Circuit Court for Baltimore City
Case No. 24-C-17-000893

UNREPORTED

IN THE COURT OF SPECIAL APPEALS

OF MARYLAND

No. 1366

September Term, 2017

MARYLAND OFFICE OF PEOPLE'S COUNSEL

v.

MARYLAND PUBLIC SERVICE COMMISSION

Meredith,
Graeff,
Beachley,

JJ.

Opinion by Meredith, J.

Filed: July 27, 2020

This case concerns a question regarding charges for electricity. After the electric utility industry went through restructuring that was intended to increase competition in Maryland for providing electricity, one electric utility company in each distribution territory was obligated to continue to offer to provide service to customers who did not take advantage of the opportunity to purchase their electricity from a new company. Maryland Code (1998, 2010 Repl. Vol., 2019 Supp.), Public Utilities Article ("PU"), § 7-506(e); § 7-510(c). As a consequence, Baltimore Gas and Electric Company ("BGE"), one of the appellees, was obligated to provide "Standard Offer Service" (sometimes referred to as "SOS") to customers in its territory who chose not to shop for electric supply, or were unable to obtain electric supply, from other providers. The dispute in this case arises from a ruling made by the Maryland Public Service Commission ("Commission" or "PSC"), the other appellee, regulating the price that BGE is authorized to charge for providing Standard Offer Service electricity to its customers.

By statute, when an electric utility company such as BGE provides Standard Offer Service in Maryland, the company is permitted to charge "a market price that permits recovery of the verifiable, prudently incurred costs to procure . . . the electricity plus a reasonable return." PU § 7-510(c)(3)(ii)(2). In this case, the Commission approved a rate that the Maryland Office of People's Counsel ("People's Counsel" or "OPC"), appellant, contends was in error. When People's Counsel sought judicial review of the Commission's decision in the Circuit Court for Baltimore City, the court affirmed the Commission's decision. In this appeal from that ruling, People's Counsel urges us to

vacate the Commission's Order No. 87891 and Order No. 87994, and remand the case for additional consideration of the appropriate amounts that BGE can charge for Standard Offer Service.[1]

For the reasons set forth herein, we shall affirm the circuit court's judgment affirming the decision of the Commission.

BACKGROUND AND PROCEDURAL HISTORY

I. Deregulation of electric utilities in Maryland

In Severstal Sparrows Point, LLC v. Public Service Com'n of Maryland, 194 Md. App. 601, 604-05 (2010), this Court described the changes in the electric utility industry that eventually gave rise to the dispute in this case:

> In 1999, the General Assembly enacted the Electric Customer Choice Act ("1999 Act"), codified at Md. Code (2008 Repl.Vol., 2009 Supp.), section 7-501 *et seq.*, of the Public Utility Companies Article ("PUC"), with, among its goals, those of establishing "customer choice of electricity supply" and creating "competitive retail electricity supply and electricity supply services markets." PUC §§ 7-504(1) and (2). To further

[1] In its brief, People's Counsel raises two questions:

> I. Whether the Public Service Commission provided an unjust and unreasonable return of 22% on the $74.4 million asset supporting SOS in violation of the Public Utilities Article?
>
> II. Whether the Public Service Commission's contradictory and cursory reasoning is insufficient to justify its outcome thereby rendering the decision arbitrary and capricious?

We consider the questions as presenting a single issue: whether the Commission committed reversible error in setting the amount BGE may charge for its Standard Offer Service.

> these goals, the component parts of electric service were to be unbundled. Distribution was to remain monopolized and, therefore, the rates charged were to remain closely regulated by the PSC. Supply was to be deregulated, however, with the rates charged to be largely established by the market. In other words, electricity customers would, for the first time, be permitted to shop on the open market for a third-party electrical energy supplier.
>
> * * *
>
> Although the 1999 Act permitted consumers to shop for their supply of electricity, its drafters recognized that not all consumers could or would do so. For that reason, the law was written to obligate the electricity utilities such as BGE to continue to provide "backstop" electricity supply, known as Standard Offer Service ("SOS"), to consumers who chose not to shop for their electric supply or, for whatever reason, could not obtain electricity on the open market. The legislative goal was to phase out SOS over time as the competitive market more fully developed in Maryland. While most commercial electricity customers now shop for their energy supply, most residential customers and many small commercial customers do not. They continue to receive SOS electricity supply by default.

(Footnote omitted.)

Under PU § 7-505(b)(8), the Commission is charged with "determin[ing] the terms, conditions, and rates of standard offer service." The statutory provision that is the focus of this appeal is PU § 7-510(c)(3)(ii)(2), which, as noted above, states: "On and after July 1, 2003, an electric company continues to have the obligation to provide standard offer service to residential and small commercial customers at **a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return**." (Emphasis added.) The Commission's allowance of one category of "costs" and the amount that represents "a reasonable return" are at issue in this case.

II. The 2003 Settlement

To facilitate implementation of the 1999 Act, the Commission negotiated a series of settlement agreements with the various electric utility companies that provide service in Maryland. In 2003, the Commission entered into an agreement with BGE and others that "establishe[d] a wholesale competitive procurement methodology to implement utility[-]provided Standard Offer Service ('SOS') to Maryland's retail electric customers after their utility-specific restructuring settlements expire." *See Re Competitive Selection of Electricity Supplier/Standard Offer Service*, 94 Md. P.S.C. 113, 2003 WL 21051678, 224 P.U.R.4th 185 (2003) ("the 2003 Settlement") (footnotes omitted). Pertinent to this case, the 2003 Settlement established various classes of Standard Offer Service that the companies would provide as well as the costs the companies were allowed to recapture through customer billings. It stated, in part:

> **The retail prices for SOS will consist of**: (1) the seasonally-differentiated and, if applicable, time-of-use differentiated load weighted average of the supply contracts for each year; (2) FERC-approved transmission charges and any other PJM charges and costs related to SOS; (3) **an Administrative Charge**; and (4) applicable taxes.[2]

[2] "PJM was first established as a power pool in 1927 as an association of utilities in Pennsylvania, New Jersey, and Maryland. On March 31, 1997, PJM became an independent entity with its own Board of Governors, and was renamed PJM Interconnection, LLC. On January 1, 1998, PJM became the first operational independent system operator ('ISO') in the United States, and became responsible for the safe and reliable operation of the transmission system serving Maryland. The grid includes all or part of 14 political jurisdictions, including Delaware, the District of Columbia, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, and West Virginia. According to Andrew Ott, Vice President of Market Services at PJM, PJM operates the world's largest competitive wholesale electricity market." *In the Matter of Baltimore Gas and Electric Company's*

continued…

> According to the Settlement, **the SOS Administrative Charge is composed of a utility return component, an incremental costs component, uncollectibles, and an Administrative Adjustment component**.

