original application decision to include a forecasted proposal to be unreasonable and imprudent.

While the Commission accepts the increased costs for this component, the Commission declines to accept Pepco's proposal to include the balance of unrecovered rate case costs in rate base, however, which Staff argues has not been accepted in previous cases.[58]

Accordingly, the Commission accepts RMA 10, subject to Staff's adjustments.

[58] Staff Reply Brief at 7-10.

e. *RMA 13—Reflection of Supplier Consolidated Billing ("SCB") Costs*

<u>Pepco</u>

In RMA 13, Pepco proposed to begin recovery of capital expenditures associated with the SCB project, under which suppliers of competitive energy services would be authorized to send customers a single bill that would bundle supplier energy charges with utility transmission and distribution charges, and which has been placed on hold since December 11, 2024, per Commission direction in Order No. 91448.[59] There are, at present, no suppliers utilizing supplier consolidated billing.[60] Pepco witness Nelson testified that RMA 13 incorporates the associated rate base and an amortization to operating income for the recovery of costs over a five-year period.

<u>AOBA</u>

AOBA witness Bruce Oliver argued that cost recovery for SCB costs should be addressed in a generic proceeding rather than in this case because all Maryland utilities face the same problem of recovering incurred costs for SCB, which were supposed to be split between ratepayers and energy suppliers.[61] Mr. B. Oliver argued that the system is not currently in use and is therefore not used and useful and cannot be placed into rates at this time. He also recommended extending the recovery period to ten years if the costs were not removed from this case.

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[59] Nelson Direct Testimony at 18, referencing Case No. 9461, *In the Matter of the Petition of NRG Energy, Inc., Interstate Gas Supply, Inc., Just Energy Group, Inc., Direct Energy Services, LLC and Engie Resources, LLC for Implementation of Supplier Consolidated Billing for Electricity and Natural Gas in Maryland*, Order No. 91448.
[60] Leming Direct Testimony Part II at 47.
[61] B. Oliver Direct Testimony at 44-47

Pepco rebuttal

In rebuttal, Pepco witness Nelson argued that, in Order No. 90696, the Commission stated that the discussion of prudency and issues regarding SCB costs were appropriate to be addressed in a rate case.[62] Mr. Nelson further argued that Pepco's proposal to establish a regulatory asset and amortize SCB implementation costs over five years is consistent with Order No. 90696, where the Commission found and participating parties generally agreed that a five-year recovery period was appropriate. He argued that AOBA's proposal to extend the recovery period to ten years would unnecessarily prolong cost recovery and create regulatory lag.

COMMISSION DECISION

The Commission finds that the SCB program costs incurred by Pepco were prudently incurred. The costs of developing the SCB program were substantial, however, and there remains the question of how best to apportion those costs among ratepayers over time.

In Order No. 90696, the Commission approved a proposal for cost recovery over five years, with costs split between ratepayers and suppliers.[63] Although the retail choice market is currently in a lull, making that original plan unworkable, the Commission notes that the legislature has taken steps to encourage use of the retail choice market again. The Commission is also disinclined to leave a bundle of costs in an indefinite unrecovered state. At the same time, the Commission notes that the retail market may revive, in which case retail suppliers will be able to shoulder their share of cost recovery.

[62] Nelson Rebuttal Testimony at 33.
[63] Order No. 90696 at 21.

Accordingly, the Commission is persuaded that those costs should be recovered now and that AOBA's recommendation of cost recovery over 10 years instead of 5 years strikes an appropriate balance in the instant case.

f. RMA 20—Annualization of Wage Increases

Pepco

In RMA 20, Pepco proposed to adjust O&M expenses to annualize employee salary and wage increases.[64]

Pepco proposed a 3 percent increase for management employees effective March 1, 2025, with a projection for an additional 3 percent management increase effective March 2026, and another 3 percent increase effective March 2027. Pepco also proposed a 4 percent increase for bargaining unit employees effective June 1, 2025, plus a 3 percent contractually obligated wage increase effective June 6, 2026, and another 3 percent increase effective June 1, 2027.

Pepco witness Nelson argued that this request is consistent with Commission precedent first set in Case No. 8315.[65] He also argued that these wage increases are known and measurable and therefore should be included in rates.

OPC

OPC witness Madsen proposed two modifications to RMA 20.

First, Mr. Madsen testified that Pepco based the adjustment on a projected 1,413 positions, but as of November, 2025, the total number of full-time employees ("FTEs")

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[64] Nelson Direct Testimony at 21-22, referencing Case No. 8315, *In the Matter of the Application of Potomac Elec. Power Co. for an Increase in its Retail Rates for the Sale of Electric Energy.*
[65] Nelson Direct Testimony at 21-22.

was only 1,355. He recommended the adjustment be modified to use 1,355 FTEs since that was the number of actual employees when testimony was presented.[66]

Second, Mr. Madsen recommended a 2 percent labor escalation rate for management employees, rather than the 3 percent rate proposed by Pepco.[67] He argues that, over the long term, wage increases should reflect inflation, and Pepco provided insufficient evidence (*e.g.*, compensation studies) to demonstrate the reasonableness of labor costs post-test year exceeding the rate of inflation.[68]

In response to Pepco's rebuttal testimony, Mr. Madsen rejected arguments that his calculations were erroneous. He testified that the purpose of their workpapers was to develop a level of wage increase relative to the base year that is supported by a known number of employees in the test year. Mr. Madsen did not elaborate further on the differences between OPC's calculation methodology and Pepco's. He argued that their recommended salary increase of 5.2% is more reasonable than the 9.2% increase proposed by Pepco and aligns with a known level of staffing.[69]

Mr. Madsen also noted Pepco's indication that Pepco is undertaking efforts to resolve a labor shortfall. He argued first that there is no evidence that Pepco has the ability to close the stated staffing gap and second that Pepco had improved its reliability metrics with existing staff, he argues is an indication that there is little evidence substantiating the need for additional staff.[70]

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[66] Madsen Revised Clean Direct Testimony at 16.
[67] *Id*. at 18.
[68] *Id*. at 16-18.
[69] Madsen Revised Clean Surrebuttal Testimony at 29-30.
[70] *Id*. at 17-18.

Mr. Madsen also disputed Pepco's claim that OPC's inflation rate of 2% is unsupported and claims that compensation studies to justify forecasted salary escalations are provided in other jurisdictions such as New York.[71]

On brief, OPC maintained that Pepco's forecasted employee count likely overstated the number of actual employees and that labor expense should be based on actual headcount.[72] OPC argued that in Case No. 9702, the Commission rejected the use of forecasted employee headcounts that exceeded actual employee levels where the evidence did not show that the forecasted increase will take place at the level projected by Pepco.[73] OPC argued that when the headcount and escalation rate adjustments proposed by witness Madsen (*i.e.*, to base labor expense on an employee headcount of 1,355 and to use a two percent post-test year labor escalation rate for management employees) are taken together, the result is a labor cost more closely aligned with Pepco's actual cost.[74]

Pepco rebuttal

Pepco witness Nelson argued that OPC witness Madsen's workpapers deviated entirely from the form, structure, and calculation methodology of RMA 20, disregarding all arithmetic calculations and data presented on lines 1 through 78 of their RMA 20 schedule and relied on data that is disconnected from the actual historic test period expense which Mr. Madsen purported to adjust, contains mathematical errors, and disregards

[71] *Id*. at 18-19.
[72] OPC Brief at 49.
[73] *Id*. at 50-51, referencing Case No. 9702, *Potomac Elec. Power Co.'s Application for Adjustments to its Retail Rates for the Distribution of Electric Energy*.
[74] *Id*. at 52-53.

adjustments made to PHI Service Company ("PHISCO") and Exelon Business Service Company ("BSC") wages, which the Commission has historically accepted.[75]

Mr. Nelson also testified that Mr. Madsen proposed the use of a headcount that is actually greater than the headcount that Pepco used in its RMA 20 adjustment.[76]

Pepco witness O'Donnell raised concerns with OPC's use of a 2% escalation rate, testifying that Pepco reviews salary structures in major compensation surveys and claims that "most large employers projected an increase in the range of 3% to 3.5%."[77] She also argues that both the management and union wage increases for 2026 are known.[78]

COMMISSION DECISION

The Commission notes that Pepco's proposed wage increases are a mix of actual and forecasted increases. The Commission approves Pepco's proposal for a 3 percent increase for management and a 4 percent increase for union employees that occurred during the test year, since those increases are known and measurable. The Commission also approves Pepco's request for existing known contracted union and managerial increases within 12 months of the test year to the extent those increases were already bargained for as of the start of the hearing in this case. The Commission disallows Pepco's subsequent forecasted union and managerial increases, beginning in 2027, because they are so far outside the test year and may land outside the rate effective period.

The Commission further notes that it is unclear how OPC arrived at its final adjustment. OPC did not explain why it did not account for PHISCO or BSC employee

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[75] Nelson Revised Rebuttal Testimony at 35.
[76] *Id*. at 37-38.
[77] O'Donnell Revised Rebuttal Testimony at 30.
[78] *Id*. at 32-33.

wages in its adjustment. At the same time, going forward Pepco should provide further justification regarding why PHISCO and BSC labor costs should be escalated when those employees are not direct employees of Pepco.

Accordingly, the Commission updates RMA 20 as derived by Pepco to remove the 2027 wage increases. The Commission reflects a downward adjustment of approximately $2,258,000 to operating income to account for adjusted wages.

g. RMA 24—Automobile and General Liability Claims

<u>*Pepco*</u>

In RMA 24, Pepco proposed to adjust the test period expense associated with Automobile and General Liability claims to the three-year average level of claims paid.[79] Pepco witness Nelson testified that the use of a three-year average reduces year-to-year cost volatility and is consistent with Order No. 89227 in Case No. 9602.[80]

<u>*AOBA*</u>

Although no party raised concerns about RMA 24 in testimony, on brief AOBA noted that Pepco's three-year average significantly increases the dollar amount compared to the test year and argued that Pepco has not demonstrated that the proposed three-year average is more representative than simply applying the costs accrued during the test year period.[81] AOBA also argued that Order No. 89227 did not address ratemaking adjustments

[79] Nelson Direct Testimony at 23-24.
[80] *See* Case No. 9602, *In the Matter of the Application of Potomac Elec. Power Co. for an Adjustment to its Retail Rates for the Distribution of Electric Energy.*
[81] AOBA Brief at 43-44.

for automobile and general liability claims, and there was no substantial discussion of that issue in that case.

AOBA also argued that Pepco had not demonstrated why ratepayers should be responsible for these claims, arguing that avoidance of negligence is a management responsibility and that Pepco has not established that these payments were reasonable and prudent. AOBA also challenged Pepco's decision to self-insure rather than retain an insurance policy, testifying that Pepco does not provide evidence that this approach is most cost-effective. AOBA recommended that all costs related to Auto and General for RMA 24 be disallowed.

Pepco Reply

In its reply brief, Pepco argued that AOBA's decision to raise the issue for the first time on brief was inappropriate.[82] Pepco then argued that AOBA's argument ignores the fact that claim costs are volatile and outside of Pepco's control and are thus appropriately normalized. Pepco argued that claims are appropriately normalized rather than set based on a single test year amount that may be unrepresentative.

COMMISSION DECISION

The Commission finds that the distribution of liability claims from year to year is likely to experience variability, and Pepco's proposed three-year average approach is more likely to represent future results than relying on the single historic test year, absent a showing that there exist specific extraordinary claims or circumstances in the three-year period that are unlikely to recur and that may distort the average. The Commission notes

[82] Pepco Reply Brief at 42.

that no party placed into the record any greater detail about the specific claims or cases that underlie the numbers in this RMA. Absent such a record, the Commission finds no basis to remove costs associated with RMA 24.

h. RMA 25—Reflection of Five-year Average Inflation on Non-Labor O&M

<u>Pepco</u>

In RMA 25, Pepco proposed to adjust test period non-labor O&M expenses for inflation, based on the five-year average consumer price index ("CPI") for the Washington-Arlington-Alexandria DC-VA-MD-WV region for the years 2020-2025.[83] Pepco witness Nelson testified that this approach is consistent with Commission Order No. 89227 in Case No. 9602. He also pointed to Order No. 88975 from Case No. 9484, where the Commission noted positive growth in inflation for an earlier time period and found that "inflation can be known and measurable."[84]

Mr. Nelson opposed all modifications to the originally proposed RMA. He stated Staff witness Rielly failed to consider the matching policy by focusing on revenue growth without accounting for the cost to serve the new customer.[85] Mr. Nelson did not oppose AOBA witness Bruce Oliver or OPC witness Madsen's adjustments, agreeing that there are multiple CPI measures; but Mr. Nelson still maintained their position from direct testimony that the Commission should approve the adjustment because it was consistent with Commission precedent.[86]

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[83] Nelson Direct Testimony at 24.
[84] Nelson Revised Rebuttal Testimony at 38-39, referencing Case No. 9484, *In the Matter of the Application of Baltimore Gas and Elec. Co. for Adjustments to its Gas Base Rates*.
[85] *Id*. at 38.
[86] *Id*. at 39-40.

AOBA

AOBA witness Bruce Oliver argued that Pepco witness Nelson's reliance on Commission Order No. 88975 from Case No. 9484 was incorrect, arguing that nothing in that order (which concerned the period of 2010 to 2017) supports Pepco's argument in favor of using a period that includes COVID-related inflation spikes from calendar year 2022 that cannot be expected to recur.[87] Mr. B. Oliver also testified that the inflation rate approved in Case No. 9484 was 1.4 percent. He also testified that the 8.97 percent inflation in 2022 was more than double the rate in any other year within the period Mr. Nelson proposed.

Mr. B. Oliver also argued that Mr. Nelson's rebuttal failed to address the fact that Mr. Nelson's preferred CPI measure was constructed for the Baltimore-Columbia-Towson area rather than for Washington-Arlington-Alexandria, where Pepco's distribution system is located.[88] He also argued that there are meaningful differences between the goods and services in the consumer CPI used by Mr. Nelson and the goods and services that Pepco purchases as part of its non-labor costs.

OPC

OPC witness Madsen recommended an alternative CPI bundle.[89] Pepco witness Nelson testified that Pepco did not oppose the alternative CPI bundle proposed.[90] Mr. Madsen also recommended basing the adjustment on the 2.5 percent inflation rate projected

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[87] Oliver Surrebuttal Testimony at 16-19.
[88] *Id*. at 18-19.
[89] Madsen Revised Clean Surrebuttal Testimony at 30.
[90] Nelson Rebuttal Testimony at 39-40 (*citing* Order No. 88975 at 25).

for Maryland in 2026, rather than the higher inflation rate experienced in 2021 through 2023.[91]

Staff

Initially in his direct testimony, Staff witness Rielly recommended disallowance of RMA 25 because the adjustment was one-sided. Mr. Rielly testified that if there are to be upward inflation adjustments, then increases in Pepco's revenues from additional customers should also be accounted for.[92] On surrebuttal, however, Mr. Rielly testified that Staff accepted Pepco's earnings adjustment in RMA 25 without explanation as to why.[93]

COMMISSION DECISION

In Order No. 88975 from Case No. 9484, the Commission authorized Baltimore Gas and Electric Company ("BGE") to adjust non-labor O&M expenses for inflation. The Commission found that "inflation can be deemed known and measurable" and authorized BGE to adjust non-labor O&M using a five-year average of the CPI.[94] The Commission also stated, however, "that an adjustment for inflation is not guaranteed in future cases, but will be examined on a case-by-case basis."[95] The Public Utility Law Judge's ("PULJ") Proposed Order subsequently allowed a similar adjustment in Pepco Case No. 9602, though that issue was not appealed to the Commission.[96] In that case, the PULJ found there was

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[91] Madsen Revised Clean Direct Testimony at 19.
[92] Rielly Direct Testimony at 16-17.
[93] Rielly Surrebuttal Testimony at 7.
[94] Order No. 88975 at 25, Case No. 9484.
[95] *Id*.
[96] Pepco Brief at 23.

no evidence that the proposal was "irrationally inconsistent with or contains material facts different than those set forth in Order No. 88975."[97]

Beyond the above-noted guidance regarding "case-by-case" analysis, the Commission has in practice not approved the use of inflation adjustments in such cases wholesale. For example, the Commission rejected the use of inflationary adjustments in Case No. 9651, where the Commission found that parties had "identified factual disputes in the record over both whether inflation is driving increased non-labor O&M costs and whether increased revenue from forecasted customer growth (not otherwise accounted for) will offset any non-labor O&M inflation."[98] The Commission also noted in that case that no protection existed to protect customers from overestimations of inflation or underestimations of customer growth when compared to a forecasted multi-year rate plan case with reconciliation.[99]

In general, post-test year adjustments should be the exception, not the norm, because they risk violating the matching principle, given that inflation adjustments tend to be one-sided adjustments that do not attempt to gauge the entire impact on operations. While Pepco witness Nelson is correct that there are costs associated with customer growth,[100] customer growth comes with increased revenues that help offset those costs. Moreover, while Pepco may face inflation as to some of its costs, the question is why this universal cost pressure should be used to increase Pepco's revenue based on projections to occur after the test-year, in order to minimize regulatory lag. At a time when affordability

[97] Proposed Order at 72, Case No. 9484 (Jul. 9, 2019).
[98] Order No. 89799 at 6, Case No. 9651, *Washington Gas Light Co.'s Application for Authority to Increase Its Rates and Charge*s.
[99] *Id*. at 7.
[100] Nelson Revised Rebuttal Testimony at 38.

is of paramount concern for customers, adjustments that attempt to mitigate regulatory lag should be closely scrutinized. Also, Pepco has not identified a strong policy reason, beyond that the adjustment has previously been allowed (and that, like many RMAs, it reduces regulatory lag), supporting its request.

Therefore, Pepco's request for an adjustment to recognize potential impacts from inflation is rejected.

i. RMA 26—Annualization of Test Year Property Tax Increase

Pepco

In RMA 26, Pepco proposed to annualize property taxes in the test period based on the latest property tax assessments.[101] Pepco witness Nelson testified that Pepco adjusted property taxes based on the assessment received in July 2025 for the fiscal year 2026. According to Pepco, the latest assessment, when annualized, resulted in an increase of 10.6 percent over property taxes incurred for fiscal year 2025.

AOBA

AOBA witness B. Oliver testified that Maryland property tax assessments are based on the value of plant reported in FERC Form 1 and Maryland Form 17 filings, but those accounts are not limited to plant costs that the Commission has found to be prudently incurred.[102] Mr. B. Oliver argued that property taxes should be adjusted to account for the portion allocatable to plant that the Commission has not found to be prudent.

[101] Nelson Direct Testimony at 24-25.
[102] Oliver Surrebuttal Testimony at 19.

Staff

Staff witness Rielly testified RMA 26 compares two overlapping periods (October 1, 2024 through September 30, 2025 and July 1, 2025 through June 30, 2026), which is not a valid comparison.[103] Mr. Rielly proposed excluding Pepco's adjustment, which would have the impact of reducing operating income by $4.056 million.

Pepco rebuttal

In rebuttal, Pepco witness Nelson argued that, while a reduction in electric plant in service will reduce property tax expenses, the proposed adjustment is substantially overstated and almost wholly duplicative of Staff's recommended disallowance of RMA 27.[104]

COMMISSION DECISION

The Commission is persuaded that the costs involved in RMA 26 are known and measurable, not speculative, and concern costs fully known during the rate effective period. However, RMA 26 shall be adjusted to account for any disallowed rate base during the test year from this case.

j. RMA 27—Rate Effective Period Property Tax Increase

Pepco

Similar to RMA 26, Pepco witness Nelson testified that RMA 27 adjusts property tax expenses to reflect forecasted FY 2027 based on assessable plant as of December 31,

[103] Rielly Surrebuttal Testimony at 6.
[104] Nelson Rebuttal Testimony at 14.

2025.[105] Mr. Nelson testified that Pepco's property tax assessments have increased by an average of 7.7% per year over the last five years, and through RMA 27 proposes to increase property tax by 7.7% to reflect an estimate of property taxes for 2027 fiscal year.[106] He explained that, while RMAs 3 and 4 adjust electric plant in service to reflect additions between April 2026 and July 2027, the property tax expense impact of these RMAs is not reflected in Pepco's proposed revenue requirement, and further property tax adjustments for RMAs 3 and 4 are unnecessary and inappropriate.[107]

Mr. Nelson testified that there is a strong, clear, five-year historical trend of increasing property assessments in Maryland for Pepco assessable property.[108] He testified that the next property tax assessment will be effective July 1, 2026, before the rate effective date in this proceeding. He further testified that the assessment will reflect assessable plant balances as of December 31, 2025, which are known and measurable and have demonstrably increased year-over-year. Mr. Nelson argued that the concept of using a historical trend growth rate for a certain cost is not an uncommon practice for Pepco in Maryland, citing RMA 23 as an example, which adjusts employee benefit expense using a three-year average growth rate based on historical costs.

AOBA

In its reply brief, AOBA argued that RMA 27 is based on amounts that are not known and measurable and should therefore be rejected.[109] AOBA argued that RMA 27 is

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[105] *Id*. at 15-16.
[106] Nelson Direct Testimony at 25.
[107] Nelson Revised Rebuttal Testimony at 15-16.
[108] Nelson Rebuttal Testimony at 41.
[109] AOBA Reply Brief at 16-17.

speculative, depends on inclusion of plant not approved by the Commission, and features an inflated adjustment factor caused by recent large project completions.

