IN THE COMMONWEALTH COURT OF PENNSYLVANIA

NRG ENERGY, INC.	:	
	:	
Petitioner,	:	
	:	Case No. 58 C.D. 2019
v.	:	
	:	
PENNSYLVANIA PUBLIC UTILITY COMMISSION,	:	
	:	
Respondent.	:	

BRIEF FOR AMICUS CURIAE
THE R STREET INSTITUTE

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STATEMENT OF INTEREST OF AMICUS CURIAE

The R Street Institute is a nonprofit, nonpartisan, public-policy research organization with a mission to engage in policy research and outreach to promote free markets and limited, effective government. R Street has a long standing interest in electricity competition because of the economic and environmental benefits it provides. R Street's energy program is headed by Travis Kavulla, who served eight years on the Montana Public Services Commission and is the former President of the National Association of Regulatory Utility Commissioners ("NARUC").

Pennsylvania is a leader in consumer choice in electricity markets. Ensuring that competition in Pennsylvania is not undermined by cross-subsidization is a core principle of the Commonwealth's law as well as an important policy matter that must be resolved appropriately for Pennsylvania and other jurisdictions that have elected to pursue electricity market restructuring.

No one other than the amicus curiae or its counsel paid for the preparation of this amicus curiae brief or authored this brief, in whole or in part.

ARGUMENT

I. The Choice Act Requires Pennsylvania's Public Utility Commission to Prevent Cross-Subsidization

In 1996, Pennsylvania passed the Electricity Generation Consumer Choice and Competition Act ("Choice Act"). The Choice Act restructured Pennsylvania's electric markets, giving residential and business customers in the Commonwealth the ability to choose their electric provider. Prior to 1996, Pennsylvania electricity operated under a monopoly utility model. Under this system, electric utilities were granted exclusive right to provide electric service in a given geographic region and were subject to extensive oversight and regulation by the Commonwealth's Public Utility Commission ("PUC"). Electric rates were determined under a cost-of-service model, according to which a utility was allowed to charge what was necessary to recover its costs plus an additional amount to provide a return on and of its investment.

Under the new system, incumbent electric utilities were required "to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." 66 Pa. Cons. Stat. § 2802(14). In passing the Choice Act, Pennsylvania recognized that the switch to competition was essential "to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs." *Id.* § 2802(7).

While the Choice Act made Pennsylvania's electric system substantially more competitive, the Legislature also decided to keep certain parts of the electric system immune to competition. Setting forth the policy goals of the Choice Act, the Legislature asserted that "[i]t is in the public interest for the transmission and distribution of electricity to continue to be regulated as a natural monopoly subject to the jurisdiction and active supervision of the commission." *Id.* § 2802(16). The Act also determined that "[e]lectric distribution companies should continue to be the provider of last resort in order to ensure the availability of universal electric service in this Commonwealth." *Id.*

Some other states that have restructured their electric markets have determined to "quarantine the monopoly" in order to ensure competition functioned properly. *See* Michael Giberson & Lynn Kiesling, *The Need for Electricity Retail Market Reforms*, Regulation, Fall 2017, at 34, 37. This is not the path that Pennsylvania chose. Instead, the Commonwealth codified a policy in which the residual poles-and-wires company—sometimes called a "default provider"—would continue to provide energy-supply service, at least to customers who did not elect to choose a third-party provider. PECO Energy Company ("PECO") is one such default provider.

The Commonwealth's policy choice to have a default provider comes with an obvious risk. The residual monopoly may seek to underprice its energy-supply offering, which is subject to competition, by allocating more costs to the poles-and-wires service, which its monopoly customers cannot help but to purchase short of cutting the cord altogether. The Choice Act, anticipating this danger, provided that the "commission shall require that restructuring of the electric utility industry be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another." 66 Pa. Cons. Stat. § 2804(7). Indeed, the act specifically imposed an affirmative duty on the PUC to examine "all default service rates shall be reviewed by the commission to ensure that the costs of providing service to each customer class are not subsidized by any other class." *Id.* § 2807(e)(7).