(Emphasis added.) We note that one of the two key points of contention in this appeal is whether the Commission erred in setting the amount BGE could recover as a return component of the SOS Administrative Charge.

The 2003 Settlement further established, for each class of SOS, the applicable initial Administrative Charge, and broke down its component parts, as follows. For Residential service, the Administrative Charge was set at 4 mills (0.4 cents) per kilowatt hour (kWh), of which 1.5 mills (0.15 cents) per kWh constituted the "return" to "be paid to the Utilities . . . for retention by their shareholders." 2003 Settlement, ¶12. For "incremental costs," the Administrative Charge for Residential service included 0.5 mills (0.05 cents). The Settlement also provided: "The remaining 2 mills (0.2 cents)" was, for BGE, "reduced by 1.1 mill" to account for its "uncollectible costs." "The remainder of the 2 mill portion after subtracting the uncollectible costs rate is henceforth referred to as the Administrative Adjustment." *Id*. The Administrative Charge for other classes of SOS

---

continued…

Proposal to Implement a Rate Stabilization Plan Pursuant to Section 7-548 of the Public Utility Companies Article and the Commission's Inquiry into factors Impacting Wholesale Electricity Prices, 98 Md. P.S.C. 124, 2007 WL 1536549, 257 P.U.R.4th 1 (May 23, 2007) ("the 2007 Settlement").

customers was similarly established with a portion covering costs, and a portion providing a "return" to the company.[3]

"Cash Working Capital," or "CWC," is what it costs BGE to finance the working capital it needs to provide Standard Offer Service. The 2003 Settlement addressed the manner in which the company's capital costs would be recovered from SOS customers. The amounts varied depending on the class of SOS customer, but §12(d) of the 2003 Settlement stated that the Residential SOS cash working capital revenue requirement "is deemed to be reflected in the return component" or reimbursed as a Residential SOS-related uncollectible. The Administrative Charge for Residential SOS included both a return and uncollectibles.

The settlement provisions bearing on recovery of CWC as a portion of the Administrative Charge for SOS customers receiving Type I, Type II, Type III, and HPS service provided for each respective class:

> The Utility shall calculate the cash working capital revenue requirement associated with [Type I, Type II, Type III, or HPS] SOS. One half of that revenue requirement is recovered as part of the return component of the Administrative Charge. The remaining half is recovered as part of the

[3] For Type I SOS, the Administrative Charge was set at 5.5 mills (0.55 cents) per kWh, which consisted of 2.0 mills (0.2) paid to the company as the return component. ¶31, 2003 Settlement. For Type II SOS, the Administrative Charge was set at 6.0 mills (0.6 cents) per kWh, of which 2.0 mills (0.2 cents) per kWh was paid to the Utilities as return. ¶50, 2003 Settlement. The Administrative Charge for Type III SOS was set at 6.5 mills (0.65 cents) per kWh, of which 3.0 mills (0.3 cents) was the "return component allowed in addition to costs. ¶68, 2003 Settlement. For HPS hourly class of customers, the Administrative Charge was set "between 2.25 mills (0.225 cents) and 3.0 mills (0.3 cents) per kWh, of which 2.25 mills (0.225) was "paid to the Utilities, for retention by their shareholders." ¶80, 2003 Settlement.

> incremental cost component of the Administrative Charge, subject to a ceiling amount of 0.15 mills per kWh. Each Utility agrees to submit the calculation procedure for the cash working capital revenue requirement for review by the Settling Parties in Phase II. The calculation of cash working capital revenue requirement shall use the Utility's total weighted cost of capital grossed up for income taxes.

(The amount the Commission allowed BGE to recover as part of the cash working capital component of the Administrative Charge in the Orders under review in this appeal is the second major issue in this case.)

Rate Stabilization/The 2006 Special Session

In June 2006, the General Assembly convened a special session to address issues regarding the deregulation of electric utility companies, and passed Senate Bill 1, which repealed, reenacted, and/or amended several provisions of the Public Utility Companies Article.[4] At issue in this case is PU § 7-510(c)(3)(ii)(2), which, as noted above, requires BGE to continue to provide Standard Offer Service at a price that covers verifiable costs plus "a reasonable return." The permitted markup of the price of the electricity (over and above the cost of acquisition from the generating provider) is referred to as the SOS Administrative Charge.

The Fiscal and Policy Note to SB 1 summarized the effect of the bill, and included in Appendix 1 this illustration of the components of an "SOS Administrative Charge for Residential Customer":

[4] The name of the Article was changed in 2010 from the "Public Utility Companies Article" to the "Public Utilities Article." Acts 2010, Chapter 37.

> Total SOS Administrative Charge (4 mills = $.004/kwh) breaks down into the following:
>
> • Utility return component (1.5 mills = $.0015/kwh) – PROFIT.
>
> • Incremental costs component (.5 mills/kwh = $.0005 kwh) – ACTUAL COST: This is actual uncollectibles that are not being recovered in a utility's distribution rates (*e.g.*, consultants, auction/procurement processes, incremental system costs, bill inserts for education, transition costs, and working capital revenue requirements).
>
> • Administrative Adjustment (2 mills/kwh = $.002/kwh) –TRUE UP: This is the mechanism used to adjust the cost of SOS (generation) while holding harmless customers through a commensurate credit. It increases the price to beat for competitive generation suppliers, which the settling parties assert will assist the development of a competitive generation market.
>
> * * *
>
> EXAMPLE:
>
> Average kwh is 1,000/month. Accordingly, the average customer will pay $4 (within SOS rates). Of the $4, $1.50 is profit/month ($1.50 x 12 = $18 per year x about 1 million customers = $18 million).