Staff

On direct, Staff witness Rielly opposed RMA 27, arguing the property tax increase is not known and measurable, was an estimated amount, and articulated concerns with certain data. He also noted the Commission had removed a similar adjustment for estimated future property tax in Case No. 9602.[110] On surrebuttal, Mr. Rielly reversed Staff's position and testified that Staff agreed with Pepco witness Nelson's rebuttal position on RMA 27 as Staff was able to confirm the accuracy of RMA 27 and because Staff expected the trend of increasing tax assessments to continue since Pepco planned to add new plant in 2026.[111]

COMMISSION DECISION

The projected costs reflected in RMA 27, (being forecasted property taxes based on existing plant from 2025) were not known and measurable for parties to challenge during discovery or at the time of the hearing. Although the Commission has in some circumstances utilized historic trend growth in allowing RMAs that go beyond the historic test year, the burden is always on the utility for justifying why a specific cost is appropriate for that treatment. In this case, the Commission is unpersuaded by the mere fact that Pepco expects its costs will eventually be higher than those of the historic test year.

By accepting RMA 26, the Commission already adjusted Pepco's revenue requirement for taxes in effect during the test period. As stated previously, at a time when

[110] Rielly Direct Testimony at 18-19.
[111] Rielly Surrebuttal Testimony at 7.

affordability is of paramount concern for customers, the need for adjustments that attempt to mitigate regulatory lag should be more closely scrutinized. Additionally, the Commission denied a similarly proposed adjustment to adjust the property tax assessment for the average over the previous five years in Case No. 9602.[112]

The Commission finds Pepco's forecast to be unreasonably speculative in this case. Costs for RMA 27 will be removed.

k. RMA 29—Removal of Industry Contributions and Jet Costs

Pepco

Pepco proposed RMA 29 to remove from operating income certain costs associated with industry memberships and contributions and private jet costs, consistent with new Maryland law stating that investor-owned electric companies may not recover any costs associated with such membership or contributions through rates.[113]

OPC

OPC witness Madsen testified that Pepco inadvertently included $29,000 of costs in FERC Account 923 related to management of employee volunteer programs, charitable giving programs, sponsorships, and other programs.[114] Mr. Madsen recommended that Pepco identify and perform a detailed quantification, at its own cost, of all internal charges it has incurred to support below-the-line activities and to remove those costs from the revenue requirement, which included the $29,000 noted above. Mr. Madsen testified that

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[112] Proposed Order at 66-67, Case No. 9602, *In the Matter of the Application of Potomac Elec. Power Co. for an Adjustment to its Retail Rates for the Distribution of Electric Energy* (Jul. 9, 2019).
[113] Nelson Direct Testimony at 26.
[114] Madsen Revised Clean Direct Testimony at 23-23.

an adjustment to remove the identified $29,000 is reflected in OPC's updated RMA No. 29.

COMMISSION DECISION

The Commission accepts RMA 29 subject to the proposed adjustment made by OPC, which was unchallenged. The Commission directs Pepco to identify for its next rate case any additional ineligible costs and to track those costs and record said costs below the line.

3. Other challenged revenue items

a. Disallowances from Order No. 92264

On March 31, 2026, the Commission issued Order No. 92264 on the final reconciliation of Pepco's multi-year rate plan.[115] That order, among other things, disallowed recovery for overspending on three capital projects in rate year 3.[116]

Raising the issue for the first time in surrebuttal testimony, OPC witness Madsen recommended that the Commission remove three capital projects–the Wheaton substation transformer number 3 replacement, circuit breaker replacement, and certain installations of tree wire/spacer cable.[117] Mr. Madsen testified that Pepco included those projects in its TTYCF and that Pepco indicated that it will not prepare an RMA to remove these projects from rates. He prepared RMA 1 in exhibit DMM-SR-1 that removes them. Mr. Madsen argued that no prudency support for those three projects was provided by Pepco.

[115] Order No. 92264, Case No. 9655, *Potomac Elec. Power Co.'s Application for an Electric Multi-Year Plan,* (Mar. 31, 2026).
[116] *Id*. at 26, 30-31, and 42.
[117] Madsen Revised Clean Surrebuttal Testimony at 4-5.

On brief, OPC argued that the Commission's finding of imprudence is a legal bar to cost recovery for utility capital expenditures, irrespective of whether it results in infrastructure that is used and useful.[118]

COMMISSION DECISION

The Commission previously ruled that it would "preserve the utility's ability to seek recovery of certain disallowed capital costs in a future rate case, subject to a showing that such costs are used and useful and prudently incurred."[119] The Commission is concerned in this case that, given the timing of the reconciliation order, the parties have not developed a record as to whether these investments have become prudent subsequent to Pepco's recent reconciliation. Therefore, the Commission directs that these projects be removed from the revenue requirement in this proceeding, with the potential for Pepco to provide appropriate materials in its next rate proceeding that adequately demonstrates the prudency of each of the removed assets discussed herein.

b. Smart Fault Sensors

In Order No. 91181 from Case No. 9702, Pepco's Application for a Multi-Year Rate Plan, the Commission directed Pepco to evaluate and demonstrate the effectiveness of smart fault sensors in a pilot project before a full deployment was initiated.[120] The Commission authorized recovery of funds expended in calendar years 2021, 2022, and 2023, but it directed that further expansion of the program should be subject to Pepco's

[118] OPC Brief at 23.
[119] Order No. 92421 at 4.
[120] Order No. 91181 at 103.

demonstration, after the 2024/2025 evaluation period is concluded, that there are no risks to full scale deployment and that program benefits are being obtained as projected.

Pepco

In this case, Pepco requested permission to move additional 2024 plant expenditures on its smart fault sensors into rate base. Pepco witness Alo testified that Pepco's smart fault sensors involved installing indicators on distribution feeders to improve fault location accuracy and reduce patrol time during outage restoration, improving operation efficiency and reducing outage duration.[121] Mr. Alo testified that Pepco completed the program in 2024, placing the sensors into service.

Staff

Staff witness Lo recommended disallowance of the 2024 plant additions, which total $1.1 million.[122] Mr. Lo testified that Pepco has not satisfied the Commission's requirements from Order No. 91181 before recovery for post-2023 expansion can be warranted. He testified that Pepco has not cured the central problem of getting the program functioning as intended. Mr. Lo testified that Pepco acknowledged that the preliminary results are mixed and that it does not have a method for isolating the reliability benefits attributable specifically to the sensors. He recommended that the Commission allow Pepco to come back in the future if it can demonstrate that the program is effective in practice and ready for broader recovery treatment.

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[121] Alo Rebuttal Testimony at 60-61.
[122] Lo Surrebuttal Testimony at 3-4.

COMMISSION DECISION

The Commission finds that Pepco has not made a record that justifies additional investments into this program, given the pre-existing concerns expressed in Order No. 91181. Pepco is directed to remove those costs from its revenue requirement and place them into a regulatory asset, to be considered for possible recovery in a future rate proceeding.

c. Regulatory Asset Treatment for Minor Storm Costs

Pepco

Although minor storm costs have traditionally been included as part of O&M, Pepco requested that the Commission authorize it to track minor storm costs in a regulatory asset going forward.[123] Pepco witness Nelson testified that the Commission previously approved this treatment of minor storm costs for BGE in Case No. 9645.[124] Mr. Nelson argued that this approach is a customer protection mechanism, preventing immediate rate impacts from volatile, externally driven storm costs and ensuring that customers only pay those costs the Commission ultimately determines to be prudent and reasonable after full review.

OPC

OPC witness Madsen argued that Commission approval of a minor storm deferral for BGE in its reconciliation was not based on the same facts that are present in this case.[125] Mr. Madsen argued that Pepco can control how it responds to minor storm events and the

[123] Leming Direct Testimony Part II at 11.
[124] Nelson Rebuttal Testimony at 9.
[125] Madsen Revised Clean Surrebuttal Testimony at 9-11.

resulting costs incurred. He further argued that Pepco should remain incentivized to address minor storm events prudently and cost-effectively, and approval of regulatory asset treatment for those costs would significantly erode such incentives.

Mr. Madsen argued that minor storm expense is different from pension expense (for which OPC supported the regulatory asset treatment) because pension costs are well outside of Pepco's control, being dependent on the stock market, debt rates, and the age of retirees, among other things. He further testified that pension costs can vary from year to year by significant amounts. Mr. Madsen argued that this is different from minor storm costs, where Pepco has control over how it responds and the costs incurred and timing thereof.

On brief, OPC argued that the Commission generally reserves regulatory asset treatment for extraordinary expenditures that are non-recurring, but minor storms rarely have variability significant enough to warrant special regulatory asset treatment.[126] OPC also maintained on brief that regulatory asset treatment would undermine cost-containment incentives, because Pepco has control over how it responds to minor storms.

COMMISSION DECISION

In Order No. 92106, the Commission allowed BGE to place certain minor storm costs into a regulatory asset but explained that this treatment is disfavored and was only allowed in that case because of exceptionally high dollar amounts and the need to reduce rate shock by spreading costs over a longer period of time.[127] Those circumstances are not

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[126] OPC Brief at 36 (*citing* Order No. 91048 at 6, Case No. 9702).
[127] Order No. 92106 at 26.

present here. Accordingly, the Commission finds that traditional O&M treatment of minor storm costs is appropriate.

d. Deferred Corrective Maintenance

Pepco

Pepco witness O'Donnell testified that Pepco had reduced its corrective maintenance budgets in 2023 and 2024 and expected to complete in 2025 approximately $5.6 million in work originally scheduled for those earlier years.[128] Ms. O'Donnell argued that a significant amount ($3.8 million) of the $5.6 million is related to budget versus actual FERC account geography for "line locates" costs and that any expectation that Pepco's reliability will be sustained if this spending is curtailed is unreasonable and relies on short-term indicators and ignores the long-term health of the system.[129]

OPC

OPC witness Madsen argued that the Commission should remove the $5.6 million in deferred corrective maintenance because it did not represent the true cost of operating Pepco's business on an annual basis and would result in customers being overcharged due to Pepco's decision to defer that work to the historic test year period.[130]

COMMISSION DECISION

The Commission is not persuaded that the removal of the deferred maintenance costs requested by OPC is likely to result in a more just and reasonable proxy for deferred

[128] O'Donnell Direct Testimony at 25; and O'Donnell Rebuttal Testimony at 36-37.
[129] O'Donnell Rebuttal Testimony at 36-37.
[130] Madsen Revised Clean Direct Testimony at 21.

maintenance costs likely to be incurred by Pepco in the rate-effective period. While OPC correctly points out that this line item was higher in the historic test year than the previous two years, it is the nature of historic test year-based ratemaking that there is variation in costs within each category across years, with some categories being higher and others lower than their recent histories. Moreover, the Commission does not find it likely that Pepco attempted to manipulate the ratemaking process in this case, given that Pepco had little to no advance notice that this case would be decided based on a historic test year. Also, given the likelihood that regulatory lag and cost inflation will operate to bring the actual costs during the rate-effective period closer to the historic test year costs, OPC's adjustment is denied.

e. New Business Connections and Contributions in Aid of Construction

<u>Pepco</u>

Pepco collects Contributions in Aid of Construction ("CIAC") from customers to cover the cost of certain infrastructure required to be built prior to providing service.[131] Those CIAC amounts billed to customers are tracked at the project level, recorded as a reduction to utility plant, and are excluded from rate base so that ratepayers do not double-pay for infrastructure that is already paid for.[132] CIAC is charged to the customer per MD tariff sections 10.e ('Charges for Service Connection') and 11 ('Extensions of the Distribution System').[133]

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[131] Williams Direct Testimony at 12-13.
[132] Williams Rebuttal Testimony at 11.
[133] *Id*. at 11.

AOBA

AOBA witness Bruce Oliver recommended the Commission disallow rate recovery for Pepco's commercial new business connections. Mr. B. Oliver argues Pepco did not "provide meaningful and verifiable support for projections of Commercial New Business expenditures" and as such should exclude the costs from the traditional test year.[134] He argued that responses to data requests did not demonstrate Pepco's New Business Procedures or its accounting for CIAC complied with guidelines or equitable treatment of new and existing customers.[135] Additionally, Mr. B. Oliver argued that Pepco offered no information regarding the portions of costs of Commercial New Business connections and/or upgrades that are offset by CIAC contributions, making it impossible to verify that customers' CIAC payments have been properly recognized in Pepco's determination of plant closing costs.[136]

Pepco Rebuttal

Pepco witness Nelson testified that AOBA mischaracterizes Pepco's accounting practices and the role of CIAC in ratemaking.[137] Mr. Nelson testified that Pepco records CIAC in accordance with established regulatory accounting requirements and generally accepted accounting principles: CIAC amounts billed to customers are tracked at the project level, recorded as a reduction to gross utility plant, and excluded from rate base, ensuring that only Pepco-funded investment is included in rates. He testified that CIAC funded assets do not earn a return and do not increase rates. Mr. Nelson argued that the

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[134] B. Oliver Direct Testimony at 22.
[135] *Id*. at 22-23.
[136] *Id*. at 6.
[137] Nelson Rebuttal Testimony at 5-7.

timing of CIAC collection does not affect ratemaking treatment of CIAC-funded facilities. He argued that this is consistent with Commission precedent and does not warrant an adjustment.

Pepco witness Williams testified in response to AOBA witness Bruce Oliver's New Business Connection recommendation, explaining how the new business budget was developed and that using customer growth was not an appropriate mechanism to use when forecasting new business due to unpredictability and that Pepco cannot control customer requests.[138] Mr. Williams also defended variances between budgeted and actual new business expenditures as they are reactive costs that are challenging to forecast.[139]

Staff

Staff witness Bunch testified that Pepco is "obligated to respond to all new electric service requests" and verified that Pepco did not double-bill ratepayers by including CIAC payments that individual customers have chosen to pay the utility.[140] Ms. Bunch did not recommend disallowance of the expenditures.[141]

AOBA Surrebuttal

In surrebuttal, AOBA witness Bruce Oliver stated Pepco witness Williams did not provide quantitative support for the budgeted and incurred costs for commercial new business.[142] Mr. B. Oliver testified that he had concerns about Pepco spending tens of millions of dollars on new business activities aimed at growing a commercial customer

[138] Williams Revised Rebuttal Testimony at 9.
[139] *Id*. at 10.
[140] Bunch Direct Testimony at 40-41.
[141] *Id*. at 41.
[142] B. Oliver Surrebuttal Testimony at 24-25.

class.[143] He also testified that he surmised that these expenditures are influenced by speculation about future data-center growth, which costs he argued should not be passed on to existing customers.[144]

Mr. B. Oliver argued that Mr. Williams did not offer any greater transparency on these CIAC, merely arguing that the accounting is accurate and consistent with established regulatory accounting requirements.[145] He argued that Staff witness Bunch's conclusion that Pepco is not double billing customers is unsupported other than a reliance on Pepco's own one-word statement that its plant additions do not include CIAC for higher cost connection alternatives. Mr. B. Oliver argued that this statement is not verifiable.

Mr. B. Oliver expressed concerns that Pepco showed receipt of over $10.6 million of CIAC for over nine months of 2024 and that those receipts did not appear to be accounted for in Pepco's need for working capital via its lead-lag studies.[146]

Mr. B. Oliver testified that he had not quantified the impact of recognizing CIAC receipts in the determination of Pepco's cash working capital allowance because the record lacks information regarding the timing of CIAC receipts for individual projects and the expenditure of funds for construction, making a proper assessment of the amount of time CIAC funds are available impossible. He recommended that the Commission assume that CIAC receipts provide a full offset of the claimed need for cash working capital allowance

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143 *Id*. at 24-26.
144 *Id*. at 26-27.
145 *Id*. at 30-31.
146 *Id*. at 32-33.

in the calculation of the revenue requirement.[147] AOBA on brief also recommended the Commission zero out Pepco's Cash Working Capital requirement.[148]

In brief and reply brief, AOBA raises concerns about actual and budgeted costs while Pepco's number of commercial customers is not growing or declining, lack of transparency as to how CIAC is accounted for when adding plant to rate base, and about projected costs from speculative customer additions.[149] In reply brief, AOBA recommended "the Commission to disallow rate base additions that are premised on unsupported cost projections."[150]

COMMISSION DECISION

The Commission declines to accept AOBA's recommendation to disallow plant additions, which appears to be related to projected costs, because the current case is for a traditional test year which should be premised upon known and measurable costs where the plant additions are in-service. As will be described below, the Commission does not believe an adjustment based on AOBA's assertions regarding CAIC is warranted. To the extent Pepco's test year revenue requirement or the associated approved RMAs include projected new customer addition plant, Pepco is directed to identify and remove these costs when it files its compliance filing in response to this Order.

The Commission does not find any evidence in the record that Pepco has double-billed customers for amounts covered by CIAC, but Pepco's records tracking how CIAC funds are accounted for may benefit from greater transparency. The Commission declines

[147] *Id*. at 33.
[148] AOBA Brief at 29-31.
[149] *Id*. at 26-28 and AOBA Reply Brief at 1-20.
[150] AOBA Reply Brief at 18.

to order an adjustment at this time, but Pepco is directed to (1) provide exhibits and testimony in the next rate case demonstrating explicitly how CIAC is accounted for when adding plant to rate base, and (2) work with Staff, OPC, and other interested parties to identify best practices in accounting for CIAC and discuss the content of filings in future rate cases regarding CIAC.

The Commission is not persuaded that the record is fully developed on the question of whether CIAC receipts should be used to offset the need for cash working capital. Parties wishing to pursue that issue may address it in subsequent rate cases. Additionally, to the extent a party, such as AOBA, is concerned regarding the amount of CIAC collected by Pepco when initiating a new customer connection, they are free to propose changes to Pepco's practices in subsequent rate cases or administrative proceedings.

f. Distribution Overhead P30/P40 Replacements (ITN 77205)

<u>Pepco</u>

Pepco witness Alo testified that ITN 77205 is a corrective-maintenance program focused on the planned replacement of aging P30/P40 overhead distribution assets that are approaching end of life or no longer meet safety or clearance standards, as identified through outage follow-ups, inspections, and condition assessments, that if left unaddressed are likely to develop into system vulnerabilities and result in customer outages.[151] Mr. Alo testified that the alternative to that approach is waiting until equipment fails, which increases outage risks, emergency restoration activity, traffic and safety exposure, and overall system disruption. He testified that variances between Pepco's early planning

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[151] Alo Rebuttal Testimony at 103-104.

estimated costs–which are based on averages from prior years–and the resulting costs after encountering actual field conditions do not indicate any lack of prudence on Pepco's part.

OPC

OPC recommended that the Commission disallow $1.76 million from ITN 77205, distribution overhead planned P30/P40 replacements, arguing that Pepco had not justified the cost variance between spending in the test year versus the year prior.[152]

OPC witness Fitzhenry testified that Pepco witness Alo's position that job complexity caused by field conditions justified the cost increase was not supported by data Pepco provided.[153] Mr. Fitzhenry testified that, based on Pepco's data request responses, many of the pole and crossarm types that were replaced were similar to work performed in previous years.[154] He further testified that Pepco completed significantly fewer crossarm replacements than the previous year—120 in 2024 compared to 306 in 2023.[155]

On brief, OPC argued that Pepco failed to provide evidence detailing the management-judgment that Pepco claims it exercised and how that resulted in significant overspending above budgeted amounts, nor did it evidence the specific need for the replacements, the individual cost of those replacements, and evidence that the replacements were prudently performed.[156]

[152] Fitzhenry Revised Clean Surrebuttal Testimony at 16-17.
[153] *Id*. at 17.
[154] Pepco response to OPC DR 27-9. *See* Fitzhenry Revised Clean Direct Testimony, Exhibit CTF-2.
[155] Pepco response to OPC DR 27-9.
[156] OPC Brief at 21-22.

Staff

Staff witness Lo testified that ITN 77205 is a "planned overhead replacement program driven by inspection findings and outage follow-up [and] is a common utility practice and supports maintaining safe and reliable service."[157] Mr. Lo does "not recommend disallowance of this program as it addresses recurring, identified overhead deficiencies and is consistent with prudent distribution asset maintenance and replacement practices."[158]

COMMISSION DECISION

The Commission finds that Pepco's explanation for the variances in this spending category is lacking detail, and in future cases Pepco is directed to more fully explain the reasons why these sorts of variances occur. However, the Commission does agree with Staff that a corrective maintenance program that addresses recurring, identified overhead deficiencies is consistent with prudent distribution asset maintenance and replacement practices. A cost variance does not necessarily indicate imprudence in a corrective maintenance program where deficiencies must eventually be remediated. OPC's proposed adjustment is denied.

g. Net Operating Loss Carryforwards ("NOLC")

Pepco

Pepco proposed an adjustment to the normalization of Net Operating Loss Carryforward ("NOLC"), which would increase rate base by $51.5 million, to ensure

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[157] Lo Direct Testimony at 21.
[158] *Id.*

ratemaking and tax accounting are aligned to avoid a normalization violation.[159] Pepco witness O'Donnell testified that on June 28, 2024, the Internal Revenue Service ("IRS") published a series of private letter rulings ("PLRs") requested by another taxpayer that provide guidance with respect to the application of normalization rules and the proper treatment of income tax benefits associated with tax net operating losses among affiliates within a consolidated group for ratemaking purposes.

Ms. O'Donnell testified that, although a PLR can only be relied on by the taxpayer that received it, it is instructive to other taxpayers as to the IRS's point of view on a particular subject.[160] She further testified that Pepco's situation is identical to the fact pattern described in the PLRs, and pursuant to Section 3.01(e) of IRS Revenue Procedure 2017-47, Pepco is required to revise its methodology at the next available opportunity, which is this proceeding, in order to avoid a penalty for a normalization violation. Ms. O'Donnell testified that, if the IRS subsequently rules that Pepco's historic methodology complies with the normalization rules, Pepco will provide customer refunds.[161]

Ms. O'Donnell testified that the Commission previously allowed both BGE and Delmarva Power and Light Company ("Delmarva") to make this same NOLC adjustment in Order No. 91768, noting the potential risks associated with a normalization violation.[162]

<u>*OPC*</u>

OPC witness Madsen argued that the IRS has a Safe Harbor provision for inadvertent and unintentional violations of the normalization rules, which would apply

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[159] O'Donnell Rebuttal Testimony at 42-43.
[160] *Id*. at 43.
[161] *Id*. at 45-46.
[162] *Id*. at 44, referencing Order No. 91768, Case No. 9681, *Delmarva Power & Light Co.'s Application for an Electric Multi-Year Plan,* (Aug. 6, 2025).

given that Pepco has a pending PLR request.[163] Mr. Madsen argued that witness O'Donnell did not address this possibility in rebuttal testimony. Mr. Madsen testified that, in discovery, Pepco could not identify any instances when the IRS imposed a normalization violation on a utility due to a regulator's decision prohibiting an accounting change to correct a normalization violation.