In order to achieve the purposes of the Choice Act, courts and regulators must vigilantly police the boundaries between the competitive and non-competitive sectors of the electricity system. This Court recognized this truth in *Lloyd v. Pa. Pub. Util. Comm'n*, 904 A.2d 1010 (Pa. Cmmw. Ct. 2006), when it noted that the Commission should not allow "one class of customers to subsidize the cost of service for another class of customers over an extended period of time." *Id.* at 1020.

Unfortunately, the act of setting default rates—as the PUC is charged to do in the instant proceeding—can become a self-fulfilling prophecy of a default choice. If default provider rates do not reflect the actual costs of serving customers who do not choose a third-party supplier, then customers do not have a true choice. Instead, competitors that do not have a monopoly function to sop up costs must lay the full freight of overhead costs on the rates they would charge customers, making the default provider's prices look more attractive by comparison. This results in a situation where "default service customers are misled about their retail market options and thus, frequently remain with their incumbent utility" even where they would not do so absent the subsidy. *See* Frank Lacey, *Default Service Pricing – The Flaw and the Fix*, 32 Electricity J. 3, 5 (2019). Such an outcome would be contrary to "the overarching goal of the Choice Act," which "is competition." *Coal. for Affordable Util. Servs. & Energy Efficiency in Pa. v. Pa. Pub. Util. Comm'n*, 120 A.3d 1087, 1101 (Pa. Cmmw. Ct. 2015).

II. Allowing Allocation of All Indirect Costs to Monopoly Services is Inconsistent with the Choice Act

One way to shift costs into the monopoly rates charged to all distribution customers is through an inaccurate accounting of indirect costs. Any business providing electric service has to incur certain indirect costs, such as costs for overhead, billing, and customer service. Such customer-service and administrative costs have traditionally been recognized as distinct from costs for distribution and should be allocated differently. *See* Nat'l Ass'n of Regulated Util. Comm'rs, *Electricity Utility Cost Allocation Manual* 20–22 (Jan. 1992).

The decision of how to allocate administrative and customer-services costs can have a significant impact on the competitiveness of a default provider's retail service. If the costs of these services are completely allocated to distribution services (and thus paid for by all electric customers, including those who do not use the utility as their default service provider), the default provider could deliver retail electric services at a lower cost than it would be able to if it was a stand-alone provider. If this is allowed, the default provider gains an unfair advantage.

The impact of these allocation decisions can be substantial. One recent research study found that:

> The indirect costs incurred to provide service to default service customers amount to billions of dollars annually and are being paid by distribution customers. This distorts significantly the retail energy markets, providing the incumbent default service provider with a pricing advantage that allows them to maintain market dominance in the residential and small commercial customer segments.

Lacey, *supra*, at 5. Testimony presented to the PUC suggests that allowing allocation of all administrative and customer service costs to residential distribution service is the equivalent of a subsidy of 1.25 cents per kilowatt hour to residential customers of the default provider's competitive business. Direct

Testimony of Chris Peterson on Behalf of NRG Energy Company, Pa. Pub. Util. Comm'n v. Phila. Energy Co., No. R-2018-3000164 (June 26, 2018).

What is happening here is obvious: PECO is underpricing a service offering that is subject to competition and shifting those costs to rates that all customers must pay. Surely this is more convenient to PECO, which faces neither a risk of losing customers to competitors nor of under-recovering the costs of offering energy supply service to Pennsylvanians. But neither the PUC nor this Court should countenance it.

There are numerous ways of reasonably allocating administrative and customer-service costs between distribution and retail electric services. But allocating all of those costs to distribution services is inherently unreasonable and not supported by any evidence in this record. The determination to let PECO allocate 100 percent of its indirect costs to its monopoly services requires a judicial response to vindicate the Commonwealth's clearly announced policy.

CONCLUSION

For the foregoing reasons, amicus curiae supports the Petition to vacate the PUC's determination as to the allocation of indirect costs and to remand the proceeding to the PUC for future action consistent with this Court's Order.

Respectfully submitted,

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