In this example provided in the Fiscal Note to SB 1, the "actual cost" of "working capital revenue requirements" was included in the "Incremental costs component" of the Administrative Charge, and the "Utility return component" was a separate amount (that was also described in the example as a "profit").

III. BGE's 12/30/09 Request

On December 30, 2009, BGE filed with the Commission a Request for Recovery of Standard Offer Service Related Cash Working Capital Revenue Requirement. BGE's initial request asked that the Commission "allow an adjustment to BGE's SOS cost recovery mechanisms" pertaining only to its Type I, Type II, and HPS SOS classes of

customers. In support of the request, BGE stated that PJM, LLC—the regional generating company from which BGE purchases its electric supply to provide electricity to SOS customers—had recently switched from billing BGE monthly for the supplied electricity to billing BGE on a weekly basis. BGE, however, continued to bill its customers monthly, after the amount of consumption was known. As a consequence of having to pay PJM on a weekly basis, there was now a lag between the time BGE had to pay PJM to purchase the electricity and the time when BGE's SOS customers paid their electric bills. BGE argued that this time lag in receipt of income increased its cash working capital requirements because it now had to wait longer to be paid. Even though the impact upon BGE's cash flow would stabilize after a transition period of a few months, the additional working capital required to provide Standard Offer Service would be a continuing need. BGE argued that its "verifiable, prudently-incurred costs to procure" the electricity to provide SOS was now higher, and, pursuant to PU § 7-510(c)(3)(ii)(2), the company was entitled to recover that new expense of providing SOS. BGE asked that the Commission allow it to recover its additional Cash Working Capital ("CWC") costs as a component of the Administrative Charge.

OPC and the Commission's Technical Staff ("Staff") requested that there be an evidentiary hearing on BGE's request, asserting that it "alters the provisions of the cost recovery mechanism established" in the 2003 Settlement. BGE amended its request to also include Residential SOS. Both OPC and the Commission's Staff then requested that the Commission examine all aspects of BGE's Administrative Charge. The Commission

granted the request for a complete review, and contested case proceedings ensued before a hearing examiner.[5]

IV. Proceedings before the Public Utility Law Judge (PULJ)

Witnesses for all parties filed testimony.[6]

On May 31, 2011, the hearing examiner issued a proposed decision, proposing that the Administrative Charge and the return component be eliminated, and that CWC costs be recovered on a dollar-for-dollar basis until BGE's next rate case.

All parties appealed to the Commission, which rejected the proposed decision and remanded the case for further consideration on November 11, 2014. The Commission overruled the proposed elimination of the Administrative Charge and the return, finding that the record was not sufficiently developed to support either recommendation. The remand order observed:

> All parties agreed that the Company is entitled to recover its incremental costs and uncollectible costs with regard to providing SOS. There was substantial disagreement, however, concerning calculation of the return, and the form in which it is to be collected --- whether that return is separately stated, included as part of the CWC requirement, or is considered within the overall context of the Company's rate of return. . . . [T]he record has not been sufficiently developed to finalize BGE's Administrative Charges. Accordingly, we remand this matter to the Public Utility Law Judge Division (PULJ) to conduct further proceedings to determine appropriate SOS Administrative Charges for BGE. . . .

[5] At the time the case was first referred for contested case proceedings, the hearing official was called a hearing examiner. The Hearing Examiner Division was later renamed the Public Utility Law Judge Division. ACTS 2015, Ch. 217.

[6] The Retail Energy Supply Association ("RESA") intervened in the case and participated in the proceedings before the Commission, but is not a party to this appeal.

(Footnotes omitted.)

All parties filed memoranda and prepared testimony, and evidentiary hearings were conducted before a Public Utility Law Judge. On November 20, 2015, the PULJ issued a proposed decision, finding in part:

> [The] CWC revenue requirement is a cost of SOS operations and is not a return for purposes of Public Utilities Article, § 7-510(c)(3). Once the CWC revenue requirement is included in the Administrative Charge as a separate component, it no longer may be deemed to be a portion of the "return component of the administrative charge," which is the portion of the residential Administrative Charge affected by the Senate [Bill] 1 provision.[7] I find nothing in the legislation or the record that convinces me that the General Assembly intended to extend the 2003 Settlement Agreement provision, which deemed the residential CWC to be a part of the return component, through December 31, 2016 or intended to prohibit the Commission from approving new or revised cost components of the Administrative Charge upon the expiration of the 2003 Settlement Agreement. Accordingly, I find that BGE is not precluded from collecting its residential SOS-related CWC revenue requirement upon a final order in this proceeding.

The PULJ proposed that the Administrative Charge for residential SOS would be 2.88 mills/kWh, consisting of 0.08 mills in incremental charges, 1.67 mills toward uncollectible costs, 0.95 mills for the CWC revenue requirement, and 0.18 mills for the return.[8] The PULJ noted that, because "no party ha[d] objected to the Administrative

[7] Senate Bill 1 was the legislation enacted during the June 2006 Special Session, as discussed above.

[8] The PULJ explained:

> As Staff and OPC argue, the only capital investment being made in the provision of BGE's SOS is the CWC asset. As the potential risk in BGE's obligation to offer SOS relates to the delay in recovering the

continued…

Charge for the commercial services, BGE's proposed changes are approved," and further ruled that the return rate for Type I, Type II, and HPS SOS "shall be determined by the same method utilized to calculate the residential Return component of the Administrative Charge." The PULJ proposed eliminating the Administrative Adjustment component of the Administrative Charge, finding that the record did not support continuing to add an Administrative Adjustment.