Mr. Madsen argued that the Commission's decision in Order No. 91768, regarding Delmarva's 2024 Annual Information Filing, is not controlling because that filing did not request any change to Delmarva's base rates or impose any cost on customers.[164] He argued that the Commission did not find that inclusion of the NOLC was prudent, but rather found that it was prudent to withhold any final ruling on the inclusion of the NOLC until the IRS issues a resolution on the outstanding PLR.

Mr. Madsen argued that the Commission could similarly withhold any ruling on the inclusion of the NOLC until after the IRS rules on Pepco's pending PLR request and direct Pepco to remove the NOLC costs from its revenue requirement, and track any incremental costs, which could be recovered in the future if the IRS issues a decision in its favor.[165] He argued that the alternative–allowing Pepco to collect those costs now but with the promise of a future refund if the IRS finds that NOLCs comply with normalization rules–would risk intergenerational inequity by requiring current customers to pay while future customers would receive the refunds.

On brief, OPC argued that the IRS's safe harbor provision applies so long as the taxpayer's regulator "establishes or approves rates subject to adjustment from the effective

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[163] Madsen Revised Clean Surrebuttal Testimony at 20-21.
[164] *Id*. at 22
[165] *Id*. at 22-23.

date of the unadjusted rates in order to conform to the [IRS's] ruling."[166] Therefore, OPC argued, the Commission can set rates conditional on future adjustment without allowing Pepco to make the adjustment now.[167] OPC pointed to Case No. 9418, where Pepco claimed that a Commission directive may violate the IRS's normalization rules, but the Commission affirmed its order setting rates, stating that rates were subject to adjustment in a Phase II proceeding pending the outcome of a PLR request, with the disputed funds tracked in a regulatory asset during the interim.[168]

Montgomery County

On brief, Montgomery County recommended that the Commission accept OPC's position, pointing to Order No. 91768,[169] in which the Commission deferred deciding on a similar issue regarding BGE and Delmarva.

COMMISSION DECISION

In Order No. 91768, the Commission was faced with a similar issue. In that case, BGE and Delmarva had already made the accounting change that Pepco now requests authorization to make, while OPC requested that the Commission direct the utilities to undo that change and to refund customers the revenues they had collected as a result of that accounting change. The utilities argued that any refund would be premature and risk a normalization violation. The Commission, noting the risks of a normalization violation to ratepayers, withheld issuing any ruling pending the issuance of a PLR from the IRS.[170]

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[166] OPC Brief at 30 (*quoting* IRS Rev. Proc. 2017-47 § 4.07(3)).
[167] *Id*. at 30-31.
[168] *Id*. at 31-32.
[169] Montgomery County "Comments in Lieu of Brief," at 4-5.
[170] Order No. 91768 at 11.

Despite the fact that the procedural posture between that case and this are reversed—here the utility has not yet implemented the NOLC adjustment—OPC and others have recommended that the Commission take the same action, *i.e*. no action. But taking no action in this case would result in ratepayers of one utility operating under a different tax accounting scheme than ratepayers of two others (all of which are owned by the same holding company). The Commission is persuaded that the practical incongruity of treating some ratepayers differently from others is less acceptable than permitting Pepco to make the NOLC adjustment it now requests. Pepco's request to make the adjustment is therefore granted. Additionally, should the IRS rule that the adjustment was deemed necessary without the incorporation of the NOLC, then utility rates and customer bills would need to increase to recover the very adjustment Pepco is requesting to recover in rates in this proceeding. Indeed, if the IRS rules in seven years, then prior period rates would need to be adjusted to account for the differences in every period. The potential impact on bills could be substantial. If the IRS rules the adjustment was not necessary, then Pepco can be directed to refund the impact of the NOLC with interest.

As such, should the IRS issue a ruling that is unfavorable to Pepco's current position, then the Commission will make an appropriate adjustment in Pepco's subsequent rate case to remove the revenue impact of the NOLC, including carrying costs at the authorized ROR.

The Commission directs Pepco to separately account for the NOLC so that the information can be more readily tracked and monitored for changes prospectively. This approach is consistent with previous decisions including Order No. 91768 from Case Nos.

9692 and 9681, as well as Order No. 85724 in Case No. 9311 and Order No. 86441 in Case No. 9336.

h. Regulatory Asset Treatment for Public Policy Costs

Pepco

Pepco requested that the Commission approve a new regulatory asset to track what it characterized as "externally driven legislative, regulatory, or accounting changes" that "can introduce significant rate volatility if recovered through the Company's base-rate mechanisms."[171] Pepco witness Nelson testified that this approach would allow the Commission to evaluate those costs without needing to make incremental or piecemeal adjustments.[172] Mr. Nelson also testified that this approach would reduce the pressure on Pepco to file more frequent rate cases.

OPC

OPC witness Madsen recommended denial of Pepco's proposed exogenous cost regulatory asset and liability accounts to remove certain items including those proposed for legislative, regulatory, and accounting changes.[173] Mr. Madsen argued that Pepco failed to identify sufficient limitations to the scope of costs that could be included in the regulatory asset. He pointed to testimony by Pepco witness Leming that the asset as proposed could include costs for "any new legislative, regulatory, or other public policy requirements, including changes in accounting rules, that have an impact" on Pepco's cost of service.[174]

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[171] Nelson Rebuttal Testimony at 7.
[172] *Id*. at 8.
[173] Madsen Revised Clean Surrebuttal Testimony at 8-9. Of note, OPC did not object to Pepco's related pension expense regulatory asset proposal, which is not disputed in this case.
[174] Quoting Leming Rebuttal Testimony, Part 2 at 3-4.

Mr. Madsen argued that this description is effectively limitless in scope because, as Pepco is a regulated entity, nearly any cost Pepco incurs could be construed as driven by regulatory actions.

COMMISSION DECISION

The Commission is not persuaded that an open-ended regulatory asset of the sort proposed by Pepco is appropriate or necessary. Regulatory assets and recovery of individual programs will continue to be addressed on a case-by-case basis. The request is therefore denied.

i. Volume-based Rebates

OPC

Raised for the first time in surrebuttal testimony, OPC witness Madsen argued that ratepayers should receive a benefit from Exelon's volume-based rebate program. This program is a financial incentive provided by suppliers to Exelon when purchasing volumes exceeding a predefined threshold, thus providing Exelon with a reduced price or refund.[175] Mr. Madsen testified that Pepco records the rebates as high level O&M projects as they occur, regardless of whether the activity resulting in a rebate relates to capital or O&M spending. He expressed concern at this practice, arguing that it deprives customers of any long-term, capital cost-reduction benefits that the volume-based rebate program could otherwise achieve and artificially depresses O&M spending. Mr. Madsen testified that this

[175] Madsen Revised Clean Surrebuttal Testimony at 23-26.

issue could not have been raised earlier because it only became apparent after multiple rounds of discovery.

Mr. Madsen testified that Pepco's approach may not align with accounting requirements, but it is difficult to provide a definitive opinion without reviewing the contractual arrangements and invoices. He testified that benefits should mirror, where possible, the costs that derived from those benefits and therefore, generally speaking, if a discount or rebate is received on the purchase of a capital asset, the rebate would ordinarily be treated as a reduction to the price of the asset from an accounting perspective, but if the rebates are not project specific, then it may be appropriate to treat them as operating income. Mr. Madsen testified that he did not have sufficient information to recommend an adjustment, noting that he raised the discussion to bring it to the Commission's attention and to encourage future efforts to clarify this matter. He also testified that his concerns should not be construed as recommending that the volume-based rebate program, a cost-reducing measure, should be discontinued.

COMMISSION DECISION

Pepco is directed to work with Staff, OPC, and other interested parties prior to filing its next rate case to determine the most appropriate accounting treatment for these rebates and to file appropriate testimony in its next rate case that fully describes the practices of the rebate program and the accounting of costs related to the program.

j. White Flint Project

<u>*Pepco*</u>

Pepco requested to move into rate base the capital costs for the White Flint Substation Project (the "White Flint Project" or "White Flint"), a major infrastructure initiative centered around the construction of a new substation in Montgomery County, which Pepco represents as totaling $164.9 million[176] over several projects.[177] Pepco witness Alo testified that the White Flint Project was designed to address forecasted capacity constraints on the nearby Parklawn Substation.[178]

Mr. Alo testified that the White Flint area was slated for development under a Montgomery County 2010 plan that was advanced in March 2020, with the potential for large developments in a short period of time.[179] Mr. Alo testified that Pepco identified capacity concerns based on that plan. He testified that the White Flint Project was heavily scrutinized in Case No. 9655, but the Commission ultimately determined that Pepco must decide whether to proceed with the project and be prepared to justify that decision in a prudency review.[180] Mr. Alo testified that, after Case No. 9655, Pepco delayed the White Flint Project for two years, but construction later resumed, driven by "load forecasts, third-party engineering assessments, economic growth, reliability needs, and the condition of aging infrastructure."[181]

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[176] Pepco's response to Bench Data Request No. 2, Table 7.
[177] Alo Direct Testimony at 43. The ITNs Pepco specifies as the "White Flint project family" are 74118, 74120, 74121, and 72002.
[178] Alo Rebuttal Testimony at 14.
[179] *Id*. at 15.
[180] *Id*. at 15-17 (*citing* Order No. 89868).
[181] *Id*. at 16.

Mr. Alo testified that the decision to resume the project relied in part on a 2023 third-party load study performed on Pepco's behalf by Quanta Technology ("Quanta Study").[182] He further testified that the Quanta Study forecasted that trends in construction redevelopment, electric vehicle adoption, and building electrification would persist and potentially intensify, particularly in light of Montgomery County policy related to electrification of new construction. The study correlated those drivers with system overload risks and found that projected weather-normalized peak load was expected to surpass current firm capability in summer 2027, and noted additional concerns regarding the subsequent winter peak occurring a few months later.

Mr. Alo testified that Pepco considered several alternatives to the White Flint Project, such as rebuilding or expanding the Parklawn substation, installing energy storage, and installing energy management tools such as demand response.[183] He testified that the alternative of expanding Parklawn was determined to be infeasible due to physical constraints. Mr. Alo testified that, under this alternative scope, Pepco would be unable to support existing Parklawn load during construction as adjacent substations lacked sufficient capacity to carry transferred load. He argued further that this alternative solution would not provide adequate area capacity for future growth.

Mr. Alo testified that Pepco determined that non-wires alternatives ("NWAs") were considered, but they did not offer sufficient capacity or lower outage risk.[184] Mr. Alo testified that energy storage was not selected for three reasons: (1) the Parklawn substation

[182] *Id*. *See also* Pepco Br. at 27: "Pepco… re-confirmed the need for White Flint through an independent Quanta Technology load forecast before resuming construction." The study was stamped "DRAFT - This document is not for distribution. It is intended for discussion only."
[183] Alo Rebuttal Testimony at 36-41.
[184] Alo Direct Testimony at 37.

footprint is not large enough for a sufficient storage system; (2) storage would only be a temporary measure and would not alleviate future additional demand; and (3) storage would not overcome the decreased reliability of aging infrastructure. Mr. Alo testified that energy management tools were not selected as an alternative to the White Flint Project because the size of the forecast overload "would have resulted in unrealistic and excessively frequent demand response events."[185] He further testified that NWA options generally could not provide firm, continuous capacity under all system conditions and would not alone result in separated cable junction points and therefore did not mitigate the risk of extended outages caused by faults on the 69 kV pipe-type supplies.[186]

OPC

OPC witness Fitzhenry recommended that the Commission disallow 64.2 percent of all project costs, based on a ten-year forecast covering 2025-2034 that showed that the combined forecasted load for the White Flint and Parklawn service areas would not exceed 35.8 percent of the available capacity for 2034.[187]

Mr. Fitzhenry argued that Pepco's stated justification in believing that this expanded capacity was necessary, the Quanta Study, failed to definitively prove any immediate necessity for the substation because it relied on variable growth scenarios and policy-driven assumptions that might not materialize as predicted and which he characterized as unrealistic and overly speculative.[188] Mr. Fitzhenry testified that, while

[185] *Id*. at 38.
[186] *Id*. at 40-41.
[187] Fitzhenry Revised Clean Direct Testimony at 22-25, referring to Table CTF-3, derived from Pepco's response to OPC Data Request No. 5-3(a).
[188] Fitzhenry Revised Clean Surrebuttal Testimony at 10-16.

the Quanta Study models different possible scenarios, the probability of whether the forecasted load would actually materialize was not modeled.

Mr. Fitzhenry also testified that several developments included in the Quanta Study failed to meet their original timelines or remain subject to uncertainty. He testified that more recent load forecasts show that most of the capacity added by the White Flint substation will not be needed to service customers in the next ten years.[189]

Based on this, Mr. Fitzhenry argued that Pepco was unreasonable and imprudent in relying on the Quanta Study because of these issues. He argued that the fact that the substation now operates at a significantly low utilization ratio is evidence that the initial forecasts were flawed and that the project could have been deferred.[190] Mr. Fitzhenry further testified that the financial risk of over-forecasting should not be shifted to ratepayers if Pepco relies on outdated or inaccurate projections to justify a major capital investment. He argued that their proposed disallowance based on the aggregate used capacity of the White Flint and Park Lawn substations is a conservative approach; if one were to instead use just the existing Parklawn substation's capacity as a basis for calculating the White Flint substation utilization rate, this would yield a utilization rate for the White Flint substation over the next ten years of zero.[191]

On brief, OPC recommended that the Commission disallow all costs related to the White Flint substation, arguing that, while Pepco commissioned Quanta to perform a load study (which OPC maintains was flawed as it did not present probabilities), Pepco lacks the alternatives analysis that would address the concerns raised by the Commission in Case

[189] *Id*. at 13.
[190] *Id*. at 14-15.
[191] *Id*. at 16.

No. 9655.[192] OPC argued that Pepco did not commission any other studies, did not issue an RFP or competitive solicitation for any third-party or non-wires alternative, did not include a cost-benefit analysis, and did not include an hourly constraint analysis. OPC argued that it was not enough for Pepco to show that it could project some possible future need and ask that the Commission trust its engineering judgment. OPC argued that Pepco's showing was defective because, at the time that Pepco decided to resume construction, the record does not show that Pepco had reasonably evaluated the other available potential solutions before making further significant investment.[193] As an alternative to full disallowance, OPC requested that the Commission disallow 64.2 percent of the core construction costs associated with ITN 74120, totaling $44.279 million, as recommended by witness Fitzhenry.[194] OPC argued that the Commission is not required to approve the full cost of an oversized project merely because Pepco chose to build the project as an all-or-nothing solution where only a portion of the capacity was justified.[195]

<u>*MEA*</u>

MEA witnesses Lombardi and Balakumar recommended partial disallowance of White Flint investments that total $136.6 million[196] as a "conservative"[197] remedy. Witness Balakumar characterizes this dollar amount as "the floor for [a non-wires solution] comparison, not as a ceiling on MEA's position."[198]

[192] OPC Brief at 10-16.
[193] OPC Brief at 14.
[194] *Id*. at 15.
[195] *Id*. at 16.
[196] Lombardi Surrebuttal Testimony at 3.
[197] OPC Brief at 24.
[198] Balakumar Surrebuttal Testimony at 37.

Witness Lombardi argued that Pepco is incorrect about the application of COMAR regulations and that Pepco knew or should have known that basing a multimillion dollar capacity upgrade on overload forecasts without adequately understanding how long those overloads would last or when they would occur would carry risk of disallowance.[199] Ms. Lombardi also argued that Pepco knew or should have known that the forecast capacity overloads at the Parklawn substation could have been candidates for more robust consideration of a non-wires solution if Pepco had used the data they already possessed to find out how long the forecast overloads would have lasted or how often they would have occurred.

Mr. Balakumar argued that there were two decision points at which a non-wires solution[200] analysis could have been conducted, 2017 and 2019, but no suitable NWA analysis was performed by Pepco at either time.[201] He also pointed to the Orange and Rockland Utilities' West Warwick project in New York as a comparable NWA project that showed that a NWS was technically feasible and cost-effective relative to the $254.2 million White Flint Project.[202]

Mr. Balakumar testified that Pepco's reliance on the Quanta Study was not reasonable because the study did not include an hourly constraint analysis to determine how many hours per year the projected overload would persist, a threshold question for determining whether a time-limited NWS could address the constraint at a lower cost.[203]

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[199] Lombardi Surrebuttal at 5-6.
[200] MEA uses the term non-wires solution, or "NWS," which is interchangeable with the term NWA used in this Order.
[201] Balakumar Surrebuttal Testimony at 8.
[202] *Id*. at 14-15.
[203] *Id*. at 17-18.

He also testified that Pepco failed to adequately consider alternatives to the White Flint substation, which was contrary to the Commission's directives in Order No. 89868.[204] Mr. Balakumar further argued that Pepco's decision to oversize the White Flint solution relative to the actual constraint is evidence of a deficient planning process.[205]

Mr. Balakumar testified that Pepco–in arguing that MEA did not provide quantitative NWA analysis or comparable project references to support MEA's position–made an error as to the burden of proof in a rate case.[206] He argued that it is Pepco, not an intervenor, that bears the legal burden of proving that a capital investment is prudent and that "prudence is not established by the absence of an intervenor's counter-modeling."[207] After reviewing the Quanta Study and Pepco's responses to data requests, Mr. Balakumar performed an independent NWA analysis using the Parklawn data that Pepco had at the time it made its White Flint planning decisions.[208] MEA's analysis performed both an hourly constraint analysis and a non-wires cost-effectiveness analysis, using actual load measurement data from 2020 through 2024 as a stand-in to replicate the load profile that would have informed a 2017 analysis. Mr. Balakumar testified that a right-sized NWA portfolio would have cost between 13 and 25 percent of the full installed asset cost spent by Pepco, depending on sizing and under what witness Balakumar considered conservative assumptions.[209] Mr. Balakumar testified that the NWA solutions produced a minimum cost savings to Maryland ratepayers of over $19 million during a 15-year period.[210]

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[204] Order 89868, Case No. 9655, *Potomac Elec. Power Co.'s Application for an Electric Multi-Year Rate Plan.*
[205] Balakumar Surrebuttal Testimony at 26.
[206] *Id*. at 15.
[207] *Id*.
[208] *Id*. at 6-9 and 18-20.
[209] *Id*. at 35-36.
[210] *Id*. at 36.

Mr. Balakumar testified that Pepco's responses to data requests show that Pepco's maximum overload above firm capacity through the 2031 forecast was 11.9 MVA, which could have been managed by a NWA project like the West Warwick project.[211] However, Pepco never evaluated whether a phased or dispersed portfolio could have addressed that constraint as it developed.[212]

Mr. Balakumar asserted that Pepco's other arguments against the use of NWA are unsupported.[213] Mr. Balakumar testified that the footprint of an NWA solution could be dispersed across multiple sites, although Pepco did not consider such a possibility. He also testified that Pepco failed to appreciate that deferral of investment during a period of uncertain load growth, at lower cost, could have been the correct outcome. Mr. Balakumar noted that five of the six White Flint ITNs that MEA considers to be part of the White Flint Project appear to be directly or derivatively driven by capacity constraint, with only ITN 73657, the Sligo 34kV to 69kV cable replacement having an independent age and condition reliability justification.[214]

Mr. Balakumar testified ultimately that he does not dispute that capacity constraints at the Parklawn station were projected, but he disputes whether those constraints required the project that Pepco selected, rather than a lower-cost alternative solution.[215] He further testified that 2017 forecasts indicated that the first overload would occur in 2022 at 1.6

[211] *Id*. at 28.
[212] *Id*. at 28-29.
[213] *Id*. at 30-32.
[214] *Id*. at 8-9 and 32.
[215] *Id*. at 50.

percent above the Parklawn substation's firm capacity of 82.5 MW, which never came to pass.[216]

AOBA

AOBA witness Bruce Oliver argued that putting an investment into service is a necessary but not sufficient condition for costs to go into rates.[217] Mr. Oliver pointed to the Commission's past emphasis on Pepco's need to support the levels of White Flint expenditures in future rate case filings, citing Case No. 9655, Order No. 89868 at 94. He argued that Pepco has provided no basis for the prudence of any components related to the White Flint investments, and therefore no cost recovery for White Flint is warranted at this time, though Pepco could seek recovery in a future rate case.

Regarding Pepco witness Alo's testimony that AOBA has not found any flaws in Pepco's planning analyses, or offer viable alternatives, or provide evidence of unreasonable decision-making, Mr. B. Oliver testified that this argument inverts the burden of proof.[218] Reasonable planning must be coupled with evidence of cost-effective execution. He argued that the Quanta Forecast presented by Pepco did not justify the decision to move forward with the White Flint Projects.

Staff

Staff witness Lo testified that Staff did not oppose recovery of the core White Flint Project, nor did Staff support a broad percentage disallowance or deferral.[219] Mr. Lo testified that utilities should be held accountable if a load forecast they plan for is not

[216] *Id*. at 50.
[217] B. Oliver Surrebuttal Testimony at 34-35.
[218] *Id*. at 35-36.
[219] Lo Surrebuttal Testimony at 2-3.

realized, and that the White Flint Project should be evaluated based on the information that was available when Pepco made decisions about the project.