---

continued…

> revenue contemporaneously or nearly contemporaneous with the payment of the expenses, I conclude that a "reasonable return" should be based on the inflationary difference in the value of money over a selected period of time. Consequently, I find that the Return component rate should be determined by applying the most recent five year preceding moving average change in the rate of the electricity (per kWh) prices as measured by the Consumer Price Index-Average Price issued by [the] United States Department of Labor to the CWC asset. The initial Return rate shall be determined by calculating the average increase in electricity CPI-Average Price from January 2011 to January 2015. The same procedure shall be used to reset the Return rate on an annual basis using the most recent five-year average. Using the aforesaid method, I find that the average five-year percent change for electricity per kWh is 2.18%. Using the CWC asset of $74,432,000, as shown in [an exhibit to the testimony of BGE's VP/CFO/Treasurer, David Vahos], and applying the rate of 2.18%, the Return on the CWC asset is $1,622,618. Based on residential sales of 8,928,000 per kWh, the residential Return component rate shall be initially set at 0.18 mills per kWh.

(Footnote omitted.)

V. The Commission's Orders that are the subject of judicial review

(1) Order No. 87891

On November 17, 2016, the Commission filed the first of the two orders on review before this Court. Order No. 87891 affirmed, in part, and reversed in part, the PULJ's proposed order of November 20, 2015. It affirmed the conclusion that the cost of providing CWC should be a separately-stated component of the Administrative Charge, and adopted the amount proposed by the PULJ. Consistent with the Commission's conclusion in cases it had recently decided with respect to SOS provided by other utility companies, the Commission ruled that "CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS."[9]

In the section of Order No. 87891 addressing the CWC component, the Commission stated:

> The record reflects that BGE's Chief Financial Officer and Treasurer David M. Vahos testified that CWC Revenue Requirement "represents the cost associated with the capital the Company must obtain in order to finance the working capital necessary to provide BGE customers with SOS-related services." On June 1, 2009, PJM changed its monthly settlement process, in accordance with which BGE paid suppliers and PJM for generation and transmission of energy to provide to SOS customers, to a weekly settlement. The revenues obtained for the recovery of CWC costs reimbursed the Company for its permanent SOS financing requirement due

[9] The Commission noted that it had previously ruled in a consolidated case concerning Delmarva Power and Light and Potomac Electric companies that CWC is recoverable as a cost component of the Administrative Charge for providing Standard Offer Service. *See* Commission Order No. 86881, issued in *Re the Review of Delmarva Power and Light Company Standard Offer Service Administrative Charge and Re the Review of Potomac Electric Power Company Standard Offer Service Administrative Charge, Case Nos. 9226 and 9232.*

> to the timing difference between the purchase of SOS power and transmission costs on a weekly basis and the customers' monthly payments.
>
> * * *
>
> . . . CWC Revenue Requirement is a cost that BGE and other utilities incur when providing SOS service. . . .
>
> . . . As we previously stated in Order No. 86881, CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS. We conclude that [approving] a CWC cost requirement and a utility return (profit) separately is beneficial because it promotes transparency. . . .
>
> . . . [The PULJ] decided that it would be appropriate to calculate CWC Revenue Requirement by using BGE's most recently authorized rate of return (grossed up for taxes). She found that this approach is the least cost possible consistent with sound utility management practices.
>
> * * *
>
> . . . We find that BGE has presented credible evidence to demonstrate that it has utilized practices that minimize SOS costs in a responsible manner and find that BGE's calculation of the CWC Revenue Requirement for SOS using its most recently authorized rate of return (grossed up for taxes) is the least cost possible consistent with sound utility management practices.

(Footnotes omitted.)

With respect to the return component of the Administrative Charge, the Commission did not adopt the PULJ's proposed finding, but substituted its own finding as to the appropriate amount of the return component. Because this portion of the Commission's ruling is a major focus of this appeal, we will reproduce this portion of Order No. 87891 at length:

> BGE has challenged the [PULJ]'s decision to set the Return Component at 0.18 mills per kWh for Residential Customers and 0.13 mills per kWh for SOS Type I and Type II Customers based upon the CPI, less

than the amount BGE sought. During the proceeding, Staff and OPC advocated that the return component should be the difference between the return rate used to calculate CWC Revenue Requirement and BGE's most recent[ ] rate of return, which is 0.92 [sic] mill per kWh for Residential Customers. Additionally, Staff on reply noted that the record also contained substantial evidence to support providing BGE a return component lower than what the [PULJ] decided using CPI. For reasons discussed below, **we reverse this portion of [the November 20 order] and set the Return Component based on the proposals of OPC and Staff.**

PUA § 7-510(c)(3) states that "on or after July 1, 2003, an electric company continues to have the obligation of providing SOS to residential and small commercial customers at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return." The question raised by BGE in this case is what is a "reasonable return."

BGE argues the Return Component set forth in Proposed Order II, which was devised using the CPI, does not satisfy what the statute means by a "reasonable return." BGE further argues that a "reasonable return" is not derived through the application of PUA § 4-101(3), or determined by the fair value of BGE's property used and useful in providing service.[10] BGE argues that a reasonable return is something that is not unreasonable, a measure that does not provide a negative return, and something that is not below the low end of the range of margins of third party suppliers. BGE amplifies its argument against the use of PUA § 4-101(3) to determine a

[10] PU § 4-101 provides:

In this title, "just and reasonable rate" means a rate that:

(1) does not violate any provision of this article;

(2) fully considers and is consistent with the public good; and

(3) except for rates of a common carrier, 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.

"reasonable return" by citing to *Severstal*[, 194 Md. App 601]. Additionally, through the testimony of Witness [Kurt] Strunk, the Company tried to convince the [PULJ] that the appropriate return authorized by PUA § 7-510 could only be determined by using BGE's application of the Return on Sales Methodology.

Staff argues that a "reasonable return" stated in PUA § 7-510(c)(3) means what the term "unreasonable return" [sic] has meant in other utility regulatory matters, i.e. **a return on invested capital as stated and applied by PUA § 4-101(3)**. OPC insists that BGE misuses *Severstal* to promote its argument, and agrees with Staff that PUA § 4-101(3) should be applied. OPC also argues that *Severstal* never reached the issue of what "reasonable return" means and thus BGE inappropriately relies on *Severstal* to support that claim. RESA also claims that the term "reasonable return" is not ambiguous and it means that the Commission is "to adopt orders and policies that foster competition, benefit customers economically, and which are fair to all stakeholders."

We have looked throughout the Electric Customer Choice Act to determine the Legislature's intended meaning of "reasonable return" and find it ambiguous. We have also reviewed *Severstal*, which does not address the issue either. We find that the Return Component alone does not by itself set [the] "market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return" for BGE SOS services, but the Administrative Charge as a whole—along with the other elements that make up SOS prices—perform[s] that measure.

After reviewing the evidence and arguments made by all parties, we adopt the Return Component proposed by OPC and Staff. We are convinced that "reasonable return" in PUA § 7-510 means a return on capital investment. As OPC Witness Hill notes in his testimony, SOS is a traditional utility service. The electricity that it provides is purchased by the electric company and it is delivered through the company's distribution system. He notes that there is no difference between a "market standard" and a "regulatory standard" for determining a return on utility service. The goal of regulatory oversight as provided by PUA § 7-510 is to achieve a competitive environment of companies that have similar risks. For that reason **as stated by OPC and Staff, the Return Component should be determined by the cost of capital on regulated assets using capital market data of similar risk.** In order **for there to be a return there must be a tangible investment as the basis for the return, which in this case**

> **is CWC**. Thus, we do not find a difference between the traditional utility regulatory standard for return and a market standard for return.
>
> Absent the argument regarding the different standards of return applicable to this case, we also are not convinced that the return proposed by BGE is proper. **BGE used the Return on Sale Methodology**; however, that method is used to determine rates for the hauling of waste and intrastate trucking industries rather than the retail electricity supply industry or other companies that provide retail products comparable to SOS. **We do not believe that such a method is appropriate for determining the market return for the sale of SOS services.** Had BGE provided us with other methods of determining a return for SOS services that are utilized by other jurisdictions similar to Maryland's electricity supply market, we may have given them some credence. However, to urge us to adopt a method that has not been used by a company that provides SOS service not only goes against our precedent but also does not prove to provide an adequate return referenced by PUA § 7-510.
>
> In this instance, **we accept the Return Component as proposed by Staff which takes into consideration the capital BGE used in providing SOS services – CWC**. Accordingly, we modify [the PULJ's November 20 proposed order] by setting the Return Component at 0.93 mills per kWh for Residential Customers, 0.64 mills per kWh for SOS Type I Customers, and at 0.69 mills per kWh for SOS Type II Customers.

(Emphasis added; footnotes omitted.)

The Commission also ruled that the option for adding an Administrative Adjustment should be retained, but it set that amount at 0 mills/kWh until further consideration of the issue during BGE's next rate case. That decision is not at issue in this appeal.

OPC filed a request for rehearing, and Staff filed a request for clarification. Both asserted that, although the Commission had indicated several times that it was adopting the position of Staff or OPC or both, they did not agree that the Commission's order had adopted their position. They had urged the Commission to hold that the BGE's use of

cash working capital to provide SOS could support a single return component, but not a return for a CWC component plus a return on the company's capital investment generally. In Staff's request for clarification, Staff pointed out:

> [I]n at least four places in Order 87891, the Commission indicated that it was adopting the return proposals of Staff and OPC. As noted in the Order, Staff and OPC proposed that CWC return be equal to 0.02 mills/kWh, with a Return Component of 0.93 mills per kWh, such that the total return BGE would receive would be equal to receiving its most recently authorized rate of return on CWC (0.95 mills/kWh). If this is what the Commission intended, BGE would receive its full CWC return, but only once.

In the Request for Rehearing filed by People's Counsel, OPC asserted that the rates the Commission had approved for the CWC component and the return component of the Administrative Charge would result in BGE "earning almost a double return on the CWC it provides for SOS, which is the only investment made by the utility in providing SOS. Therefore, the rates set forth in the [Order] would allow the Company to earn an unreasonably high return and would not be just and reasonable."

BGE responded to the requests for rehearing and clarification by pointing out that the Commission had expressly rejected the arguments of OPC and Staff that had urged the Commission to find that the cost of covering its cash working capital needs would be just 0.02 mills if the Company financed its need for working capital by borrowing on a short-term basis. The Commission had instead agreed with expert testimony that had expressed the view that it was more appropriate for BGE to provide its own working capital to cover that need, and the cost of doing so was 0.95 mills/kWh. *In addition to recovering that cost, BGE asserted,* it was also entitled to a return for providing SOS, and

for that component of the Administrative Charge, the Commission had chosen the exact figure recommended by Staff and OPC, 0.93 mills/kWh for residential customers. And, BGE argued, this result was consistent with the precedent established in the Delmarva/Potomac Electric cases that had found that CWC was recoverable *as a cost* component of the Administrative Charge. BGE also asserted that, when considered "as a margin on sales," a return component of 0.93 mills/kWh in the SOS Administrative Charge would "yield a return of 1.2%."