Pepco Rebuttal

In rebuttal, Pepco witness Alo testified that Pepco did not quantify the exact number of hours that overloads would occur or the frequency of overloads because distribution systems are not planned to tolerate recurring overloads for a specified number of hours but designed to prevent them from occurring in the first place.[220]

Mr. Alo also testified that OPC witness Fitzhenry's capacity-utilization framing was incomplete and relied on hindsight, whereas substation planning is driven by contingency analysis, overload risk, transfer capability, and operational flexibility, not simply aggregation utilization percentages.[221] Mr. Alo argued that OPC's proposed 64.2 percent disallowance was an arithmetic deduction untethered to any specific evidence that Pepco acted in an imprudent manner and was a results-oriented conclusion.[222] Mr. Alo argued that Mr. Fitzhenry's disallowance did not identify any specific components, equipment, or scope that should have been redesigned or eliminated, merely applying a proportional disallowance to all core costs.[223] Mr. Alo testified that, in discovery, Mr. Fitzhenry could not identify a specific date when Pepco should have known that forecasts were overstated or components that should have been redesigned or removed.[224] Mr. Alo

[220] Alo Rebuttal Testimony at 41.
[221] *Id*. at 5-6.
[222] *Id*. at 6.
[223] *Id*. at 25.
[224] *Id*. at 25-26.

testified that Mr. Fitzhenry did not identify any errors in the planning methodology, data inputs, or engineering criteria.[225]

Mr. Alo testified that Mr. Fitzhenry unreasonably relied only on a single forecast that was undertaken at a time period several years subsequent to when Pepco began investing in the White Flint Project, while offering no testimony about previous forecasts that projected a capacity overload at the Parklawn substation, all of which he testifies were provided to stakeholders in discovery in Case Nos. 9702 and 9655.[226]

Mr. Alo also testified that Pepco's lack of usage of NWA reflects the "historical reality of limited DER maturity and scale, combined with the absence of regulatory requirements mandating formal nonwires screening [prior to the adoption of COMAR 20.50.15] during the period when many of these projects were planned."[227] Mr. Alo noted MEA witness Balakumar's acknowledgement that the Commission has not adopted a formal NWA screening methodology requirement as a prerequisite to cost recovery.[228] He further argued that NWAs have only recently begun to reach levels of maturity, controllability, and scale necessary to make them candidates for deferring certain types of projects.[229] Mr. Alo also testified that it considered multiple options, including NWAs, but determined that those alternatives would not provide the capacity necessary to meet projected load growth or adequately mitigate reliability risk to the surrounding substations.[230] Mr. Alo testified that the Company determined that an NWA would provide

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[225] *Id*. at 27.
[226] *Id*. at 19-22.
[227] *Id*. at 41-42, referring to distributed energy resources, or DERs.
[228] *Id*. at 32.
[229] *Id*. at 43.
[230] *Id*. at 8.

only a short-term deferral and not address long-term capacity needs for the area, based on capacity requirements and reliability risk considerations known at the time.

Pepco witness Nelson argued that OPC's analysis was backward-looking and was not an appropriate review based on information available at the time decisions were made.[231] Pepco witness Alo pointed to Order No. 87591 at 117, where the Commission stated that prudent does not mean clairvoyant or perfect.[232] Mr. Alo also pointed to Order No. 89868 in Case No. 9655, where the Commission observed that projects like this require planning years in advance and must be based on forecasts, the accuracy of which cannot be determined until after the project is completed.

COMMISSION DECISION

A review of Case No. 9655's Order No. 89868, issued June 28, 2021 and setting Pepco's rates for a forecasted rate-effective period covering parts of 2021 through parts of 2024, finds similar concerns about Pepco's White Flint Projects to those raised in this case: skepticism about the economic growth projections that underlay Pepco's load growth forecasts and concerns that Pepco had failed to thoroughly consider potentially less expensive alternatives such as energy storage and demand response.[233]

In Case No. 9655, faced with those concerns, Pepco, which had already constructed approximately one-third of the planned White Flint substation, made assertions that development in the White Flint area would resume in 2021 or 2022, and that the forecasted

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[231] Nelson Surrebuttal Testimony at 11.
[232] Alo Rebuttal Testimony at 15, *citing* Order No. 87591, Case No. 9406, *In the Matter of the Application of Baltimore Gas and Elec. Co. for Adjustments to its Electric and Gas Base Rates* (Jun. 3, 2016).
[233] Case No. 9655, Order No. 89868 at 87-95.

development would require completion of the substation.[234] At that time, Pepco was already planning a battery storage pilot project at Livingston Road[235] (a project that was ultimately abandoned).

The Commission, in Order No. 89868, allowed Pepco to recover for the White Flint Project costs incurred up to that point but also explained that the Commission was "not sufficiently confident in Pepco's load forecasting, consideration of alternatives, and cost-benefit considerations" to allow recovery of future costs, *i.e.*, the costs in question in the instant case. The Commission did not make any final determination as to the accuracy of Pepco's forecasting or Pepco's consideration of alternative solutions or cost-benefit analyses, however, and stated that if Pepco chose to proceed with the project, Pepco would be required to thoroughly justify its decision.[236]

Following issuance of that Order, the Company halted construction of the substation. The projected development in the White Flint area that Pepco forecasted would produce load growth did not materialize in 2021, 2022, or 2023 (and has still not materialized). Nevertheless, Pepco elected in 2023 to resume construction of the White Flint substation. The Commission now reviews that decision for prudency based on the information available to Pepco at the time the decision to resume construction was made. That analysis calls forth two central questions: (1) whether Pepco was prudent in its forecasting that demand would exceed capacity in the near-term; and (2) and whether Pepco was prudent in choosing to complete the White Flint substation project as the solution to any forecasted capacity constraint or to any other problem.

[234] *Id*. at 92.
[235] *Id*.
[236] *Id*. at 94-95.

To the first point, the Commission observes that Pepco has given significant weight to the Quanta Study[237] as a basis for concluding that forecasted demand would produce a capacity shortfall. The Commission has reviewed the Quanta Study[238] and is greatly concerned that, as OPC witness Fitzhenry points out, the study does not offer any analysis of the probability that the forecasted demand might not materialize, as it has repeatedly failed to materialize for years. In fact–although its stated methodology included review of service requests, building permits, zoning changes, and leading indicators of new development and then applying Pepco-generated estimated peak loads for those projects, and for other areas of demand growth such as electrification[239]–the study explicitly states as a base assumption that projected demand growth *will* take place during the modeled planning horizon[240] and proceeds to analyze various scenarios of how this might occur in the ten-year planning window, without giving any attention to the likelihood of any particular outcome occurring, explaining that its scenarios: "aim not to identify what is likely to happen but the limits of what could happen."[241] This was reiterated in hearing testimony, where Pepco witness Alo testified that there was no attempt to determine whether any one scenario was more likely than another.[242] Additionally, the study lacks detailed rationale and development timelines for a significant portion of the load Quanta is

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[237] Initially marked confidential, the Quanta Study was subsequently placed into the record unsealed by Pepco. Hr'g Tr. at 385-386.
[238] Alo Direct Testimony, Schedule (TOA)-5.
[239] *Id*. at 12-14.
[240] *Id*., Schedule (TOA)-5. Section 3.4.8 of the Quanta report is titled "No Chance of Not Developing," and explains that "no consideration was given to any of the three projects [sic: scenarios] never developing. The reason is that even if the developer planned to fall through completely, any parcel of land available for development or redevelopment in a high-growth area like the White Flint Study Area would likely develop or redevelop in time."
[241] *Id*., Schedule (TOA)-5 at 14.
[242] Hr'g Tr. 454-455.

modeling.[243] Pepco did not offer any other studies or evidence persuasive on the question of the probability that demand growth would materialize.

This issue was previously present in Case No. 9655, where parties expressed concern that Pepco's load forecasts were overstated due to a lack of consideration of the possibility that load would not materialize.[244] It is deeply concerning that Pepco does not appear to have modified its approach on this front. The Commission therefore finds that the Quanta Study was not a reasonable basis on which to rely for the level of demand growth that Pepco presumed in constructing the White Flint substation. The Commission further finds that any basis for reliance by Pepco on local development plans is undeveloped in the record and does not justify the immense expenditure that has been undertaken.

The Commission is further concerned with the Company's assertions that the Quanta Study justified the decision to resume construction of the White Flint substation. The study, dated May 9, 2023, was initially marked as "Privileged and Confidential. DRAFT–This document is not for distribution. It is intended for discussion only." The Commission questions the appropriateness of relying on a draft report for a decision of this magnitude. Moreover, there is testimony in the record that suggests the Company might have actually resumed construction work in April 2023, before the study was completed.[245] While not dispositive, these factors certainly raise questions on whether the study could be used as justification for resumption of construction of the substation.

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[243] *See id.*, Appendix B table. The column in this table specifying the schedule for development of each project is empty or has no completion date specified for over half of the total load in megawatts.
[244] *See* e.g., Order No. 89868 at 89 para. 214.
[245] *See* Alo Direct Testimony (Confidential), Schedule (TOA)-2, at 3.

On the second point, the Commission observes that, while Pepco claims to have considered other alternatives, the record is nearly silent on the details of whatever alternatives analysis Pepco might have undertaken.[246] Alternative wired solutions are described and dismissed at a high level as being infeasible due to physical constraints.[247] As for NWA, Pepco's basis for dismissing them as an option similarly consists of high-level statements that (1) energy storage and demand response were found to be incapable of meeting the forecasted demand, including long duration, high load scenarios; (2) the Parklawn substation footprint was not sufficient for a storage system large enough to alleviate the overload; (3) storage did not provide the reliability or resiliency benefits of a substation.[248] In hearing testimony, Pepco witness Alo testified that Pepco "did not do a formal analysis of non-wires alternative solution. We evaluated it as one of the alternative options that could address the overload at Parklawn, but due to the nature of the overload at Parklawn, deemed that a non-wire solution would not solve the problem."[249]

While the Commission appreciates Pepco's concerns that energy storage is a developing technology and also might not have ultimately resolved the system needs, Pepco had been developing energy storage pilot projects as part of Case No. 9619 since at least 2020,[250] years before the decision in 2023 to proceed with completing the White Flint projects, making the casual dismissal of energy storage—without placing into the record

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[246] When asked at the hearing if Pepco had any results of specific studies of alternatives, Pepco witness Alo testified that Pepco did not have any formal documentation of the results of that analysis. Hr'g Tr. at 470.
[247] *See* Alo Rebuttal Testimony at 36; *Id*., n. 72 (citing testimony from Case No. 9655 by a witness who did not offer testimony in this case)
[248] See Alo Rebuttal at 8, 37, and 40-41
[249] Hr'g. Tr. 465.
[250] *See* Case No. 9619, *In the Matter of the Maryland Energy Storage Pilot Program*. For example, in November 2020, the Commission issued Order No. 89664, approving two separate energy storage projects proposed by Pepco.

anything that could be called an alternatives analysis or any evidence that such an analysis was done—not reasonable given the Commission's prior decision in Order No. 89868 where it expressed the importance of alternatives analysis for a project such as this.

The Commission is also not persuaded based on the record that there existed an immediate reliability need that required the project to be constructed at the scale and cost that ultimately occurred. Pepco expressly characterized the White Flint projects as "built to address capacity needs, but in so doing, they also improve the reliability and resilience of the local distribution network."[251] The statement of ancillary reliability benefits without also proving a reliability need for the project in the first place does not aid in demonstrating that alternatives which did not incorporate this benefit were not viable. The Commission notes with concern that Pepco did not put forward any cost-benefit analysis or other assignment of monetary value or customer benefit that might offer a numerical impression of additional reliability benefits provided by this project separate and apart from relieving capacity constraints. The Commission is therefore unable to give significant weight to those considerations.

The Commission also observes with concern that Pepco, as noted by AOBA, has presented an "all or nothing" scenario for acceptance of White Flint expenditures, choosing not to provide independent cost-justification of portions of the overall project costs.[252]

For these reasons, the Commission agrees with OPC, MEA and AOBA that Pepco's decision to resume construction of the White Flint projects in 2023 was not prudent at the time the decision was made.

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[251] Pepco Brief at 31.
[252] *See* B. Oliver Surrebuttal Testimony at 35.

As a potential independent basis for authorizing recovery, the Commission also cannot find that the White Flint projects are—while imprudent at the time the decision was made—necessary now, given that Pepco's forecast as of 2025 shows that the original 82.5MW capacity of Parklawn will not be exceeded through 2034, leaving the imprudently expanded capacity of the Parklawn and White Flint substations combined (177.5 MW) at no more than 35.8% utilization through 2034.[253]

Having so found, the Commission must determine what level of disallowance is appropriate. The Commission observes that OPC and AOBA recommended a full disallowance (with OPC also offering an alternative partial disallowance recommendation) and MEA recommended a partial disallowance covering three project ITNs–74118, 74120, and 72200–as a floor for an NWS comparison, not as a ceiling on MEA's position. The Commission is not persuaded that a partial disallowance is justified, as this would require the Commission to conclude that some portion of the project was prudent, which the Commission cannot do based on this record.

The Commission therefore directs that all costs associated with the White Flint substation (ITNs 74118, 74120, and 74121[254]) not be included as a component of Plant in Service at this time.

Should Pepco develop in a future rate case a record showing that these projects have become prudent due to changed circumstances, the Commission will consider such an application at that time. While the Commission provides this opportunity for potential recovery in a future rate case, Pepco alone bears the burden of providing sufficient

[253] Fitzhenry Revised Clean Direct Testimony at 23, Table CTF-3.
[254] While Pepco represented four ITNs, including ITN 72002, as the White Flint project, it is not seeking recovery of any costs associated with ITN 72002 in this case. *See* Table 7, Bench Data Request No. 2.

information that demonstrates the adequacy of the project that would allow recovery of White Flint investment costs.

B. Cost of Capital

The cost of capital for a company is calculated using the rate base, capital structure, cost of debt, and ROR. The utility recovers its return on equity ("ROE") and return on debt through charges paid by ratepayers. The ROE requires analysis, as it is typically estimated based on market conditions and different analytical approaches. The cost of debt can be directly observed, as bonds are issued subject to specific interest rates, though the appropriate cost may still require examination. Once the cost of debt and ROE are determined, they are weighted according to the percentage of debt and equity in the utility's capital structure. The sum of the weighted cost of debt and ROE is the utility's overall ROR. The parties submitted varying analyses based on differing methodologies and models. In assessing the various proposals, the Commission must, in accordance with PUA § 4-201, determine "just and reasonable" rates for the regulated service that the utility provides.

1. Capital Structure and Cost of Debt

Pepco has proposed a capital structure consisting of 51.53% common equity and 48.47% debt. In opposition, Staff, OPC, and AOBA presented lower equity requirements, which are shown below in Table 4.

Table 4:
Capital Structure as Recommended by Parties

	Pepco[255]	**Staff**[256]	**OPC**[257]	**AOBA**[258]
Long-Term Debt	48.47%	49.50%	57.00%	49.50%
Common Equity	51.53%	50.50%	43.00%	50.50%

Pepco

Pepco requested an overall ROR of 7.83%, derived from a capital structure consisting of approximately 51.53% common equity and 48.47% long-term debt, with debt priced at average cost of 5.02%, and equity with an average cost of 10.50%.[259] Pepco emphasized that its proposed structure reflects its actual financing mix, adjusted appropriately to exclude debt associated with the EmPOWER Maryland program in accordance with legislative requirements.[260] Pepco explained that failing to include the adjustment "would artificially inflate the debt ratio by including debt that is statutorily dedicated to EmPOWER."[261]

Pepco maintained that its proposed equity ratio is consistent with industry benchmarks and falls within the range observed among comparable utilities in its proxy group.[262] Pepco witness O'Donnell argued that Pepco's proposed capital structure is

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[255] Pepco Initial Brief at 48.
[256] Staff Initial Brief at 37.
[257] OPC Initial Brief at 9.
[258] AOBA Initial Brief at 60.
[259] Pepco Initial Brief at 48-49. *See also* Pepco Reply Brief at 32. Pepco revised the Company's proposed cost of debt from 5.03% to 5.02% and overall ROR from 7.85% to 7.83% based on current market conditions.
[260] *Id*. at 49.
[261] O'Donnell Direct Testimony at 6.
[262] Pepco Initial Brief at 49.

reasonable given the "average common equity ratio of 52.0% and a range of 43.1% to 61.7% for the electric operating subsidies of the companies in Company witness McKenzie's proxy group."[263] The Company also asserted that its capital structure aligns with equity ratios implicitly reflected in prior Commission-authorized returns, reinforcing that its proposal is not anomalous but rather consistent with regulatory precedent.[264]

Pepco opposed alternative capital structure proposals advanced by other parties and discussed further below.[265] Pepco criticized OPC's recommended structure—approximately 57% debt and 43% equity—as unreasonable, inconsistent with Commission precedent, and disconnected from the Company's actual financing practices.[266] Pepco further argued that OPC's proposal would violate conditions established in the Exelon–PHI Merger—specifically, Condition No. 31, which requires that Pepco maintain a minimum equity ratio of 48% on a rolling basis.[267] Additionally, Pepco challenged OPC's reliance on a "double leverage" methodology, asserting that it is flawed, unprecedented, and produces illogical results, including a cost of equity ("COE") below the cost of debt.[268]

Pepco also opposed the proposals advanced by Staff and AOBA, which rely on an unadjusted capital structure that includes debt associated with the Company's EmPOWER program.[269] Pepco explained that such debt should be excluded because it is recovered through a separate surcharge and, by statute, earns a return based on the Company's weighted cost of debt.[270] Including this debt in the capital structure used for setting

[263] O'Donnell Direct Testimony at 7.
[264] Pepco Initial Brief at 49.
[265] *Id*.
[266] *Id*. at 49-50.
[267] Pepco Initial Brief at 50. *See also* Pepco Reply Brief at 26.
[268] Pepco Initial Brief at 50. *See also* Pepco Reply Brief at 25-26.
[269] Pepco Initial Brief at 51.
[270] *Id*.

distribution rates would, in Pepco's view, artificially inflate the debt ratio and misrepresent the capital actually available to finance distribution system investments.[271]

Overall, Pepco contended that its proposed capital structure appropriately reflects its regulated operations, complies with legislative directives, and supports its ability to maintain financial integrity and attract capital.[272] The Company asserted that adopting alternative proposals would create a disconnect between ratemaking assumptions and actual financing practices, potentially impairing the Company's ability to fund necessary infrastructure and provide reliable service.[273]

Pepco also proposed that the cost of debt be set at 5.02% which is based on its actual cost of debt and adjusted for projected debt issuances in 2026.[274] Pepco witness O'Donnell explained there would be debt issuances in March and June of 2026 and recommended these be included.[275] Ms. O'Donnell argued it is Commission precedent to allow "pro forma" adjustments to capital structures for bond issuances after the test period but prior to a Commission decision.[276]

Table 5:
Pepco Proposed Cost of Capital

Component	Capital Ratio	Cost	Weighted Cost Rate
Long-Term Debt	48.47%	5.02%	2.42%
Common Equity	51.53%	10.50%	5.41%
Rate of Return	100.00%		7.83%

[271] *Id*.
[272] *Id*.
[273] *Id*.
[274] *See also* Pepco Reply Brief at 32. Pepco revised the Company's proposed cost of debt from 5.03% to 5.02% and overall ROR from 7.85% to 7.83% based on current market conditions.
[275] O'Donnell Rebuttal Testimony at 57.
[276] *Id*. at 55.

OPC

OPC argued that Pepco's proposed capital structure is overly weighted toward equity and, as a result, shifts unnecessary costs onto ratepayers while reducing financial risk for shareholders.[277] OPC noted that Pepco's proposed structure of 48.47% debt and 51.53% equity contains a significantly higher equity ratio than the average of its own proxy group, which is closer to 57% debt and 43% equity.[278] OPC witness Garret recommended a 57% debt and 43% equity structure because it reflects the proxy groups debt structure as reported by Value Line and comparable industries have higher debt.[279]

OPC emphasized that equity is more expensive than debt, and therefore an elevated equity ratio directly increases the utility's weighted average cost of capital ("WACC"), revenue requirement, and ultimately customer rates.[280] OPC contended that, absent regulatory intervention, utilities lack a natural incentive to minimize WACC because higher equity levels can enhance shareholder returns.[281] For this reason, OPC maintained that it is the Commission's responsibility to ensure that the approved capital structure reflects an efficient balance of debt and equity consistent with the utility's actual risk profile.[282]

OPC further argued that regulated electric utilities, such as Pepco, face relatively low business risk due to their monopoly status and the essential nature of their services.[283] This reduced risk, in OPC's view, supported the use of a more debt-heavy capital structure

[277] OPC Initial Brief at 9.
[278] *Id*.
[279] Garrett Direct Testimony at 68-72.
[280] OPC Initial Brief at 10.
[281] *Id*.
[282] *Id*.
[283] *Id*.

than what Pepco has proposed.[284] By carrying more debt, the utility can lower its overall cost of capital without jeopardizing financial stability.[285] Based on these considerations, OPC supported Mr. Garrett's recommendation that the Commission adopt a capital structure of approximately 57% debt and 43% equity for ratemaking purposes.[286] OPC stated that adopting this more balanced and cost-efficient capital structure would produce a fair overall ROR while avoiding unnecessary costs to customers.[287]

Furthermore, OPC criticized Pepco's ROE testimony, stating that the Company misinterpreted its prior recommendations.[288] OPC clarified that the recommended capital structure of 57% debt and 43% equity was for ratemaking purposes only.[289] As such, the recommendation would not require the Company to actually operate with a capital structure that might conflict with any merger condition.[290] Additionally, OPC dismissed the accusation that the double-leverage model was utilized in witness Garrett's capital structure recommendation.[291]

<u>AOBA</u>

ABOA witness T. Oliver proposed to maintain the Company's current capital structure of 50.50 % equity and 49.50% debt as he saw no support to alter it.[292] Mr. T. Oliver claimed that Pepco's proposed capital structure was "reasonable in composition" but argued it lacked assurances it will minimize ratepayer costs, promote financial stability,

[284] *Id*.
[285] *Id*.
[286] *Id*.
[287] *Id*.
[288] OPC Reply Brief at 9.
[289] *Id*. at 9-10.
[290] *Id*. at 10.
[291] *Id*.
[292] T. Oliver Direct Testimony at 13.

and not subsidize or provide financial advantage to its parent company's non-utility operations.[293]

AOBA argued that Pepco's proposed ratemaking capital structure places undue reliance on high-cost common equity and, if adopted, would unnecessarily increase costs for Maryland customers.[294] AOBA emphasized that the equity ratio is not merely a reflection of corporate finance preferences but a key regulatory input that directly determines the Company's WACC and resulting revenue requirement.[295]

AOBA contended that the Commission should evaluate Pepco's capital structure from the standpoint of ratepayer impact rather than the preferences of Pepco or its parent company.[296] According to AOBA, investor-owned utilities have a natural incentive to favor higher equity ratios, but the regulatory objective is to identify a capital structure that minimizes customer costs while preserving reasonable access to capital.[297]

Based on these considerations, AOBA recommended that the Commission adopt a more moderate capital structure with no more than approximately 50.50% equity and 49.50% debt.[298] AOBA asserted that this approach better reflects Pepco's regulated risk profile, aligns with the goal of minimizing ratepayer costs, and ensures that customers are not burdened with an unnecessarily high cost of capital.[299]

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[293] *Id*. at 13-14.
[294] AOBA Initial Brief at 60.
[295] *Id*.
[296] *Id*. at 61.
[297] *Id*. at 60.
[298] *Id*.
[299] *Id*.