(2) Order No. 87994

On January 24, 2017, the Commission filed **Order No. 87994**, the second of the two orders addressed in this appeal, denying the requests of PSC Staff and OPC for reconsideration of Order No. 87891. The Commission provided the following ostensibly clarifying comments regarding its November 17, 2016 Order:

> In their requests for clarification and rehearing, Staff and OPC both suggest that the November 17 Order gives BGE a return of 1.88 mills/kWh on Residential SOS when in fact the Order *separately* set the Cash Working Capital ("CWC") of the SOS Administrative Charge for Residential Customers to 0.95 mills/kWh and the Return Component of the SOS Administrative Charge for residential customers to 0.93 mills/kWh. However, Staff and OPC conflate the two as a single return, when in fact they are stated separately. In doing so, OPC's filing suggests that BGE is authorized to earn a 22.19 percent return on SOS (a return well above the Company's overall authorized return).
>
> In its response, the Company states that, on a percentage basis, the return represented by 0.93 mills/kWh authorized in Order No. 87891 reflects a return of about 1.2 percent [on total sales], not the 22.19 percent yield [on capital] that OPC suggests. While OPC's and the Company's computations are not directly comparable, BGE's analysis demonstrates to the Commission's satisfaction that at this time, [ ] the Company is not over-

> earning on SOS (from any of its customer classes) based on the Administrative Charge authorized in the November 17 Order.
>
> **In adopting the 0.95 mills/kWh as the Residential CWC rate and 0.93 mills/kWh as the Residential Return rate respectively, the Commission accepted the CWC rate recommended by the [PULJ] in [the November 17 proposed order] and the Return rate recommended by OPC and Staff.** These rates, along with the rates adopted for other SOS cost components[,] produce reasonable rates, as demonstrated by the record in this case. The compliance filings submitted by BGE for both Type II and Residential SOS were approved by the Commission as consistent with the November 17 Order.

(Footnotes omitted; bold emphasis added.)

OPC filed a petition for judicial review in the Circuit Court for Baltimore City; that court affirmed the orders of the Commission. This appeal followed, as permitted by PU § 3-209.

STANDARD OF REVIEW

In *Maryland Office of People's Counsel v. Maryland Public Service Comm'n*, 461 Md. 380, 384 (2018), the Court of Appeals observed that judicial review of discretionary decisions of the Public Service Commission "is to be deferential to the Commission's expertise and findings." The Court noted that PU § 3-203 "sets forth the standard for judicial review of Commission actions." *Id*. at 391. That statute provides:

> Every final decision, order, or regulation of the Commission is prima facie correct and shall be affirmed unless clearly shown to be:
>
> (1) unconstitutional;
>
> (2) outside the statutory authority or jurisdiction of the Commission;
>
> (3) made on unlawful procedure;

> (4) arbitrary or capricious;
>
> (5) affected by other error of law; or
>
> (6) if the subject of review is an order entered in a contested proceeding after a hearing, unsupported by substantial evidence on the record considered as a whole.

After observing that this standard of review "does not depend on whether we would reach the same conclusions as the Commission, but on whether the Commission's decision or process is infected by the specified defects" listed in PU § 3-203, 461 Md. at 391-92, the Court of Appeals also pointed out that, despite its similarity to the Maryland Administrative Procedure Act, PU § 3-203 appears to require even more judicial deference to the Commission's decisions than the APA requires with respect to other administrative agencies' rulings:

> . . . PU § 3-203 also appears to be a more deferential standard in some respects compared to the standard of review under the APA. In particular, **with respect to decisions of the Commission, the General Assembly has directed that the Commission's decision is "*prima facie* correct" and is to be affirmed unless the listed defects are "clearly shown."** That language is absent from the APA's provision concerning judicial review. The distinction does not appear to be unintended. The statute establishing the Commission preceded the APA and the APA provision concerning judicial review was enacted just two years after enactment of the current version of the judicial review provision in the Commission's statute. *See Mid-Atlantic Power Supply Ass'n v. Public Service Commission*, 361 Md. 196, 214, 760 A.2d 1087 (2000). ("Had the Legislature intended that the standard for judicial review of . . . Commission proceedings be the same as . . . under the APA, it is inconceivable that it would have excluded the . . . Commission from the APA").
>
> **In giving meaning to this language in PU § 3-203 without rendering it surplusage, we believe that <u>it calls for a court to be particularly mindful of the deference owed to the Commission on those</u>**

> **issues on which courts typically accord some degree of deference to administrative agencies – *i.e.* findings of fact, mixed questions of law and fact, and the construction of particular statutes administered, and regulations adopted, by the agency. On** those questions on which a court does not typically defer to an agency – **general questions of law, jurisdiction and constitutionality – PU § 3-203 requires no greater deference to the Commission than any other agency.** Such legal questions "are completely subject to review by courts." In sum, with respect to the Commission, "this Court has tended to accord particular deference (though not total deference) to PSC decisions." *Accokeek, Mattawoman, Piscataway Creeks Community Council, Inc.*, 451 Md. at 12, 150 A.3d 856; *see also Baltimore Gas & Elec. Co.*, 305 Md. at 170, 501 A.2d 1307 (recognizing that this Court has "consistently held that Commission orders enjoy a high degree of judicial deference on review") (citations omitted).

Id. at 392-94 (emphasis added; footnotes omitted).

DISCUSSION

I. Contentions of the parties

OPC asserts that the Commission's Orders No. 87891 and No. 87994 "do not present a reasoned basis for the rates adopted." Furthermore, OPC contends, "the rates are arbitrary and capricious, and not supported by substantial evidence in the record." OPC recognizes that the Administrative Charge the Commission authorized for BGE's Standard Offer Service (SOS) includes, as two of its five components, a Cash Working Capital Component (generally referred to as the CWC Component), and a Return Component, but OPC contends that the two separate charges authorized by the Commission in this instance are unreasonable and violate the Public Utilities Article "because they both provide a return on the same asset."