Staff

Staff argued that the Commission should adopt Pepco's unaltered (*i.e.*, current) capital structure and reject proposed adjustments that, in its view, would artificially increase customer costs.[300] Specifically, Staff recommended a capital structure consisting of approximately 49.5% long-term debt and 50.5% common equity, asserting that this reflects Pepco's true financing mix and provides an appropriate basis for ratemaking.[301]

Staff witness McAuliffe opposed Pepco witness O'Donnell's proposed adjustments to Pepco's capital structure, arguing that debt associated with EmPOWER programs should not be excluded.[302] Mr. McAuliffe asserted that EmPOWER investments remained part of the utility's overall operations and capital structure, and that removing the associated debt would artificially increase the Company's equity ratio and, consequently, its overall ROR.[303] He further contended that such an adjustment would be inconsistent with the intent of the Maryland Legislature, which sought to reduce program costs without increasing distribution rates.[304]

Mr. McAuliffe also rejected Ms. O'Donnell's proposal to include forecasted debt issuances in the calculation of Pepco's capital structure.[305] While Mr. McAuliffe accepted the inclusion of known and actual debt issuances, he argued that any issuances occurring after the start of hearings were speculative and should not be considered in determining the Company's cost of debt.[306]

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[300] Staff Initial Brief at 37.
[301] *Id*.
[302] McAuliffe Surrebuttal Testimony at 5. *See also* Staff Initial Brief at 37 and Staff Reply Brief at 24.
[303] *Id*.
[304] McAuliffe Surrebuttal Testimony at 5.
[305] *Id*.
[306] *Id*.

Finally, Staff objected to Pepco's proposed long term debt cost in favor of 5.00% as the known and measurable cost of debt at the time of the hearing, arguing that Pepco's estimated cost of debt was uncertain and speculative.[307] Staff explained that the 5.00% value was based on the "removal of the June debt issuance coupled with updated debt information provided by Pepco."[308] Based on the updated 5.00% updated cost of debt, Staff's calculated 9.5% ROE resulted in an overall ROR of 7.28%.[309]

COMMISSION DECISION

The Commission must determine a capital structure that yields a fair ROR while ensuring that resulting rates are just and reasonable, consistent with PUA § 4-201. In making this determination, the Commission balances the utility's need to maintain financial integrity and access to capital with its obligation to protect ratepayers from excessive costs. Generally, the Commission will not impute a capital structure unless there is evidence that the actual capital structure would impose an undue burden on ratepayers.[310] The Commission finds that maintaining Pepco's unadjusted capital structure—consisting of 49.50% long-term debt and 50.50% common equity—provides the most reasonable balance between investor and ratepayer interests.

The Commission is not persuaded that Pepco has demonstrated that an adjustment to remove EmPOWER-related debt is appropriate for ratemaking purposes. EmPOWER programs are part of Pepco's regulated operations and involve investments made by the

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[307] Staff Initial Brief at 37-38.
[308] *Id*. at 38.
[309] *Id*.
[310] *See also* Order No. 91181 at 149, Case No. 9702, *Potomac Elec. Power Co.'s Application for Adjustments to its Retail Rates for the Distribution of Electric Energy* (Jun. 10, 2024).

Company in furtherance of its utility obligations. The fact that Pepco is permitted to earn a return on investments that have not been approved in a rate case is a benefit to Pepco to incentivize those investments, but Pepco capital used to fund Pepco's EmPOWER investments cannot be meaningfully differentiated from capital used to fund any other investment made by Pepco because money is fungible. The debt that Pepco asserts is attributable to EmPOWER is therefore an undifferentiated part of Pepco's overall financing structure and should be reflected in the capital structure used to determine the Company's ROR in the same way that debt or equity used to fund any other investment would be.

Accordingly, the Commission adopts Staff's recommended capital structure consisting of 49.50% long-term debt and 50.50% common equity. This capital structure appropriately reflects Pepco's actual financing mix, recognizes the Company's need to maintain financial integrity, and avoids imposing unnecessary costs on customers. Furthermore, the Commission accepts Staff's recommendation for long-term debt cost of 5.00% as known and measurable.

2. Return on Equity

Pepco, Staff, OPC, AOBA, and MEA each proposed a different ROE as summarized below:

Table 6:
Return on Equity as Recommended by Parties

	Pepco	Staff	OPC	MEA	AOBA
Recommended Range	10.00% - 11.00%[311]	9.335% - 9.725%[312]	5.70% - 8.20%[313]	7.70% - 9.20%[314]	Did not use a model to develop recommended ROE
Recommendation	10.50%[315]	9.50%[316]	7.70%[317]	9.00%[318]	9.40%[319]

Pepco

Pepco argued that its requested 10.50% ROE is necessary to preserve its financial integrity and ensure continued access to capital on reasonable terms.[320] Pepco emphasized that rising capital costs, increasing interest rates, and Maryland-specific regulatory and operational risks justify a higher ROE than proposed by intervenors.[321]

Pepco argued that the *Hope* and *Bluefield*[322] standards articulated by the U.S. Supreme Court required an authorized ROE that reflected investors' opportunity cost and provided a return comparable to investments of similar risk.[323] According to Pepco, the evidentiary record demonstrates that its requested ROE falls within a reasonable range of

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311 McKenzie Revised Direct Testimony at 3.
312 McAuliffe Direct Testimony at 12 and 55.
313 Garrett Direct Testimony at 4.
314 Kihm Direct Testimony at 34.
315 McKenzie Revised Direct Testimony at 3.
316 McAuliffe Direct Testimony at 12.
317 Garrett Direct Testimony at 4.
318 Kihm Direct Testimony at 4.
319 T. Oliver Direct Testimony at 10.
320 Pepco Initial Brief at 47-48.
321 *Id*. at 48.
322 *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).
323 McKenzie Direct Testimony at 6. *See also* Pepco Initial Brief at 51-52.

returns required by investors and will enable the Company to meet its ongoing infrastructure and service obligations.[324] Pepco maintained that, because investors' required return was not directly observable and no single methodology should be relied upon in isolation, multiple analytical approaches should be considered to develop a balanced and reasonable ROE.[325]

To support its position, Pepco relied on the testimony of witness McKenzie, who employed multiple widely accepted financial models: Discounted Cash Flow ("DCF"), Capital Asset Pricing Model ("CAPM"), Empirical CAPM ("ECAPM"), risk premium, and expected earnings methods.[326] These quantitative approaches produced a range of ROE estimates from which Mr. McKenzie concludes a range of 10.0-11.0% is appropriate for a COE and recommends the midpoint of 10.50% ROE.[327] Pepco emphasized that no single model should be determinative and that regulatory judgment should consider a range of analytical results.[328]

Witness McKenzie explained that DCF models "are based on the assumption that the price of a share of common stock is equal to the present value of the expected cash flows (*i.e.*, future dividends and stock price) that will be received while holding the stock, discounted at investors' required ROR."[329] Using the constant growth DCF model with multiple earnings per share growth rates and calculated sustainable growth rates, Mr. McKenzie calculated the following after eliminating certain illogical values:[330]

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[324] Pepco Initial Brief at 52.
[325] McKenzie Direct Testimony at 6.
[326] Pepco Initial Brief at 54 and McKenzie Direct Testimony at 6.
[327] McKenzie Direct Testimony at 9.
[328] Pepco Initial Brief at 53.
[329] McKenzie Direct Testimony at 36.
[330] *Id*. at 36-43.

Table 7:
DCF Results–Utility Group

Growth Rate	Average
Value Line	9.8%
IBES	10.5%
Zacks	10.3%
br + sv	9.3%

Additionally, Mr. McKenzie defined CAPM as "a theory of market equilibrium that measures risk using the beta coefficient," which resulted in an average ROE of 10.4% and 10.7% after adjusting for firm size which was premised upon a calculated market risk premium for dividend paying firms in the S&P 500 using a DCF analysis, 30-year treasury bond, and Value Line Betas.[331] Whereas Mr. McKenzie distinguished ECAPM as the "[e]mpirical tests of the CAPM [that] have shown that low-beta securities earn returns somewhat higher than the CAPM would predict, and high-beta securities earn less than predicted," and thus creates a weighting to correct this concern.[332] The ECAPM used the same inputs as the CAPM model and resulted in an average ROE of 10.8% and 11.1% after adjusting for firm size.[333]

Regarding Utility Risk Premium, the definition was proposed as "the risk-return tradeoff observed with bonds to estimate investors' required ROR on common stocks."[334] Taking a regression of authorized utility ROEs and utility bond yields, Pepco calculated an implied equity risk premium of 4.68% for electric utilities, which when added to a Baa-

[331] *Id*. at 44-48.
[332] *Id.* at 48.
[333] *Id*. at 48-50.
[334] *Id*. at 50.

rated bond yield Mr. McKenzie states results in a ROE of 10.74%.[335] With regards to the expected earnings method, Mr. McKenzie states the "return available from alternative investments of comparable risk can provide an important benchmark in assessing the return necessary to assure confidence in the financial integrity of a firm and its ability to attract capital" and claims "it avoids the complexities and limitations of capital market methods and instead focuses on the returns earned on book equity, which are readily available to investors."[336] Mr. McKenzie used projected year-end returns on common equity from Value Line and then converted them to average returns, which estimated a ROE of 11.2%.[337]

Pepco argued that qualitative factors reinforce the need for its proposed ROE.[338] The Company highlighted materially higher bond yields since 2021, indicating increased costs of long-term capital, as well as broader industry risks such as elevated capital spending requirements, supply chain pressures, and weakening credit metrics across the utility sector.[339] Pepco asserted that its substantial capital investment plan and the evolving regulatory environment increase its risk profile, thereby necessitating a competitive ROE to ensure adequate cash flow and financial flexibility.[340]

Pepco argued that the Commission should reject the lower ROE recommendations advanced by other parties, discussed below, arguing that they fail to reflect current capital market conditions and would represent a significant and unwarranted reduction from its

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[335] *Id*. at 53, Schedule (AMM)-9.
[336] Pepco Direct McKenzie at 53.
[337] *Id*. at 55.
[338] Pepco Initial Brief at 53.
[339] *Id*. at 54-55.
[340] *Id*. at 56.

existing authorized return.[341] Pepco maintained that these proposals rely too heavily on selective model outputs and do not appropriately apply the *Hope* "end result" doctrine.[342] According to Pepco, proposals ranging from 7.70% to 9.50% fail to reflect the returns required by investors for comparable-risk utility investments and would make Pepco less attractive to capital providers.[343] The Company emphasized that authorized ROE is a critical metric for equity analysts and credit rating agencies, and that an inadequate ROE could weaken credit quality and increase borrowing costs—ultimately harming customers.[344]

Pepco specifically challenged each intervenor's recommendation. With respect to Staff, Pepco argued that the reliance on "gradualism" to support a 9.50% ROE was vague and unsupported by the record.[345] Pepco maintained that if gradualism were applied appropriately, it would justify an increase—not a decrease—in ROE, given that utility bond yields have risen significantly since the Company's last authorized ROE.[346] Pepco contended that because the COE generally tracks movements in bond yields, current market conditions support a higher return.[347]

Pepco criticized OPC's proposed 7.70% ROE, characterizing it as extreme, unprecedented, and punitive. The Company noted that this recommendation falls well below recently authorized ROEs for electric utilities and significantly undercuts both Staff's recommendation and broader industry averages.[348] Pepco further argued that OPC's

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341 *Id*.
342 *Id*. at 56-57.
343 *Id*. at 56.
344 *Id*. at 57.
345 *Id*. at 57-58. *See also* Pepco Reply Brief at 19-20.
346 Pepco Initial Brief at 58. *See also* Pepco Reply Brief at 19-20.
347 Pepco Initial Brief at 58. *See also* Pepco Reply Brief at 19-20.
348 Pepco Initial Brief at 58.

reliance on the "double leverage" methodology renders its analysis unreliable, emphasizing that this approach has not been adopted by regulatory commissions to set ROEs.[349] In Pepco's view, adopting such a low ROE would violate the *Hope* and *Bluefield* standards by undermining financial integrity and failing to provide returns commensurate with comparable investments.[350]

Additionally, Pepco rejected AOBA's recommendation of a 9.40% ROE because it lacked any supporting ROE analysis.[351] Pepco asserted that AOBA failed to account for elevated capital costs and rising bond yields, which, in the Company's view, clearly support an ROE above its currently authorized 9.50%.[352] As such, Pepco argued that AOBA's position is inconsistent with both market evidence and the broader evidentiary record.[353]

With respect to MEA, Pepco argued that its analysis placed undue reliance on theoretical relationships between ROE, COE, and market-to-book ratios, rather than adhering to established ratemaking principles.[354] Pepco criticized MEA's DCF analysis for relying on unsupported growth assumptions and failing to screen out illogical results.[355] Pepco also challenged MEA's CAPM analysis, asserting that it relied on non-transparent inputs, inappropriate benchmarks such as 10-year Treasury yields, and failed to incorporate

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349 *Id*.
350 *Id*.
351 *Id*.
352 *Id*.
353 *Id*. at 58-59.
354 *Id*. at 59.
355 *Id*.

adjustments for firm size.[356] According to Pepco, these methodological flaws render MEA's proposed ROE unreliable.[357]

More broadly, Pepco contended that all opposing recommendations are inconsistent with both the evidentiary record and Commission precedent.[358] The Company emphasized that the Commission has historically considered factors such as utility risk, capital market conditions, and the need to attract capital when setting ROE.[359] Pepco argued that intervenors' proposals ignore key risks facing the Company, including its substantial capital investment program, evolving regulatory requirements, and increased financing costs.[360] Furthermore, Pepco noted that "the midpoint of the Federal Funds target range increased by 350 basis points," and other parties' key interest rate benchmarks increased by roughly 250 to 280 since Pepco's last rate case.[361] As a result, Pepco argued that the current authorized ROE has not "kept pace with market changes, evidenced by the fact that Baa[-rated] utility [bond] yields have increased by more than 260 basis points since 2021, while Pepco's allowed ROE has decreased by seven basis points."[362]

In conclusion, Pepco urged the Commission to adopt its 10.50% ROE as a balanced and evidence-based outcome that supports both investor requirements and long-term customer benefits.[363] Pepco observed that the adjusted national average ROEs support a COE of 9.93% to 10.30%, and an ROE of 10.79% based on comparable capital market

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[356] *Id*.
[357] *Id*.
[358] *Id*.
[359] *Id*.
[360] *Id*. at 59-60.
[361] Pepco Reply Brief at 20.
[362] *Id*.
[363] Pepco Initial Brief at 60.

conditions.[364] As such, Pepco argued benchmarks and methodologies in the record confirm that the recommendations opposing the proposed 10.50% ROE are too low.[365]

OPC

OPC witness Garrett recommended an ROE of 7.7%, asserting that it satisfied the constitutional standards by ensuring financial integrity, maintaining access to capital, and aligning with returns expected for investments of comparable risk.[366] OPC noted that investors could generally expect a 6% to 7% return in the market; as such, a 10.50% return for a low-risk industry with a captive customer base was excessive.[367] Furthermore, OPC maintained that Pepco's financial condition remained strong, citing increasing net income in recent years, and argued that a reduced ROE would not jeopardize the Company's financial health or its ability to recover costs and earn a reasonable return.[368]

Mr. Garrett relied upon the multiple variations of DCF and CAPM models, and a review of the parent company's leverage relative to Pepco's.[369] He calculated the following results: [370]

[364] Pepco Reply Brief at 21-22.
[365] *Id*. at 22.
[366] OPC Initial Brief at 3.
[367] OPC Reply Brief at 6.
[368] OPC Initial Brief at 5.
[369] Garrett Direct Testimony at 3.
[370] *Id*. at 3-4.

Table 8:
Garrett's Cost of Equity Model Results

Model	Cost of Equity
Double Leverage ROE (Parent WACC)	5.7%
CAPM (at Proxy Debt Ratio)	8.2%
Hamada CAPM (at Company-Proposed Debt Ratio)	7.7%
DCF Model (Sustainable Growth)	7.3%
Model Average	7.2%
Recommended ROE	7.7%

This recommended ROE took into consideration all modeling results and applied the concept of gradualism.[371] Mr. Garett noted that although 7.7% is a lower ROE than that authorized by regulatory commissions on average, Pepco's ROE should be based on "an objective estimate of its COE results in a fair and reasonable authorized ROR."[372] Additionally, OPC stated that the Commission should not give less consideration to innovative analytical models as compared to traditional models.[373]

Mr. Garrett used a 30-day average of stock prices, annualized forward dividends published by Yahoo Finance and two different measures of growth rates.[374] One measure of growth rate was premised upon analysts' projections which were based on historical, short-term annual dividend growth rates from Value Line and another referred to as a sustainable growth rate which used the long-term forecast for nominal United State's Gross Domestic Product ("GDP") growth.[375] Mr. Garrett did not rely upon the analysts' growth

[371] *Id*. at 4. *See also* OPC Initial Brief at 8.
[372] Garrett Direct Testimony at 4-5.
[373] OPC Reply Brief at 6-7.
[374] Garrett Direct Testimony at 27-37.
[375] *Id*. at 34-35.

rate variation claiming it overstates Pepco's COE and presents it because it is normally presented in rate cases.[376] Mr. Garrett criticized Pepco witness McKenzie's DCF for using short-term growth rates applied into perpetuity since it is unreasonable to assume a firm's earnings or dividend growth can exceed U.S. GDP in the long run.[377]

Mr. Garrett derived CAPM result of 8.2% using the 30-day average of the 30-year treasury yield, the average of Value Line and Yahoo betas, and the average of four sources of equity risk premium (a survey, industry source, an independent experts calculation of implied ERP, and witness Garrett's own implied ERP).[378] Mr. Garrett criticized Mr. McKenzie's CAPM for using high ERP inputs, adding a size premium, and for using the ECAPM.[379]

OPC further rejected claims that a lower ROE would impair Pepco's ability to attract capital, noting that such assertions were unsupported and inconsistent with industry experience.[380] OPC pointed to examples of large utilities operating successfully with ROEs below 8% and argued that any impact from a reduced ROE would more likely affect the cost of debt rather than access to capital markets.[381]

Mr. Garrett defended the use of a sustainable growth DCF model that relied on long-term GDP growth, against Pepco witness McKenzie who argued that growth rates should instead reflect investors' expectations and noting that analysts' projections often exceeded GDP growth.[382] He asserted that Mr. McKenzie conflated investors'

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376 *Id*. at 37.
377 *Id*. at 38.
378 *Id*. at 39-53.
379 *Id*. at 54.
380 OPC Initial Brief at 6.
381 *Id*.
382 Garrett Surrebuttal Testimony at 6.

"expectations" with the concept of expected return, emphasizing that the relevant metric for ROE determination was the COE, which was synonymous with investors' expected return and more appropriately estimated through models such as the CAPM.[383]

Furthermore, Mr. Garrett acknowledged that ERP is a significant metric for financial and market analysts, which when inflated, will result in an increased COE to the benefit of utilities.[384] He maintained that the ERP estimate was derived from widely recognized and objective sources, including surveys and analyses from IESE Business School, Kroll, and Dr. Aswath Damodaran, and had emphasized that the ERP was a critical input affecting the indicated COE and, consequently, the authorized ROE.[385]

Mr. Garrett also calculated the CAPM equation but using the Hamada model which adjusts betas based on debt ratios which would lower the resulting ROE to 7.7% since Pepco has less debt than the proxy group in its capital structure.[386]

OPC proposed that Pepco and its parent company could be double leveraged, adversely impacting ratepayers. Mr. Garret defined "double leverage" as "a scenario in which a parent holding company has both debt and equity capital, then uses that capital to fund a wholly owned subsidiary."[387] He explained that potentially a parent's funds may be reported as "equity" on the subsidiary's balance sheet, "while the subsidiary also issues its own debt," resulting in "debt at both the parent and subsidiary levels."[388] Mr. Garrett pointed out that in this situation, "the cost of the subsidiary's 'equity' is lower than the

[383] *Id*. at 7.
[384] *Id*. at 11.
[385] *Id*. at 11-12.
[386] Garrett Direct Testimony at 72-75.
[387] *Id*. at 75.
[388] *Id*.

parent's COE, because the subsidiary's 'equity' also includes a significant portion (50% in this example) of low-cost debt," as reflected in the hypothetical figure below.[389]

Figure 1

	Capital Component	Ratio	Cost Rate	Weighted Cost
	Debt	50.0%	5.00%	2.50%
Parent Corp, Inc.	Equity	50.0%	10.00%	5.00%
	Total			7.50%
	"Equity"	50.0%	7.50%	3.75%
Subsidiary, Inc.	Debt	50.0%	5.00%	2.50%
	Total			6.25%

Finally, OPC argued that Pepco's requested ROE was excessive and would result in an unwarranted transfer of wealth from ratepayers to shareholders.[390] OPC contended that Pepco's proposed rate increase was driven in large part by significant capital spending combined with an unreasonably high ROE, and that the Commission should instead ground its determination in real-world investor expectations rather than prior authorized returns or outcomes in other jurisdictions.[391] OPC emphasized that the Commission's obligation

[389] *Id*. at 76.
[390] OPC Initial Brief at 2.
[391] *Id*.

under *Hope* and *Bluefield* was to set an ROE supported by the evidentiary record and reflective of the utility's actual risk profile.[392]

<u>*AOBA*</u>

AOBA witness Timothy Oliver recommended that the Commission authorize a ROE for Pepco of 9.40%, which would reflect a 10-basis point downward adjustment from the Company's authorized ROE of 9.50%.[393] Mr. T. Oliver explained that this reduction was supported by principles of gradualism and the removal of forecasting as a variable.[394]

Mr. T. Oliver criticized Pepco's requested 10.50% ROE, arguing that the Company's supporting analyses, as presented by Pepco witness McKenzie, relied on multiple methodologies—including DCF, CAPM, ECAPM, risk premium, and expected earnings approaches—that produced an overly broad range of results.[395] He asserted that the resulting ROE range of 9.30% to 11.20% was so wide as to be of limited probative value.[396]

Mr. T. Oliver further contended that Mr. McKenzie's DCF analysis was only partially reasonable, asserting that it relied too heavily on Value Line projections, which differed materially from other financial data sources and therefore should not be relied upon.[397] Additionally, he argued that the proxy group used in Mr. McKenzie's analyses consisted of companies that were riskier than Pepco's distribution operations, and that he

[392] *Id*. at 3.
[393] T. Oliver Direct Testimony at 10.
[394] *Id*.
[395] *Id*. at 18.
[396] *Id*.
[397] *Id*. at 20.

failed to demonstrate that his beta estimates appropriately adjusted for these risk differences.[398]

Moreover, AOBA averred that the requested ROE materially inflated Pepco's revenue requirement—approximately $119.9 million under the Company's Traditional Test Year—at a time when significant rate base growth and proposed post-test year additions already placed upward pressure on customer rates.[399] As a result, AOBA argued Pepco's proposed increase was inconsistent with recent Commission precedent and the principle of gradualism.[400] AOBA maintained that its own revenue requirement position reflected a more reasonable increase, driven in part by rejection of Pepco's elevated ROE request.[401]

AOBA emphasized that the Commission had recently rejected the same 10.50% ROE in Case No. 9702, finding it unsupported and not reflective of market conditions.[402] AOBA asserted that Pepco had failed to present new or materially different evidence in the current proceeding to justify revisiting that determination.[403] Given the recency of Case No. 9702 and the similarity of circumstances, AOBA argued that the Commission should give substantial weight to that decision and maintain consistency in its ratemaking approach.[404]

AOBA further contended that Pepco had not demonstrated an increase in risk sufficient to warrant a higher ROE.[405] AOBA highlighted that Pepco remained a low-risk,

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398 *Id*. at 21.
399 AOBA Initial Brief at 56-57.
400 *Id*. at 56.
401 *Id*. at 57.
402 *Id*.
403 *Id*.
404 *Id*.
405 *Id*. at 58.

regulated electric distribution utility with access to regulatory mechanisms that mitigate financial risk.[406] While acknowledging that Pepco was entitled to a reasonable opportunity to earn a fair return, AOBA argued that this standard did not justify a premium ROE disconnected from the Company's actual risk profile, particularly where the Company had pursued significant capital investment growth.[407]

AOBA also argued that Pepco's rapid expansion in rate base, which outpaced growth in service demand, amplified the impact of cost of capital inputs on rates.[408] In this context, AOBA asserted that an excessive ROE would disproportionately increase the revenue requirement and rate burden on customers.[409] AOBA witnesses further expressed concern regarding Pepco's reliance on proxy groups composed largely of utility holding companies, which they argued did not accurately reflect the risks or COE associated with regulated distribution utilities, particularly in light of reduced market data due to industry consolidation.[410]

Finally, AOBA stressed that the Commission's policy of gradualism required restraint in adjusting authorized returns and avoiding abrupt or unsupported increases.[411] AOBA argued that the record did not support departing from this principle and, if anything, warranted a more conservative approach given affordability concerns and questions surrounding Pepco's cost evidence.[412] Accordingly, AOBA recommended that the Commission reject Pepco's 10.50% ROE request and instead adopt a lower ROE of 9.40%,

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406 *Id*.
407 *Id*.
408 *Id*.
409 *Id*.
410 *Id*. at 58-59.
411 *Id*. at 59.
412 *Id*.

consistent with recent precedent, the low-risk nature of regulated utility operations, and the need to protect ratepayers.[413]

<u>*MEA*</u>

MEA argued that Pepco's proposed 10.50% ROE was unjust and unreasonable, exceeded the level necessary to attract capital, and was inconsistent with market-based estimates of investor return requirements.[414] MEA contended that approval of the requested ROE would result in excessive charges to customers and fail to appropriately balance investor and ratepayer interests.[415] MEA therefore recommended that the Commission reject Pepco's proposal and instead adopt a 9.0% ROE, which it asserted was supported by the record, aligned with *Hope* and *Bluefield*, and consistent with the Commission's policy of gradualism.[416]

In addition, MEA stated that Pepco's ROE analysis was fundamentally flawed due to its improper treatment of the COE and ROE as interchangeable concepts.[417] MEA emphasized that COE and ROE were distinct: COE represented the market-based return required by investors, while ROE was an accounting measure applied to a utility's book value.[418] MEA contended that Pepco's conflation of these concepts resulted in an artificially inflated ROE that exceeded the appropriate zone of reasonableness for a regulated utility with Pepco's risk profile.[419]

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[413] *Id*. at 59-60.
[414] MEA Initial Brief at 39.
[415] *Id*.
[416] *Id*.
[417] *Id*. at 40. *See also* MEA Reply Brief at 15.
[418] *Id*.
[419] MEA Initial Brief at 40 and 48. *See also* MEA Reply Brief at 15-16.

MEA recommended a COE of 7.7% based upon witness Kihm's three-stage DCF model and the CAPM model.[420] For the three-stage DCF model, Mr. Kihm utilized the stock price as of January 7, 2025, ValueLine projected dividends per share ("DPS" for the short-term growth rates, and for the long-term growth rate he used 4% to represent GDP growth.[421] Mr. Kihm stated the average results of this model for the individual companies are 6.4%-9.1% with the median of 7.9%.[422]

Regarding MEA's CAPM evaluation, Mr. Kihm utilized the market return based on a calculation proposed by "McKinsey & Co. who studied forward looking S&P 500 COE estimates going back to 1960."[423] Witness Kihm explained that the McKinsey model produced an estimate of 9.2%, which he believed had the strongest analytical foundation. Additionally, he considered the following estimates from investment professionals:[424]

Table 9:
McKinsey's Estimates

Investment Professional	Recommendation
Corporate CFOs	9.9%
McKinsey Model	9.2%
Morning Star	9.2%
Damodaran	8.3%
Average	9.1%

[420] Kihm Direct Testimony at 4 and 20.
[421] *Id*. at 20.
[422] *Id*. at 21.
[423] *Id*. at 22.
[424] *Id*. at 23-24.

Mr. Kihm described McKinsey's 9.2% calculation as serving two purposes: (1) setting an upper limit for a utility ROE, and (2) feeding into the CAPM model.[425] As additional inputs to the CAPM witness Kihm used a 10-year U.S. Treasury yield and the average of Value Line and Zack's Investment Research betas.[426]

Mr. Kihm criticized Pepco witness McKenzie's application of the CAPM, arguing that he mischaracterized investor risk by focusing on relative volatility rather than the correlation of a stock's returns with overall market return volatility.[427] Mr. Kihm asserted that investor risk was driven by the timing and co-movement of volatility with the broader market, rather than its magnitude alone, and maintained that the CAPM appropriately adjusted for this distinction.[428] He further contended that, although utility stocks may exhibit higher standalone volatility than the market, they were less risky because their returns were less correlated with periods of market-wide volatility.[429] Additionally, Mr. Kihm highlighted that when the Arizona Corporation Commission lowered Arizona Public Service's ROE to 8.7% from 10.0%, the company did not have noticeable difficulty obtaining investors.[430]

With respect to the DCF framework, Mr. Kihm disputed Mr. McKenzie's rejection of the market-to-book ("M/B") ratio as a regulatory guide, asserting that an M/B ratio of 1.00 satisfied established legal standards under *Hope* and *Bluefield*.[431] MEA argued that, consistent with principles underlying the DCF model, regulators should use the M/B ratio

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[425] *Id*. at 24.
[426] *Id*. at 25.
[427] Kihm Surrebuttal Testimony at 3.
[428] *Id*.
[429] *Id*.
[430] Kihm Direct Testimony at 14.
[431] Kihm Surrebuttal Testimony at 4.

as a directional indicator in setting ROE, such that returns above or below the COE would be reflected in corresponding deviations of market value from book value.[432]

MEA also asserted that Pepco's analytical approach relied on improper methodologies and assumptions.[433] MEA criticized Pepco's use of financial models such as DCF and CAPM to estimate ROE, explaining that these models were designed to estimate COE rather than ROE.[434] As a result, MEA argued that Pepco's analysis failed to produce a reliable measure of either COE or ROE.[435] MEA further contended that Pepco's assumptions—particularly its use of an inflated 12.0% expected market return compared to a market consensus of approximately 9.2%—artificially increased its ROE estimate.[436]

MEA maintained that its proposed 9.0% ROE more appropriately reflected a proper application of financial theory and regulatory policy.[437] MEA explained that its analysis indicated a current COE of approximately 7.7%, and that its recommended ROE incorporated policy considerations, including gradualism and the need to ensure a reasonable opportunity for the utility to earn a fair return.[438] Furthermore, MEA explained that Pepco mischaracterizes the concept of gradualism to coincide with increases in the utility bond yields.[439] MEA pointed out that Pepco's application of the Company's gradualism principle assumes that prior ROE levels are just and reasonable.[440] In this case, MEA argued that the prior ROE was unreasonably high and should be disregarded, and

[432] *Id*.
[433] MEA Initial Brief at 43.
[434] *Id*.
[435] *Id*. at 44.
[436] *Id*. at 45.
[437] *Id*. at 47.
[438] *Id*.
[439] MEA Reply Brief at 19.
[440] *Id*.

based on submitted testimony, the concept of gradualism should rather result in a gradual decrease in ROE.[441] MEA asserted that its recommended ROE fell within the upper end of the zone of reasonableness and remained sufficient to maintain Pepco's financial integrity, support its credit, and attract capital.[442]

Finally, MEA concluded that its proposed 9.0% ROE appropriately balanced investor and consumer interests, reflected the low-risk nature of Pepco's regulated operations, and avoided imposing unnecessary costs on ratepayers.[443] MEA emphasized that its recommendation would not impair Pepco's ability to raise capital or earn a reasonable return, while ensuring that rates remained just and reasonable.[444]

Staff

Staff argued that its recommended ROE and overall ROR reflected a balanced, market-based, and analytically sound approach consistent with Commission precedent and current economic conditions.[445] Staff witness McAuliffe recommended 9.50% ROE and (based on Staff's recommended capital structure) 7.28% overall ROR, asserting that these recommendations adhered to established ratemaking principles and were supported by the evidentiary record.[446]

Mr. McAuliffe criticized several aspects of Pepco witness McKenzie's analytical framework, arguing that the Commission should reject his size adjustment to the CAPM, give little weight to his ECAPM, Risk Premium, and Expected Earnings analyses, and

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441 *Id*.
442 MEA Initial Brief at 51-52.
443 *Id*.
444 *Id*.
445 Staff Initial Brief at 24.
446 *Id*. *See also* Staff Reply Brief at 16.

reject his use of a non-utility DCF model.[447] He further challenged Mr. McKenzie's ROE benchmark comparison, which Mr. McAuliffe asserts relied on an overly simplistic approach that improperly tied ROE recommendations to changes in interest rates and market conditions, rather than relying on comprehensive financial modeling.[448]

Staff explained that ROE represented the return investors expect on the capital invested in utility infrastructure and was a key component in determining the utility's overall ROR and resulting revenue requirement.[449] Staff emphasized that the Commission's determination must be guided by the standards established in *Bluefield* and *Hope*, as well as Maryland law, which require rates to be just and reasonable and to balance investor and ratepayer interests.[450] Staff noted that an authorized ROE should provide an opportunity—not a guarantee—for the utility to earn a reasonable return sufficient to maintain financial integrity, attract capital, and offer returns comparable to investments of similar risk.[451]

Staff further highlighted that Commission precedent supported the use of multiple financial methodologies and a "zone of reasonableness," rather than reliance on any single model, and incorporated the principle of gradualism to avoid rate shock.[452] Staff explained that Pepco's proposed increase from 9.50% to 10.50% would represent a substantial change and would likely result in rate shock that would negatively impact customer

[447] McAuliffe Surrebuttal Testimony at 4.
[448] *Id*. at 7.
[449] Staff Initial Brief at 24.
[450] *Id. at 25*. *See also* Staff Reply Brief at 16.
[451] *Id*.
[452] Staff Initial Brief at 26. *See also* Staff Reply Brief at 18.

affordability.[453] Staff also noted that the Commission generally seeks alignment with ROEs authorized for similarly situated utilities.[454]

Staff witness McAuliffe also raised concerns that Pepco's proposed ROE was much higher than the nationwide ROE average of 9.71% in 2025 for all electric utilities, including vertically integrated utilities, and also noted that distribution electric utility (which is what Pepco is) ROEs are lower than the nationwide average (in 2025 the average was 9.55%).[455]

In support of its ROE recommendation, Staff relied on both DCF and CAPM analyses.[456] Mr. McAuliffe calculated a range of 9.34 to 9.73% which averaged to 9.53% to ultimately recommend a ROE of 9.50%.[457] Mr. McAuliffe relied upon a proxy group of 30 companies compared to Pepco witness McKenize's proxy group of 24 companies due to different selection criteria.[458] Mr. McAuliffe's DCF analysis employed a single-stage constant growth model, utilizing a 180-day average stock price to mitigate short-term volatility, three different sources of earnings per share growth rates, and dividends paid from January 1 through December 31, 2025.[459]

Staff's CAPM analysis estimated the COE based on the relationship between market risk and expected return, incorporating beta, the equity risk premium, and a risk-free rate derived from long-term U.S. Treasury yields.[460] Specifically, Staff relied upon a historic equity risk premium, two different calculations of beta (Blume adjusted from Value

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[453] Staff Reply Brief at 19-20.
[454] Staff Initial Brief at 26. *See als* Staff Reply Brief at 16.
[455] McAuliffe Direct Testimony at 31-33.
[456] Staff Initial Brief at 26.
[457] McAuliffe Direct Testimony at 11-12.
[458] *Id*. at 15-16.
[459] *Id*. at 19-20.
[460] Staff Initial Brief at 30.

Line and Vasicek adjusted as derived by witness McAuliffe), and a projected 30-year treasury rate.[461] Mr. McAuliffe raised concerns that inflated equity risk premium values have caused inflated CAPM results, citing an academic and a professional source with lower ERPs, which he argued showed his CAPM results were not excessively conservative and were higher than some experts predict (noting if the other sources were used the CAPM results would range from 7.79% to 8.37% using the Value Line betas).[462]

Staff rejected Pepco's inclusion of a size adjustment in its CAPM analysis, noting that the Commission had consistently disallowed such adjustments and that regulated utilities like Pepco do not face the elevated risks associated with small or growth-oriented companies.[463] Staff emphasized that Pepco's status as a mature, low-risk, regulated utility with a monopoly service territory rendered a size premium inappropriate.[464] Moreover, Mr. McAuliffe also rejected Mr. McKenzie's comparisons of 2026 interest rates to those from 2021, arguing that such comparisons were not relevant to the current proceeding and that, in any event, interest rates represented only one input among many in determining ROE.[465] Similarly, Mr. McAuliffe criticized Mr. McKenzie's utility bond yield benchmarking analysis as overly simplistic and insufficient to support conclusions regarding appropriate ROE levels.[466] Furthermore, in response to witness McKenzie's argument that nationwide commissions are approving inappropriately low ROEs, Mr. McAuliffe proposed that

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[461] McAuliffe Direct Testimony at 23-26.
[462] *Id*. at 26-27.
[463] Staff Initial Brief at 33.
[464] *Id*.
[465] McAuliffe Surrebuttal Testimony at 8.
[466] *Id*. at 11.

commissions "realized that (prior) ROEs were too high and have changed how they award ROEs."[467]

With respect to the CAPM, Mr. McAuliffe argued that Mr. McKenzie's criticism of its use of projected bond yields as the risk-free rate was inconsistent with Pepco's prior positions favoring forward-looking inputs, and maintained that both historical and forward-looking data could appropriately inform ROE analyses.[468] Staff noted that alternative beta adjustments, including the Vasicek adjustment, produced materially lower ROE results than those derived using Blume-adjusted betas, underscoring the importance of careful input selection.[469]

Finally, Staff recommended that the Commission give little weight to alternative models and methodologies proposed by Pepco.[470] Staff argued that the inclusion of non-utility companies in proxy groups was inappropriate due to differing risk profiles, and that ECAPM approaches should be discounted consistent with prior Commission determinations that such methodologies tend to overstate ROE by diluting the relevance of utility-specific risk measures.[471] Staff emphasized that its 9.5% ROE recommendation was consistent with nationwide averages of distribution only electric utilities, in contrast to higher ROEs of utilities that also own generation.

[467] *Id*. at 9 and 12.
[468] *Id*. at 15-16.
[469] Staff Initial Brief at 34.
[470] *Id*. at 35.
[471] *Id*.

COMMISSION DECISION

A public utility must charge just and reasonable rates for the regulated services that it provides.[472] Pursuant to well-established regulatory principles, regulated utilities are entitled to the opportunity to recover prudently incurred costs and earn a reasonable return on capital invested in utility operations. The United States Supreme Court decisions in *Bluefield*[473] and *Hope*[474] established the standards by which the Commission evaluates whether an authorized return provides a utility with a reasonable opportunity to attract capital, maintain financial integrity, and earn returns comparable to those available on investments of similar risk. As the Supreme Court stated in *Bluefield*:

> [a utility's] return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.[475]

In rate proceedings, the burden of proof rests with the proponent of the requested change. Accordingly, Pepco bears the burden of demonstrating that its requested increase in ROE is supported by the evidentiary record and results in just and reasonable rates.[476]

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[472] A "just and reasonable rate" is one that: (1) does not violate any provision of the Public Utility Article of the Maryland Code; (2) fully considers and is consistent with the public good; and (3) will result in an operating income to the public service company that yields, after reasonable deduction for depreciation and other necessary and proper expenses and reserves, a reasonable return on the fair value of the public service company's property used and useful in providing service to the public. PUA § 4-201.
[473] *Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923).
[474] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).
[475] *Bluefield Water Works, 262 U.S. at 693.*
[476] PUA § 3-112.

As an initial matter, the Commission reaffirms that the determination of an appropriate ROE requires a careful balance between investor and ratepayer interests. An authorized ROE must provide the Company with a reasonable opportunity to attract capital and maintain financial integrity, while also ensuring that customers are not required to pay excessive rates. The Commission recognizes that ROE is a significant component of the overall ROR and directly affects the revenue requirement borne by customers. At the same time, the Commission must consider the financial requirements of the utility and ensure that the authorized return is sufficient to support continued access to capital. A fair rate of return should balance all interest and ensure a utility is not making speculative profits. No single financial model or methodology is dispositive. Rather, the Commission considers the results of multiple quantitative approaches, along with qualitative factors, in determining a just and reasonable ROE. Nonetheless, the Commission has previously addressed its concerns with the ECAPM, size adjustments, and inclusion of non-utility companies when evaluating ROE.[477]

The Commission has carefully reviewed the record evidence, including the competing ROE recommendations and supporting analyses presented by Pepco, Staff, OPC, AOBA, and MEA. The parties' recommendations varied significantly, ranging from OPC's 7.70%, MEA's 9.00%, AOBA's 9.40%, Staff's 9.50%, and Pepco's requested 10.50% ROE. The wide range of recommendations reflects differing views regarding appropriate proxy groups, model inputs, the interpretation of market conditions, and the

[477] For ECAPM and Size Adjustment, *see* Case No. 9702, *Potomac Elec. Power Co.'s Application for Adjustments to its Retail Rates for Distribution of Electric Energy*, Order No. 91181 at 134 and 147. For non-utility companies, *see* Case No. 9484, *In the Matter of the Application of Baltimore Gas and Elec. Co. for Adjustments to its Gas Base Rates*, Order No. 88975 at 63. Case No. 9490, Order No. 89072 at 74-75.

application of financial methodologies. The Commission notes that even within individual witnesses' analyses, the results produced by the various models varied considerably, resulting in wide ranges of reasonableness from each witness, demonstrating the importance of regulatory judgment in applying the *Bluefield* and *Hope* standards.