BGE responds that OPC's argument errs in conflating BGE's recovery of its carrying *cost* to provide CWC with the reasonable return to which BGE is separately entitled under PU § 7-510(c)(3)(ii)(2) for providing Standard Offer Service. None of the parties disputed that, when PJM changed its billing cycle to require BGE to pay weekly for electricity, that created the need to provide (in round numbers) an extra $74 million of working capital to cover cash flow needs. BGE described CWC as representing "the annual average, or permanent level of capital the Company needs to finance these SOS-related services." BGE argues that the Commission correctly found that, under PU § 7-510(c)(3)(ii)(2), BGE is entitled to "recover its SOS costs, *plus* a reasonable return." Here, BGE asserts, the Commission's findings regarding the amount needed to cover BGE's "financing costs and what to grant for BGE's return" resolve a factual dispute that was within the Commission's "rate-making expertise" to decide. And, BGE pointed out in its brief: "[A]s further noted by the Commission, because BGE is required to file a study of its costs associated with providing SOS as part of its next base rate case filing, OPC (as well as any other party who intervenes in those proceedings) will be 'free at any time in the future to address any alleged or potential over-earning.'" (Quoting Order No. 87994, page 3.)[11]

The Commission also filed a brief as appellee, asserting: "The Circuit Court properly affirmed the Commission's decision to set the residential CWC Component of

[11] At oral argument in this Court, BGE's counsel reiterated the assertion: "If OPC or others disagree with [the Commission's determination], they can always raise that issue in a subsequent rate case."

BGE's Administrative Charge at 0.95 mills/kWh as well as the Return Component at 0.93 mills/kWh. The Commission had authority to do so under PUA §§ 7-509 and 7-510. Substantial evidence of record supports the Commission's decisions."

II. Analysis

Our deferential review of the record persuades us that the Commission's decision setting the amounts that BGE could include in the Administrative Charge for its SOS was within the discretion of the Commission, was supported by substantial evidence, and although debatable, was not an arbitrary or capricious determination.

OPC's argument focuses upon an apparent doubling up on the rate of return allowed on BGE's capital investment. That concern is attributable, at least in part, to the manner in which the Commission explained its two decisions regarding the amount it would allow for the CWC component and the amount it authorized BGE to recover as a "reasonable return" for providing Standard Offer Service. In Order No. 87891, the Commission first decided that it would set the amount of the recoverable cost of BGE's cash working capital by adopting the PULJ's recommendation that the appropriate manner of valuing that cost would be to apply "BGE's most recently authorized rate of return (grossed up for taxes)." Then, the Commission said it would set the amount authorized for the return component by adopting the recommendation of Staff and OPC, which the Commission summarized as follows: "We are convinced that 'reasonable return' in PUA § 7-510 means a return on capital investment. . . . In order for there to be a return there must be a tangible investment as the basis for the return, which in this case

is CWC." The Commission concluded its discussion of the return component in Order 87891 by stating:

> In this instance, we accept the Return Component as proposed by Staff which takes into consideration the capital BGE used in providing SOS services – CWC. Accordingly, we modify [the PULJ's November 20 proposed order] by setting the Return Component at 0.93 mills per kWh for Residential Customers, 0.64 mills per kWh for SOS Type I Customers, and at 0.69 mills per kWh for SOS Type II Customers.

These two passages in Order No. 87891 lend support to OPC's argument that the Commission authorized a duplicate charge for the CWC component. But, after both OPC and PSC Staff objected that they had not proposed permitting duplicate returns on CWC, the Commission explained, in essence, that it had intentionally adopted two different recommendations for the two different components, stating in Order No. 87994:

> In adopting the 0.95 mills/kWh as the Residential CWC rate and 0.93 mills/kWh as the Residential Return rate respectively, the Commission accepted the CWC rate recommended by the [PULJ] in [the November 17 proposed order] and the Return rate recommended by OPC and Staff. **These rates, along with the rates adopted for other SOS cost components[,] produce reasonable rates, as demonstrated by the record in this case.**

(Emphasis added.)

In reviewing the Commission's orders in this case, we are mindful of the cautionary language offered by the Court of Appeals in *Maryland Office of People's Counsel*, 461 Md. at 391-92, where Judge Robert McDonald wrote for the Court and said that the standard of review is *not* "whether we would reach the same conclusions as the Commission." Under PU § 3-203, "the Commission's decision is '*prima facie* correct'

and is to be affirmed unless [any of the defects listed in § 3-203] are 'clearly shown.'" 461 Md. at 392.

Of the defects listed in PU § 3-203, OPC focuses two, contending that the decision was arbitrary or capricious, and unsupported by substantial evidence on the record considered as a whole. Although we find the Commission's explanation of its rationale troubling, we conclude that OPC has not "clearly shown" that the decision was arbitrary, capricious, or unsupported by substantial evidence.

We note that the Commission had previously (and recently) considered the proposals of two other electric utility companies for recovering the costs of their cash working capital needed to provide Standard Offer Service. In Order No. 86881, the Commission concluded that CWC is a "cost" that could be separately recovered as part of the administrative charge, in addition to a reasonable return component. Order No. 86881 was entered in cases brought by Delmarva Power (Case No. 9226) and Potomac Electric (Case No. 9232), seeking, as BGE did in the instant case, "increases in their Administrative Charges due to purported increases in cash working capital costs." *See Re the Review of Delmarva Power and Light Company Standard Offer Service Administrative Charge and Re the Review of Potomac Electric Power Company Standard Offer Service Administrative Charge, Case Nos. 9226 and 9232,* 2015 W.L. 995098 (Md. P.S.C.) (March 3, 2015). ("Delmarva/Potomac Electric case"). In those consolidated cases, the Commission was asked to approve a proposed settlement agreement resolving the rates that SOS customers could be charged to recover the costs of the companies'

CWC requirements. According to Order 86881, OPC argued in that case: "Because CWC is the only type of investment utilities make in providing SOS, . . . the CWC return satisfies the reasonable return requirement [of § 7-510(c)(3)(ii)(2)]. Consequently, no other return is justified." The companies disagreed, pointing out "that the 'language is clear' in § 7-510(c)(3)(ii)(2) that they are permitted SOS cost recovery *plus a reasonable return*." Further, the companies pointed out that § 7-510(c)(3)(ii)(2) "'provides that the Companies are permitted to earn a return on the provision of SOS, with no mention of any 'investment' by the Companies to provide SOS.'" Order No. 86881 further stated:

> OPC asserts that the Companies are not entitled to a return for providing SOS separate and apart from their CWC revenue requirement. Additionally, OPC argues that the CWC revenue requirement should be calculated based upon the short-term debt rate. The Settling Parties [Delmarva and Potomac Electric] disagree.
>
> PUA Section 7-510(c)(3)(ii)(2) states:
>
> > On and after July 1, 2003, an electric company continues to have the obligation to provide standard offer service to residential and small commercial customers at a market price that permits recovery of the verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return.
>
> Based upon this section, we find that it is clear that utilities are allowed a "reasonable return" in addition to the recovery of SOS "costs". Further, we agree with the Settling Parties that CWC represents a cost that is to be recovered for the lag in customer receipts for providing SOS. If a "return" is not included in the CWC revenue requirement then it must be included elsewhere. We conclude that stating a CWC <u>cost</u> requirement and a utility return (profit) separately is beneficial because it promotes transparency. Consequently, we approve the inclusion of a return component in the Administrative Charge along with a separately stated CWC <u>cost</u> requirement for SOS to be recovered outside of the Administrative Charge.