Arguments were presented that suggest that if ROEs are lowered, this would not harm the utility's ability to attract capital and there are valid measures of ROE on the record that indicate it could be lower. Economic indicators, such as interest rates, do imply an upward pressure and the Commission does not believe it is appropriate to engage in drastic modifications to the return at this time that may risk a credit downgrade and which would be contrary to the Commission's reliance upon gradualism.

The Commission acknowledges that capital market conditions, including interest rates and utility bond yields, are relevant considerations in determining an appropriate ROE. However, the Commission is not persuaded that changes in a single market indicator, standing alone, establish that a corresponding increase in authorized ROE is warranted. ROE analyses are intended to consider a broad range of factors, including the Company's relative risk, investor expectations, and the results of accepted financial models. The Commission finds that Pepco's reliance on increased interest rates does not, by itself, demonstrate that the Company's risk profile or COE has increased sufficiently to justify the Company's requested ROE.

Ultimately, the Commission is persuaded that the recommendations of MEA (9.0%) and Staff (9.5%) set the most reasonable bounds of outcomes in the present case. After weighing the quantitative results and qualitative factors set forth in the record, the

Commission concludes that lowering the authorized ROE modestly to 9.40% is just and reasonable and satisfies the *Bluefield* and *Hope* standards.

This ROE falls within the zone of reasonableness supported by the record, appropriately considers current capital market conditions, and recognizes both investor and customer interests. The Commission is not persuaded that Pepco has demonstrated sufficient evidence to justify increasing the authorized ROE to 10.50%. Additionally, the Commission is persuaded by arguments that a modest reduction in ROE will not improperly harm the Company's ability to attract capital. This outcome is also only slightly below the 2025 national average ROE awarded to electric distribution utilities.

This ROE also provides Pepco a reasonable opportunity to attract capital, maintain financial integrity, and earn returns comparable to investments of similar risk, while appropriately balancing the interests of customers. The Commission therefore adopts a 9.40% ROE for purposes of establishing rates in this proceeding.

Combining the ROE with the capital structure and expected cost of debt results in Pepco's ROR. The parties' ROR recommendations and the Commission's findings are reflected in the following table:

Table 10:
Rate Base and Rate of Return Comparison

(000's)	Pepco[478]	Staff[479]	OPC[480]	AOBA[481]	**Commission Determined**
Rate of Return	7.83%	7.28%	6.22%	7.24%	7.22%

The Commission believes this ROR fairly compensates Pepco and protects ratepayers. The Commission further concludes that a ROR of 7.22% satisfies the above-described policy considerations underlying ratemaking.

C. Cost of Service

The purpose of a class cost of service study ("CCOSS") is to determine the costs a customer class, or in some cases a jurisdiction, imposes upon a utility company. Costs may be directly assigned or allocated based upon various allocation methodologies. Once costs are assigned, then class (and jurisdictional) rates of return can be developed, which are used to design customer rates. The Commission uses the results from cost of service studies as a guide in developing appropriate rates for the numerous customer classes.

Pepco's CCOSS is presented in the Direct Testimony of Lance Schafer. As part of his testimony, witness Schafer also presented a cost analysis in relation to Pepco's proposal to gradually eliminate seasonal rates for rate schedules R, RTM, GS-LV, and TN.[482] Mr.

[478] Pepco Reply Brief at 33.
[479] Staff Reply Brief at 3.
[480] Garrett Direct Testimony at 8.
[481] AOBA Initial Brief at 62-63.
[482] Schafer Direct Testimony at 28-29.

Schafer also presented an updated study of the Standard Offer Service ("SOS") Administrative Adjustment Cost of Service, with some updated methodological changes.

Mr. Schafer explained that there are generally three basic steps to measure customer class responsibility for rate base and expense: (1) functionalization; (2) classification; and (3) allocation.[483] Functionalization is the process of dividing the total revenue requirement into functional categories related to Pepco's operations.[484] Classification is the process of separating the functionalized rate base and expenses into categories that relate to how costs are caused.[485] Distribution costs are primarily classified between demand- and customer-related components. Allocation is the process through which rate base and expenses in each of the classified cost categories are assigned to customer classes based on principles of cost causation.[486]

Staff witness Lee proposed no adjustments to Pepco's historic test year CCOSS, as updated during rebuttal, the administrative adjustment update, or the seasonality study.[487] OPC witness Whited raised concerns regarding the seasonality study which will be discussed below but otherwise raised no objections.

The only disagreement raised to Pepco's CCOSS was by AOBA witness Bruce Oliver, who raised four concerns.

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[483] *Id*. at 6.
[484] *Id*.
[485] *Id*. at 7-8.
[486] *Id*. at 8.
[487] Lee Surrebuttal Testimony at 3 and 32.

a. Presentation of retail sales

First, witness B. Oliver raised concerns about the presentation of retail sales in the CCOSS, stating that "without greater detail regarding the non-base-rate components of Revenue - Retail Sales presented in witness Schafer's exhibits it is not possible to determine whether the resulting class rates of return properly reflect [Pepco's] recovery of its Maryland Distribution system costs by rate class."[488]

In rebuttal, Pepco witness Schafer testified that retail sales in this case are presented in the same manner as they were in the CCOSS studies accepted in Case Nos. 9655 and 9702.[489]

b. Assignment of RMAs to FERC accounts

Second, witness B. Oliver testified that there was no explanation or data or analyses for assignments of RMAs to FERC accounts, making it difficult to determine if those assignments were appropriate.[490]

In rebuttal, Pepco witness Schafer testified that the RMAs included in the CCOSS come directly from the revenue requirement of the historical test year, and the electronic version of the CCOSS identifies the FERC account classification of those elements and shows into which accounts each RMA flows and the allocation factors applied to those accounts.[491] Mr. Schafer testified that the CCOSS study does not decide in which FERC accounts an RMA should be included. He argued that witnesses may audit individual

[488] B. Oliver Direct Testimony at 54.
[489] Schafer Rebuttal Testimony at 10.
[490] B. Oliver Direct Testimony at 55-56.
[491] Schafer Rebuttal Testimony at 11-13.

accounts to confirm that the contents of those accounts are appropriately categorized, but CCOSS models do not generally include underlying accounting data because it would increase the size and be confusing because the CCOSS is not traditionally the source of accounting detail for individual accounts.

In surrebuttal, AOBA witness Bruce Oliver argued that information that can only be found "buried within large electric models" is not information that can be readily addressed in an evidentiary proceeding or made subject of cross-examination.[492] He argued that parties should be provided a clear view of the manner in which adjustments to test year costs are applied to individual rate classes and that cost of service studies should be expanded to reflect that detail.

c. Level of supporting detail

Third, Mr. B. Oliver testified that large revenue increases and potential disallowances will have a large impact on URORs and that Pepco's CCOSS does not provide the level of supporting detail that would allow for the removal of additions to plant in service.[493]

In rebuttal, Pepco witness Schafer argued that an intervenor can remove identified plant or expense amounts from the CCOSS electronic model and review the updated results.[494]

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[492] B. Oliver Surrebuttal Testimony at 41-42.
[493] B. Oliver Direct Testimony at 56.
[494] Schafer Rebuttal Testimony at 12-13.

d. Accuracy of cost of service allocations

Fourth, Mr. B. Oliver testified that, if Pepco has substantial uncertainty regarding the accuracy of its cost of service allocation results for its Street Lighting classes, the Commission should question what other elements of Pepco's CCOSS also reflect unreliable results.[495]

In rebuttal, Pepco witness Schafer testified that Pepco's updating of streetlighting data had no impact on the methodology of the CCOSS and no impact on the reliability of other elements of the CCOSS results.[496]

COMMISSION DECISION

The Commission uses the CCOSS as a guide. No alternatives have been proposed, nor does the Commission find the concerns raised constitute sufficient reason to deny the study.

The Commission will require Pepco to address two items in the CCOSS in its next rate case. First, Pepco is directed to explicitly explain what drove the changes in rate class unitized rates of return ("UROR" The Commission believes more detail should have been provided as to why the UROR shifted so drastically from one case to the next for the streetlighting class. Second, if Pepco chooses to conduct a CCOSS inclusive of RMAs in future rate cases, it shall also provide one without RMAs so it is clear how much the inclusion of RMAs impact the final results.

[495] B. Oliver Direct Testimony at 69.
[496] Schafer Rebuttal Testimony at 11.

D. Rate Design

Pepco presented its proposed rate design through witness Peter Blazunas. Its proposed rate design: (1) supported the continued use of the Bill Stabilization Act ("BSA") and Effective Rate Adjustments ("ERAs"); (2) put forth a proposal to gradually remove seasonally differentiated base distribution rates for applicable rate schedules; (3) proposed to begin consolidating Schedules R and R-TM into a single class; (4) selected billing determinants; and (5) proposed a distribution revenue allocation methodology and rate design.[497] Relatedly, Pepco also made proposed tariff language modifications.

Stakeholders raised challenges to two aspects of Pepco's proposed rate design: (1) the methodology behind the Effective Rate Adjustment/BSA calculation; and (2) the proposal to eliminate seasonality.

The Commission accepts Pepco's proposal to begin consolidation of Schedules R and R-TM (with a combined BSA for both classes) as undisputed. The Commission also accepts Pepco's proposed tariff modifications as undisputed, conditioned on revision to reflect rates and other changes approved in this Order, and directs Pepco to file revised tariff pages for approval.

1. Effective Rate Adjustments/BSA

Pepco

Pepco incorporates BSA revenue adjustments–in the form of ERAs–into the revenue allocation portion of its rate design. Witness Blazunas testified that the purpose of

[497] Blazunas Direct Testimony at 2-3.

this adjustment is to reflect the effect of the BSA on future customer bills.[498] Effectively, the ERA's use forecasted billing determinants to adjust proposed base distribution rates with the goal of collecting no more or less than the revenues authorized by the Commission.[499] Mr. Blazunas further testified that ERAs have been approved for use in rate design by the Commission in Pepco rate cases since the inception of the BSA.[500]

AOBA

AOBA witness Bruce Oliver recommended that the Commission disallow the use of ERAs in rate design. Mr. B. Oliver argued that Pepco witness Blazunas failed to present data or analysis upon which the Commission could rely to conclude that Pepco's proposed ERAs have any verifiable cost basis.[501] Mr. B. Oliver testified that Pepco's ERAs misuse the BSA mechanism to approximate changes in class cost responsibilities since its previous rate case, rather than using values supported by actual experience.[502] He pointed to commercial rate classes that incorporate customers with more diverse service requirements and argued that Pepco's ERA has resulted in mischaracterization of the marginal changes in class cost responsibility per customer in those classes.[503] Mr. B. Oliver stated that Pepco's reliance on the Commission's past approvals of Pepco's ERA methodology demonstrates that the Company merely presumes its monthly computations of adjustments to class cost responsibilities under the BSA mechanism are sacrosanct and must be approved, without an examination of how well its BSA adjustments actually tracked

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[498] *Id*. at 32.
[499] Blazunas Rebuttal Testimony at 17.
[500] *Id*. at 16-17.
[501] B. Oliver Surrebuttal Testimony at 45-46.
[502] B. Oliver Direct Testimony at 74-75.
[503] AOBA argues that this is because the BSA assumes that there is a uniform relationship between customer count and customer cost responsibility. *Id*. at 74.

changes in class cost responsibilities, effectively undermining the cost basis for rate determinations.[504]

COMMISSION DECISION

The Commission notes the concerns raised by AOBA regarding Pepco's use of monthly BSA adjustments to calculate its ERAs. However, the Commission has historically approved use of BSA adjustments to establish ERAs for the purposes of revenue allocation during rate design and does not find that the concerns raised regarding class cost responsibilities are adequately developed in this record or persuasive to upset established precedent.

AOBA argues that Pepco's ERAs yield imperfect representations of revenues at current rates because BSA adjustments are merely a proxy for actual data or analysis. But a proxy by its nature has a close correlation with the variable it represents. In this instance, the alleged proxy is based on the *actual* amount of revenue collected by Pepco from each respective class when Pepco's BSA adjustments are factored into the value of revenue at approved rates. AOBA intimates that, absent a detailed calculation of actual changes in class cost responsibilities, the Commission's approved class revenue requirement in the Company's previous rate case–or the Company's tariffed rates–should serve as the alignment point for revenues at current rates. What AOBA did not explain, though, is how these values would result in a *more* accurate representation of class cost responsibilities simply because they are known values. Likewise, AOBA did not supply record evidence demonstrating that the ERAs produce results that deviate from cost-causation to such an

[504] B. Oliver Surrebuttal Testimony at 45-46.

extent as to make them unjust and unreasonable for the purposes of rate design. Because the Commission finds no clear fault in Pepco's proposed use of ERAs in designing rates, Pepco's proposal is approved.

2. Seasonality in residential rates

In Pepco's last rate case, the Commission stated that it intended to eliminate seasonal rate differentiation in Pepco's next rate case and directed Pepco to provide a cost analysis regarding the gradual elimination of seasonal rates for rate schedules R, RTM, GS-LV, and TN.[505]

Pepco

Pepco witness Schafer presented that analysis in their direct testimony, where he testified that the analysis determined that customer classes R and RTM peak in the summer, while customer class GS-LV varied between summer and winter peaking.[506] Class TN results were not found to be meaningful. Mr. Schafer testified that the seasonality study showed, ultimately, that the actual impact of applying a seasonal peak load ratio to costs is, in total, lessened by the fact that many costs are fixed and appropriately should not be seasonally differentiated.[507] Pepco witness Blazunas also included in their rate design proposed structural changes to rates to effectuate the gradual removal of seasonal rates for affected classes, which will take more than one rate case.[508]

[505] Order No. 91181 at 190-191, Case No. 9702.
[506] Schafer Direct Testimony at 29-30.
[507] *Id*. at 31.
[508] Blazunas Direct Testimony at 28-40.

OPC

OPC witness Whited argued that, in light of the fact that Pepco's system remains strongly summer peaking for classes R and RTM, the elimination of seasonal rates would go against cost causation, raise equity concerns, and increase the cost of achieving Maryland's electrification goals.[509] Ms. Whited stated that the seasonality study adjusted certain demand allocators to reflect the fact that summer peaks are approximately 20 percent higher than winter peaks, resulting in relatively less costs being allocated to the winter than the summer.[510] Ms. Whited also testified that the load carrying capacity of the distribution system is also greater during winter due to lower ambient temperatures, which reduces system stress and is recognized in the NARUC Electric Utility Cost Allocation Manual.[511] Ms. Whited testified that Pepco's seasonality study did not take this into account.

Ms. Whited further testified that the 2023 Electrification Study Work Group study relied on by Staff witness Bowser in concluding that Pepco will soon become winter-peaking does not support that conclusion, and that in only one of six scenarios studied did Pepco become winter peaking before 2031.[512] Ms. Whited testified that this scenario made several assumptions that may not be reliable, including: (1) by 2030, all new equipment sales are heat pumps; (2) most heat pumps are less efficient varieties of air source heat pumps; (3) heat pumps use electric resistance backup, rather than using gas furnaces as backup; and (4) utilities only implement energy efficiency programs to mandated minimum

[509] Whited Surrebuttal Testimony at 2.
[510] *Id*. at 9.
[511] *Id*. at 13.
[512] *Id*. at 14-15.

levels.[513] She also testified that recent data have not shown significant growth in winter peak load compared to the scenarios modeled in the study.[514]

To Pepco's argument that some distribution system costs are fixed by nature and do not vary by season, Ms. Whited argued that costs nonetheless increase on the margin with peak demand, and cost causation should result in the peaking season that drives cost increases having higher rates.[515] Ms. Whited testified that there are multiple initiatives underway in Maryland designed to reduce peak demand to avoid or defer distribution capital spending. Ms. Whited argued that customers being aware of long-run marginal costs through electricity prices will lead to consumption decisions that will help minimize long-run system costs.[516] She also argued that removing seasonality would disincentivize customers from switching from gas heating to electric heat pumps for winter heating, while maintaining seasonality will encourage greater conservation during the peaking season.[517]

Ms. Whited argued that these reasons support the continuation of seasonality in rates for residential consumers. Ms. Whited also recommended that the Commission include October in the winter season and could consider changing May to a summer month but need not.[518]

Ms. Whited argued that, if the Commission removes seasonality, it should direct Pepco to develop opt-in rate designs that remain cost-reflective and supportive of heat pump adoption.[519] She testified that the PC44 Rate Design Work Group could be an

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[513] *Id*. at 14.
[514] *Id*. at 15-16.
[515] *Id*. at 10-11.
[516] *Id*. at 11.
[517] *Id*. at 16.
[518] *Id*. at 18.
[519] *Id*. at 20.

effective forum to discuss innovative rate designs but that Commission directives can be necessary to bring forward concrete rate designs in a timely manner.

Staff

Staff witness Bowser recommended that the Commission accept Pepco's proposed structure to gradually eliminate seasonality.[520] Mr. Bowser agreed with Pepco witness Blazunas that the ratios between summer and winter distribution rates in certain classes are too high for immediate removal without causing rate shock, and that those classes should be gradually transitioned.

COMMISSION DECISION

The Commission appreciates the concerns raised by OPC regarding the current and projected system peaks, as well as the value of consumer price signals in encouraging behavior that supports energy efficiency. Still, the Commission must consider a variety of factors when determining whether seasonality in rates is appropriate. The extent to which seasonal differentiation can be demonstrated to accurately reflect costs impacts how much weight the Commission gives to those factors.

In this case, there are reasonable disagreements on this point between the parties in their respective interpretations of the results of Pepco's seasonality study. Costs do vary to some degree between seasons, but the Commission finds credible Pepco's assertion that the nature of many costs are such that they can and should be collected equally between seasons without violating the principles underlying cost-based rates.

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[520] Bowser Direct Testimony at 53.

Given this conclusion, the Commission must decide how to properly weigh OPC's concerns about energy efficiency together with concerns about affordability, predictability, and equity. In general, seasonally variable rates have the potential to adversely impact customers that have little means or limited opportunity to respond to seasonal price signals to manage their bills. Low-income families, low-usage customers, and other customers who cannot significantly curtail their consumption of energy will be impacted more by higher rates in a season than other customers. The Commission also notes that seasonal differentiation is not the only rate design tool for promoting energy efficiency–customers with the ability to curtail or shift energy usage may choose to take service under a time of use tariff.

At this time, the Commission finds that Pepco's proposal to continue to move gradually towards the elimination of seasonal differentiation is reasonable and consistent with the Commission's prior orders. The Commission therefore adopts Pepco's proposal to reduce the rate differential for most classes in this case and move to one rate for schedules EV and TN. Given the decision to continue moving toward elimination of seasonal rates, the Commission finds that adjusting the classification of October is not justified. The Commission will continue to consider arguments related to seasonality, cost-causation, and energy efficiency in subsequent cases.

E. <u>Revenue Allocation</u>

There were two competing approaches proposed by the parties for allocating the authorized revenue increase across customer classes, a four-step method proposed by Pepco and a two-step method proposed by Staff.

Pepco

Pepco witness Blazunas proposed that the Commission use a four-step method. Mr. Blazunas testified that the objectives of the four-step method are: (1) the Unitized Rate of Return ("UROR") for a customer class within the UROR steady state range does not materially shift out of UROR steady state; (2) the UROR for a customer class that exceeds the UROR steady state range does not increase or fall below the UROR steady state; (3) the UROR for a customer class that falls below the UROR steady state range does not decrease or exceed the UROR steady state; and (4) allocations follow the ratemaking principles of cost-causation and gradualism.[521]

The steps of Mr. Blazunas's four-step method—as revised on rebuttal–are as follows:[522]

First, Mr. Blazunas explained that his method uses an upper limit to the UROR[523] threshold of 2.0, which excludes Schedule GT-3B from allocation, which has a UROR of 2.05 and has been historically over-earning.[524]

Second, Mr. Blazunas testified that he selected a UROR Steady State of +/- 10% of the overall system average ROR.[525] He testified that R, R-TM MGT-3A, GT-3A, TM-RT, SL, and SSL under-contributed relative to the system average ROR, though Schedules R

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[521] Blazunas Direct Testimony at 9-10.
[522] *Id*. at 51.
[523] The UROR is an attempt to calculate the ratio of an individual class's rate of return to the overall system rate of return, with values above 1.0 indicating that a class is over-earning compared to the overall system, while values below 1.0 indicate that a class is under-earning.
[524] Blazunas Rebuttal at 8-10. Pepco's original allocation exemption threshold was 1.5, which would have resulted in three classes receiving no allocation. Blazunas Direct Testimony at 52-53.
[525] Blazunas Direct Testimony at 53.

and R-TM are within a close range of a 1.0 UROR. Mr. Blazanus testified that he allocated a system average increase to Schedules R and R-TM.[526]

Third, Mr. Blazunas testified that he calculated the revenue allocation to under-earning classes–those with a UROR less than 0.9–using a multiplier to the system average. While Mr. Blazunas originally testified that he used a multiplier of 1.16 to the system average increase because it is consistent with allocations approved by the Commission in the past five rate cases,[527] he later increased the multiplier to 1.75 in order to allocate more of the revenue increases to significantly under-earning classes.[528] This resulted in approximately 13.4% of the total revenue increase being apportioned to Schedules MGT-3A, GT-3A, SL, SSL, and TM-RT, all of which have a UROR less than 0.9.[529]

Fourth and finally, Mr. Blazunas testified that he allocated the remaining amount to the remaining rate classes based on their level of current annualized distribution revenue for the 12-month period ending September 30, 2025.[530] He testified that this allocation meets the above-listed goals.