Delmarva/Potomac Electric case at 19-20. (Emphasis in original.) But the Commission rejected the agreed amounts proposed for the CWC component and the return component in the Delmarva/Potomac Electric case, and remanded that case to the PULJ for further proceedings.

In the instant case, as in the Delmarva/Potomac Electric case, OPC's own witness recommended adopting BGE's "proposal to implement a separate component of the Administrative Charge to recover SOS-related cash working capital revenue requirements." The same witness made recommendations as to how much each component of the Administrative Charge should be, and separately stated a recommendation for CWC (0.02 mills/kWh) and the return (0.93 mills/kWh). The Commission adopted OPC's own figure of 0.93 mills/kWh *for the return*.

We find no reversible error in the Commission's decision to allow 0.93 mills/kWh for the return component, even though OPC's proposal was premised upon allowing a lesser amount for the CWC component. As noted above, the applicable standard of review requires a court to affirm the Commission's decision unless the court detects one of the defects listed in PU § 3-203. It was well within the Commission's discretion to decide that that amount would provide BGE a reasonable return for providing Standard Offer Service.

With respect to the CWC component, OPC had urged the Commission to find that the PULJ had erred in finding that the cost recoverable for that component should be

based upon BGE's most recently authorized rate of return, which was 11.35%.[12] OPC argued that, instead of using its own capital to meet its cash flow needs, BGE should have financed its cash working capital requirements using short-term debt. OPC asserted that the PULJ should have required BGE to demonstrate that financing CWC with short-term debt was inconsistent with sound utility-management practices, "rather than finding that it was within sound utility management for [BGE] to finance CWC Revenue Requirement with [BGE's] authorized rate of return." (Footnote omitted.)

But the Commission expressly disagreed with this portion of OPC's argument, and cited expert testimony in the record for doing so:

> During the proceeding, BGE provided testimony from Company Witness Kurt G. Strunk asserting that although short-term debt could be the lowest cost to finance CWC, it would not be sound utility management to do so. Mr. Strunk further stated that in the current market it was possible for BGE to finance CWC Revenue Requirement with short-term debt, but it was not advisable to do so. Mr. Strunk insist [sic] that his opinion is based on relevant financial textbooks and the known fact that rating agencies would consider on-going financing of cash needs with just short-term debt would give the impression that the Company was involved in a risky, aggressive activity. He also opined that short-term debt could in the future become impossible to obtain, which he asserts could force BGE to refinance CWC Revenue Requirement with more expensive long-term debt that would have higher than normal rates. Overall Mr. Strunk testified that it was against "best" corporate practices to finance BGE's SOS operations with short-term debt, even if it the corporation presently receives lower financing costs for using short-term debt.
>
> We find that the testimony and arguments presented by BGE on this issue is persuasive. From a logistical point of view, to require BGE to

[12] OPC notes: "The authorized return used in the instant proceeding was established in *Re Baltimore Gas and Electric Company*, 105 Md. P.S.C. 596, 602, Case No. 9355, Order No. 86757 (2014)."

> finance CWC Revenue Requirement on a monthly basis by issuing commercial paper, short-term debt financing, or construct a hypothetical capital structure to calculate the SOS CWC Revenue Requirement would not be based on sound utility judgment and could actually cost BGE and its customers more money due to secondary effects. CWC is an on-going permanent expense which the Company does not typically finance with short-term debt. BGE establishes a "permanent" CWC Revenue Requirement based on the average of 12 months of CWC. According to the Company's testimony, BGE does not have separate accounts to segregate monies that flow into its operations. We find that BGE has presented credible evidence to demonstrate that it has utilized practices that minimize SOS costs in a responsible manner and find that BGE's calculation of the CWC Revenue Requirement for SOS using its most recently authorized rate of return (grossed up for taxes) is the least cost possible consistent with sound utility management practices.

It was within the Commission's discretion and expertise to weigh the competing testimony on this issue and decide to reject the recommendation of OPC that BGE be required to use short-term debt to meet all of its cash flow needs. Consequently, it was not error for the Commission to reject OPC's proposed figure for the CWC component and adopt the PULJ's proposed figure. As the Court of Appeals said in *Communications Workers of Am. v. Pub. Serv. Comm'n of Maryland*, 424 Md. 418, 433 (2012):

> So long as a reasoning mind could have reached the same conclusion as the agency, we will not disturb the agency's decision. *Public Serv. Comm'n v. Delmarva Power & Light Co.*, 42 Md. App. 492, 499, 400 A.2d 1147, 1151, *cert. denied*, 286 Md. 746 (1979). Because the Commission is well informed by its own expertise and specialized staff, a court reviewing a factual matter will not substitute its own judgment on review of a fairly debatable matter. *Public Serv. Comm'n v. Baltimore Gas & Elec. Co.*, 273 Md. 357, 362, 329 A.2d 691, 694 (1974).

We conclude that the Commission's decisions in this case setting the rate that can be charged for Standard Offer Service are entitled to our deference.

JUDGMENT OF THE CIRCUIT COURT FOR BALTIMORE CITY AFFIRMED. COSTS TO BE PAID BY APPELLANT.