In rebuttal, Mr. Blazunas provided updated streetlight counts based on the results of Pepco's streetlight survey, which resulted in an increase in base distribution revenue during the test year.[531] He revised his revenue allocations accordingly, including moving the SL and SSL classes from the second step to the third.[532]

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[526] *Id*. at 55. Though witness Blazunas originally indicated that Schedules SL and SSL would be included in the Steady State allocation, as discussed below they later moved those classes into the under-earning category.
[527] *Id*. at 53-54.
[528] Blazunas Rebuttal Testimony at 8.
[529] *Id*., Schedule (PRB-R)-14 at 2.
[530] Blazunas Direct Testimony at 55.
[531] Blazunas Rebuttal Testimony at 26.
[532] *Id*., *see* Schedule (PRB-R)-17 at 25.

Staff

Staff witness Bowser disagreed with the four-step allocation method recommended by Pepco witness Blazunas.[533] Mr. Bowser argued that Pepco witness Blazunas allocated over 25% of the total incremental revenue requirement to Schedule MGT-LV, which is historically an over-earning class, with CCOSS URORs ranging from 1.52 to 1.22 in Pepco's last six rate cases. Mr. Bowser argued that this allocation far exceeds the combined incremental revenue requirement allocation to the under-earning classes in Step 3 (MGT-3A, GT-3A, and TM-RT).[534] He also raised concerns with the low amount of revenue allocated to Schedule R, which had a UROR just above 0.9.[535]

Mr. Bowser recommended that the Commission instead use a two-step revenue allocation method which (1) first allocates a 15% portion of the total incremental revenue requirement to classes that have been historically under-earning (UROR under 0.90), in proportion to their revenue contributions to the total system revenues; then (2) allocates the remaining 85% portion of the incremental revenue requirement to all non-excluded classes.[536] Mr. Bowser recommended a threshold cutoff for excluding classes of a UROR of 2.00 (compared to the 1.50 originally chosen by Pepco), which is consistent with the exclusion threshold used by the Commission in Pepco's last two rate cases.[537] He testified that he selected the 15%/85% allocation to concentrate more of the incremental revenue

[533] Bowser Direct Testimony at 37.
[534] Bowser Direct Testimony at 38-39. Based on the updated allocation provided by witness Blazunas in rebuttal, the allocation percent to MGT LV dropped to just below 20%. However, this is still greater than the combined percentage allocated to the underearning classes. *See* Blazunas Rebuttal Schedule (PRB-R)-14 at 2.
[535] Bowser Direct Testimony at 38.
[536] *Id*. at 42-45.
[537] *Id*. at 43, *citing* Order Nos. 91181 and 89868.

requirement to under-earning classes while spreading the majority of the increase more broadly, which serves to promote fairness while limiting rate shock.[538]

Mr. Bowser testified that the four-step method is more appropriate for cases when customer classes have starting URORs that are spread evenly, between under-earning, UROR steady state, and over-earning.[539] In this case, seven of the twelve major classes have starting URORs that fall below 1.00 and five are below 0.90–ranging from 0.31 to 0.74–with only one exceeding the 2.00 total exclusion threshold. Mr. Bowser argued that, given this under-earning trend, it is appropriate to give those under-earning classes a larger revenue increase. In this case, Staff's proposed rate design results in an allocation to under-earning classes that is 2.8 times higher than the system average, which results in a nearly 30% increase in base distribution revenues for those classes.[540] Mr. Bowser testified that, although high, Staff's proposal yields percentage increases that are more gradual than those under Pepco's four-step method.[541]

Mr. Bowser acknowledged that Schedule R and Schedule R-TM have under-earned in the past, but they have been closer to 1.00 URORs compared to other classes (MGT-3A, GT-3A, TM-RT, SL, and SSL) and are projected to be in the UROR steady state under Staff's allocations in this case.[542]

Mr. Bowser also testified that schedule SL has seen an accelerated decrease in UROR over the last several rate cases, while schedule SSL has seen more variability from

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[538] *Id*. at 42.
[539] Bowser Surrebuttal Testimony at 15.
[540] *Id*. at 20.
[541] *Id*. at 17-18.
[542] *Id*. at 18-19.

case to case.[543] Additionally, he testified that he agreed with Pepco's approach in updating its streetlighting billing determinants following its updated streetlight survey, and updated Staff's rate design workpapers to reflect those results.[544]

AOBA

AOBA witness B. Oliver testified that the four-step method is not reasonable and will not be effective in this case. Mr. B. Oliver testified that Pepco's use of the four-step method in its last rate case resulted in six classes moving further from parity.[545] He also argued that Pepco is overly-reliant on determinations made about revenue allocations in previous cases.[546] Mr. B. Oliver characterizes the results of Pepco's revenue allocation as "perverse," with certain overearning classes–GT-LV and MGT-LV–receiving a larger percentage increase than less-earning classes.[547] Also, even after Pepco adjusts its allocations based on the street lighting survey, Schedules GS-LV and GT-3B are left with URORs that are more than 1.5 times the system average.[548]

Mr. B. Oliver recommends adjustments to Pepco's allocation design as follows: (1) add an additional 3% onto the increase allocated to the residential classes; (2) apply an increase of 1.2 times the system average to significantly under-earning classes; and (3) rather than exempting any class, apply an increase of 10% of the system average to classes with UROR greater than 1.5.[549] Mr. B. Oliver testified that any reductions in the size of

[543] *Id*. at 16.
[544] *Id*. at 8-11.
[545] B. Oliver Direct Testimony at 57.
[546] *Id*. at 57-58.
[547] *Id*. at 61.
[548] B. Oliver Surrebuttal Testimony at 47.
[549] B. Oliver Direct Testimony at 71.

Pepco's overall revenue increase should be used to facilitate a greater narrowing of differences in class rates of return.[550]

COMMISSION DECISION

When determining an appropriate allocation of the incremental revenue requirement, the Commission must balance concerns of cost-causation, rate shock, equitable treatment, and consistency. In every rate case, the Commission aims to establish a revenue allocation that yields cost-based rates based on predictable conventions, including fairness and gradualism. The Commission must ensure that its approved allocation results in just and reasonable rates, which may necessitate prioritizing certain concerns over others as the facts of the particular case warrant.

As discussed above, Staff's proposed 2-step methodology in this case results in base distribution revenue increases for under-earning classes that exceed 20%.[551] While the Commission appreciates that Staff's approach focuses on fairness and cost-causation by targeting these under-earning classes, it may present potential issues of rate shock for those classes.

Pepco's four-step methodology, as updated in rebuttal, lessens the impacts on the under-earning classes by capping their increase in base revenues to 1.75 times the system average. The trade-off when limiting increases to under-earning classes is that other classes must bear more responsibility to cover costs that they do not cause. The Commission must determine to what extent such a trade-off is just and reasonable.

[550] B. Oliver Surrebuttal Testimony at 47.
[551] Bowser Surrebuttal Testimony at 20. This is true even when the allocation methodology is applied to the Commission's lower approved incremental revenue requirement.

Given that Pepco's under-earning classes in this case on average have URORs that are significantly lower than the steady state, the Commission does not believe that Pepco's proposal allocates enough of the revenue increase to these classes. This results in too much cost burden being shifted onto classes that are at steady state or are over-contributing. AOBA's proposal to cap the increase to under-earning classes to 1.2 times the system average creates an even larger burden shift.

The Commission finds that a 4-step allocation approach is optimal in this case to delicately balance the concerns of cost-causation, fairness, and gradualism, but does not find the four-step proposals offered by the parties best address this balance. Therefore, the Commission adopts modifications to Pepco's proposed four-step allocation as follows: (1) Classes with a UROR greater than 1.5 receive an increase of 0.5 times the system average increase; (2) Steady State classes with URORs between 0.9 and 1.1 receive an increase equal to 0.85 times the system average increase; (3) Classes with URORs below 0.9 receive an increase equal to 2 times the system average increase; and (4) Remaining classes are apportioned the rest of the revenue increase in proportion to their share of base distribution revenues.

Using the Commission's approved incremental revenue requirement, this allocation results in an increase to under-earning classes that falls between Pepco's and Staff's proposals, and fairly consistent percentage increases for classes with URORs between .9 and 1.5. The Commission notes that this allocation results in Schedules MGT-LV and GT-LV receiving a slightly higher percent increase than Schedules R and RTM despite having higher URORs; however, given the need to balance bill impacts to the residential class against the principle of cost causation, the Commission finds this result acceptable in this case. The Commission finds its allocation is an equitable result and will yield just and reasonable rates for all classes. The results of the Commission's approved revenue allocation applied to the approved incremental revenue requirement are shown in Table 11 below.

Table 11:
Commission Approved Incremental Revenue Requirement Allocation

Class	Current UROR	Revenue Allocated ($)	Revenue Allocated (%)	Updated UROR
R	0.93	$ 23,933,042.02	46.98%	0.93
RTM	0.97	$ 3,551,938.08	6.97%	0.95
GS-LV	1.56	$ 976,296.33	1.92%	1.42
MGT-LV	1.19	$ 11,930,565.06	23.42%	1.15
MGT-3A	0.31	$ 222,184.13	0.44%	0.47
GT-LV	1.31	$ 2,673,958.65	5.25%	1.25
GT-3A	0.59	$ 4,981,072.28	9.78%	0.75
GT-3B	2.05	$ 68,877.83	0.14%	1.78
TM-RT	0.46	$ 601,768.39	1.18%	0.59
SL	0.74	$ 264,468.60	0.52%	0.85
SSL	0.36	$ 1,726,238.76	3.39%	0.77
TN	1.78	$ 15,589.86	0.03%	1.56

1. Rate Design

Pepco

Pepco witness Blazunas presented in testimony a rate design for each customer class, which was updated in rebuttal to account for concerns raised by AOBA and Staff.[552] Mr. Blazunas testified that Pepco's distribution charges for each schedule may include any combination of a customer charge, a demand charge, and an energy–or volumetric–

[552] Blazunas Direct Testimony at 60-68.

charge.[553] A customer charge is a fixed-minimum charge each month. A demand charge is a variable per kilowatt charge billed on the basis of the customer's highest usage during a defined period, while a volumetric charge is a per kilowatt hour rate billed purely on the basis of usage volume.[554] Mr. Blazunas explained that the company calculates the customer charge, as applicable, for each schedule prior to setting the demand and volumetric energy rates.[555]

For the customer charge, Pepco proposes a design that is based on the percentage increases approved by the Commission in Pepco's last rate case for most classes.[556] Aside from rate schedule TM-RT, no increase for any rate schedule would result in a customer charge that would exceed the schedule's unit costs as reflected in the CCOSS.[557] As part of its plan to eventually combine schedules R and R-TM, Pepco proposes that the customer charge for class R-TM be calculated by multiplying its allocated change in distribution revenue by the difference between its current customer charge and the new customer charge for schedule R.[558]

For any class which utilizes a demand charge–MGT-LV, MGT-3A, GT-LV, GT-3A, and GT-3B–Pepco proposes to collect the revenue requirement increase that remains after the customer charge is applied through the volumetric energy charge and demand charge such that they maintain their existing relationship to one another, which varies per class based on their respective number and type of customers.[559] Mr. Blazunas also

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[553] *Id*. at 30.
[554] *Id*.
[555] *Id*.
[556] *Id*., Schedule (PRB)-5 at 2.
[557] *Id*. at 31. Schedule TM-RT consists solely of a customer charge, so the customer charge for that class is designed to recover its entire allocated revenue requirement.
[558] *Id*. at 60-61.
[559] *Id*. at 32.

discusses the use of the ERA and the gradual elimination of seasonality as part of designing volumetric rates, which are both addressed above.

Staff

Staff witness Bowser recommended that the Commission accept Pepco witness Blazunas's proposed rate design for the customer charge for all classes, noting that the calculations for schedules R-TM and TM-RT are dependent on revenue requirement. Accordingly, their values for those classes are adjusted for the reduced revenue requirement proposed by Staff.[560]

Mr. Bowser also recommended that the Commission accept Mr. Blazunas's proposed volumetric charge designs for all applicable classes, adjusted for the reduced revenue requirement and revenue allocations proposed by Staff.[561]

COMMISSION DECISION

The Commission adopts Pepco's rate design proposals as uncontested by any party, noting that they must be adjusted where necessary to account for the reduced incremental revenue requirement approved by the Commission. The Commission's approved customer charge rates are shown in Table 12 below.

[560] *Id*. at 48; Bowser Surrebuttal Testimony at 8-9.
[561] Bowser Direct Testimony at 50.

Table 12:
Commission Approved Customer Charges

Class	Current Charge	New Charge	Change (%)	Change ($)
R	$8.44	$8.67	2.68%	$0.23
RTM	$17.74	$17.10	-3.71%	-$0.64
GS-LV	$12.66	$13.02	2.84%	$0.36
T	$12.87	$13.24	2.88%	$0.37
EV	$4.76	$4.89	2.81%	$0.13
MGT LV	$47.56	$48.92	2.85%	$1.36
MGT 3A	$45.15	$46.42	2.82%	$1.27
GT LV	$386.37	$397.34	2.84%	$10.97
GT 3A	$362.77	$373.07	2.84%	$10.30
GT 3B	$340.51	$350.18	2.84%	$9.67
TM RT	$4,539.03	$5,245.33	15.56%	$706.30

With each of the Commission's distribution rate design decisions above incorporated, a bill impact summary is below:

Table 13:
Bill Impacts by Customer Class

Class	Bill Impact ($)	Montgomery Co. Bill Impact (%)		Prince George's Co. Bill Impact (%)	
		Dist.	Total	Dist.	Total
R	$3.94	5.19%	2.25%	5.07%	2.23%
RTM	$5.65	4.97%	2.03%	4.84%	2.01%
GS LV	$2.59	2.69%	1.36%	2.87%	1.40%
MGT LV	$53.55	4.28%	1.63%	4.76%	1.69%
MGT 3A	$235.45	5.63%	1.73%	6.57%	1.81%
GT LV	$812.70	4.35%	4.35%	4.83%	4.83%
GT 3A	$5,541.48	6.50%	6.50%	7.47%	7.47%
GT 3B	$675.83	0.69%	0.69%	0.85%	0.85%

2. Non-revenue Items

A number of other items were raised during testimony and briefing in this proceeding that do not directly drive the revenue and rate-setting function of this Order.

a. MEA's proposal for a DER roadmap, integrated data platform, and non-wires alternative framework

MEA proposed that the Commission establish a requirement that cost recovery of grid modernization investments be contingent on Pepco's delivery of a DER roadmap within one year of a final order in this case to prevent siloed standalone investments.[562]

MEA also proposed that the Commission direct Pepco to deliver an integrated data platform within one year that would serve as a one-stop shop that replaces existing utility portals with a streamlined interface to provide automated and electronic access to a broad set of data to stakeholders.[563] MEA noted that customer data exchange remains an ongoing initiative across Case Nos. 9778 and 9761 and in the Data Exchange Working Group. MEA expressed concern that the existing Commission efforts do not cover access to system and rates/tariff data, which MEA argued was critical to DER integration and utilization. MEA proposed that cost recovery in this case be conditioned on Pepco providing this platform.

MEA witness Lombardi proposed that the Commission require Pepco to file a formal NWS screening framework, hourly 8760 constraint analysis, benefit-cost analysis, and integration with the Electric System Planning Process.[564]

In its brief, Pepco argued that the Commission has historically not conditioned recovery of otherwise prudently incurred and used and useful investments on completion of a future filing related to policy objectives.[565] Pepco argued that these matters should be addressed in a policy docket. Pepco also pointed to witness Leming's hearing testimony

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562 MEA Brief at 59-63.
563 *Id*. at 55-59
564 Lombardi Surrebuttal Testimony at 4.
565 Pepco Brief at 69-71.

that Pepco has made significant progress on its DER roadmap in other proceedings and that there are other forums for continued stakeholder engagement. Pepco also stated that it is in substantial alignment with MEA on the direction of Maryland's grid modernization policy but recommended that the correct path is through statewide or issue-specific dockets, rather than Pepco-specific rate recovery conditions.[566]

COMMISSION DECISION

The Commission declines to condition rate recovery on post-rate case activities. That proposal would create unnecessary uncertainty in rates and depend on greater clarity in expectations than the present record supports. Nonetheless, the Commission appreciates MEA's concerns regarding the expansion of DERs, and all of these concerns can and should be raised in the dockets and workgroups MEA has specified.

b. Concerns with Pepco's data and project information and general errors

In its brief, Staff raised several concerns regarding Pepco's data and project information and general errors in the application.[567] Staff stated that Pepco has continued filing inconsistent data over dissimilar time periods, making it difficult to reconcile with the historic test year. Staff also objected to Pepco's inclusion of Washington, D.C.-specific projects (such as the CREF Automation project originally contained in RMA 38), even though such projects are not properly part of Pepco's Maryland system. Staff also expressed concern that Pepco has consistently failed to provide specific project expenditure

[566] *Id*. at 73-74.
[567] Staff Brief at 14-23.

details. Staff recommended that the Commission consider a future civil penalty if Pepco does not improve.

In its reply brief, Pepco argued that the final record is sufficient for decision and that any documentation concerns must be evaluated in the context of the unusual procedural posture of this case–which included Pepco filing both a fully forecasted and historical test year case, and the intervening passage of the Utility RELIEF Act–and the final evidentiary record that is now before the Commission.[568] Pepco argued that there was no support for a revenue requirement reduction or civil penalty warning, arguing that there was no record finding of bad faith, intentional misconduct, refusal to respond to discovery, or inability of the Commission to determine the final revenue requirement.[569] Pepco argued that it filed redlined copies of its relevant testimony impacted by the necessary removal of the forecasted test year. Pepco also stated that Staff was given the data it needed to reconcile the data in the revenue requirement comparison charts.[570]

COMMISSION DECISION

The Commission is greatly concerned by the ongoing issues raised by Staff regarding Pepco's project data and information as well as other errors in the application. The Commission directs Pepco to work with Staff, OPC, and other interested parties prior to its next rate case to address the above-raised concerns, including working towards an agreement on the sorts of data that will be made available during rate cases. Parties are free

[568] Pepco Reply Brief at 33-34.
[569] *Id*. at 35.
[570] *Id*. at 34.

to make recommendations if they believe improvement does not materialize in the next rate case.

c. *OPC's proposal to set a Phase II of this proceeding*

In its brief, OPC proposed that the Commission schedule a Phase II for this proceeding in order to adjust revenues to account for the recently enacted Utility RELIEF Act, which among other things capped rate recovery for supervisory compensation over 110 percent of the Commission Chair's salary.[571]

In its reply brief, Pepco states the Company's next base rate case will be subject to the new law and notes that the record in the case is closed and that Maryland legal doctrine "presume that newly enacted laws will only apply prospectively to proceedings filed after the new law has already taken effect."[572] Additionally, Pepco argues that Phase II processing on a single component of compensation expense raises single-issue ratemaking concerns.[573] Pepco ultimately argues that "to the extent the Commission determines that implementation guidance is needed, it should address that issue prospectively through compliance guidance, a policy process applicable to all utilities, or future rate cases with a record designed for that purpose."[574]

In its reply brief, Staff recommended a Phase II in response to OPC's suggestion and discussed legal reasons why the Commission is enabled to undergo a Phase II proceeding.[575]

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[571] OPC Brief at 57-58.
[572] Pepco Reply Brief at 59, *citing Traore v. State*, 290 Md. 585, 593 (1980).
[573] *Id*. at 59.
[574] *Id*. at 60.
[575] Staff Reply Brief at 12-15.

Pepco subsequently requested leave to respond to Staff's reply brief as it was the first time their arguments had been raised.[576] Pepco opposed Staff's legal arguments and claimed the circumstances in Case No. 9820 are different from Case No. 9849 where the Commission ordered a Phase II; also, Pepco argues it would be "facially prejudicial" and "run counter to Commission practice and precedent."[577]

COMMISSION DECISION

The Commission is required by the statute to ensure a utility does not recover certain expenses through rates. The Commission's approved rates will go into effect prospectively and thus are logically subject to the requirements of the statute. The Commission notes also that this issue, raised late, was not addressed in the record due to the timing of the legislation in question.

The Commission agrees that a Phase II proceeding is appropriate given the Utility RELIEF Act was signed into law during the pendency of this proceeding, and the relevant section became effective on May 12, 2026. None of the parties nor the Commission have had an opportunity to determine its impact on Pepco's revenue requirement, if any, in this proceeding.

The Commission is not persuaded that this treatment would create unfair prejudice against Pepco, which like every utility is required to comply with the Utility RELIEF Act, which has now gone into effect.

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[576] Pepco Request to Leave to Respond to Staff's New Argument, Case No. 9820, Maillog No. 332616 at 1-2 (Jul. 29, 2026).
[577] *Id*. at 205.

The Commission initiates a Phase II to address Utility RELIEF Act compliance. Pepco is directed to track all costs potentially prohibited from being included in rates under the Utility RELIEF Act.

IT IS, **THEREFORE**, this 28th day of August, in the year Two Thousand Twenty-Six, by the Public Service Commission of Maryland, **ORDERED**:

(1) that the Application of Potomac Electric Power Company, filed on October 14, 2025 (as supplemented by the Company over the course of this proceeding), seeking to adjust electric rates to be effective August 10, 2026, and claiming an electric revenue deficiency of $133,000,000 is hereby denied;

(2) that Pepco is hereby authorized to increase its Maryland electric distribution rates by no more than $50,946,000;

(3) that Pepco is directed to file tariffs in compliance with this Order with the effective date of August 10, 2026,[578] subject to acceptance by the Commission; and

(4) that all motions or requests not granted herein are denied.

/s/ Kumar P. Barve

/s/ Frederick H. Hoover, Jr.

/s/ Bonnie A. Suchman

/s/ Odogwu Obi Linton

/s/ Ryan C. McLean

Commissioners

[578] Application of rates for the period August 10 through August 27, 2026, shall be governed by the terms of the Commission's Letter Order of August 7, 2026. Maillog No. 333008.