169 FERC ¶ 61,172
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick and Bernard L. McNamee.

Potomac Electric Power Company Docket No. ER09-1159-000

ORDER DENYING FORMAL CHALLENGE

(Issued December 3, 2019)

1. On May 15, 2018, Potomac Electric Power Company (Pepco) submitted its 2018 annual informational formula rate update (Annual Update), as required by the formula rate protocols set forth in Pepco's formula filed as Attachment H-9B of the PJM Interconnection, L.L.C. (PJM) Open Access Transmission Tariff (Tariff). On January 18, 2019, Southern Maryland Electric Cooperative, Inc., (SMECO) filed a formal challenge pursuant to section 4(a) of Attachment H-9B of the PJM Tariff (Formal Challenge), challenging the balance of the Prepaid Pension Assets included in Pepco's 2018 Annual Update. As discussed below, we deny the Formal Challenge.

I. The Formula Rate and Protocols

2. Attachments H-9A and H-9B of the PJM Tariff set forth Pepco's formula rate template and protocols under which Pepco recovers its annual transmission revenue requirement (ATRR), and through which it establishes charges for transmission service for facilities it owns that are under PJM's functional control.

3. Pepco's protocols detail how its formula rate is to be updated annually and how it can be challenged. Section 2 of the formula rate protocols requires Pepco to update its transmission rates annually by May 15 (Annual Update), post the Annual Update on the PJM website, cause notice of such posting to be provided to PJM's membership, and file the Annual Update with the Commission as an informational filing (Publication Date). Section 3 of the protocols states that any interested party shall have up to 150 days after the Publication Date to review the calculations (Review Period) and to notify Pepco in writing of any specific challenges, including challenges related to accounting changes, to the application of the formula rate (Preliminary Challenge). Section 3 of the protocols also provides interested parties with up to 120 days after the Annual Update is published to serve reasonable information requests on Pepco. Section 3 further explains that Pepco shall work toward resolution with the interested party that submitted a Preliminary Challenge. Section 4 of the protocols states that if Pepco and any interested parties have not resolved any preliminary challenge to the Annual Update within 60 days after the Review Period, an interested party shall have an additional 30 days to make a formal

challenge with the Commission. Section 4 of the protocols requires that any response by Pepco to a formal challenge must be submitted to the Commission within 30 days of the filing of the formal challenge.

4. Preliminary and formal challenges are limited to six issues as listed in section 3(d) of Pepco's formula rate protocols: (1) whether Pepco has properly calculated the Annual Update under review; (2) whether the costs included in the Annual Update are properly recordable and recorded, and otherwise consistent with Pepco's accounting policies, practices and procedures consistent with the FERC Uniform System of Accounts; (3) whether Pepco's actual costs and expenditures were reasonable and prudent (including whether such costs were incurred according to cost control methodologies); (4) whether the input data used in the Annual Update are accurate and correctly used in the formula rate; (5) whether the formula rate has been applied according to its terms, including the procedures in Pepco's protocols; and (6) whether Pepco's accounting changes are reasonable and consistent with the Uniform System of Accounts.

II. Background

5. SMECO is a cooperative, nonprofit membership corporation, incorporated under the Electric Cooperative Act of Maryland that serves more than 160,000 consumers in the Maryland counties of Calvert, Charles, St. Mary's, and Prince George's. SMECO is a load-serving entity within PJM and a network transmission customer taking service under the PJM Tariff in the Pepco zone. After turning over its 230 kV transmission facilities to the operational control of PJM, it became a PJM Transmission Owner on January 1, 2017.

6. SMECO states that on January 31, 2005,[1] Pepco, Delmarva Power & Light Company (Delmarva) and Atlantic City Electric Company (Atlantic City), which were all public utility operating affiliates of Pepco Holdings, Inc. (PHI) (collectively, PHI Companies), as well as Baltimore Gas and Electric Company (BGE), filed their formula rates and accompanying protocols in Docket No. ER05-515-000. SMECO states that, on April 19, 2006, the Commission accepted a settlement agreement, including formula rates and formula rate implementation protocols for each of the PHI Companies and BGE.[2] SMECO states that the formula rates of each of the PHI Companies are used to calculate their individual ATRR.

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[1] SMECO's Formal Challenge contains an inadvertent error, stating that the companies filed their respective formula rates on January 31, 2015.

[2] Formal Challenge at 3 (citing *Baltimore Gas and Elec. Co.*, 115 FERC ¶ 61,066 (2006)).

7. Pursuant to section 3 of the protocols, SMECO submitted one set of data requests to Pepco regarding its 2018 Annual Update. These data requests did not concern Pepco's Prepaid Pension Assets.[3] On October 12, 2018, pursuant to section 3(a) of the protocols, SMECO submitted a timely Preliminary Challenge on several issues, and on November 9, 2018, Pepco submitted its response. On December 19, 2018, SMECO and Pepco discussed the Preliminary Challenge during a conference call. On December 20, 2018, pursuant to the parties' agreement, SMECO sent written questions to Pepco about the Prepaid Pension Assets. On January 9 and January 16, 2019, Pepco provided SMECO its responses and information relating to the Prepaid Pension Assets.[4] Pepco also agreed to extend the Formal Challenge deadline from January 10, 2019 to January 17, 2019.[5]

III. Formal Challenge

8. On January 18, 2019, SMECO submitted a Formal Challenge to Pepco's 2018 Annual Update.[6] SMECO contends that Pepco's Prepaid Pension Assets are neither a reasonable, nor prudent expenditure. SMECO also asserts that Pepco's pension funding methodology and strategy are not transparent. SMECO requests that the Commission disallow the Prepaid Pension Assets in Pepco's 2018 Annual Update and require refunds. Alternatively, SMECO requests that the Commission establish hearing and settlement judge procedures and direct Pepco to provide the required information.

IV. Filings and Responsive Pleadings

9. On February 19, 2019, Pepco filed an answer to SMECO's Formal Challenge. On March 6, 2019, SMECO filed a motion for leave to answer and an answer to Pepco's answer. On March 21, 2019, Pepco filed a motion for leave to answer and an answer to SMECO's answer.

V. Discussion

A. Procedural Matters

10. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2019), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We accept the answers filed by SMECO on March 6,

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[3] Pepco Answer, Attachment E (SMECO July 10, 2018 Data Requests).

[4] *See* Formal Challenge, Exs. TMM-2, TMM-3, TMM-5.

[5] Pepco Answer at 9.

[6] SMECO submitted an unopposed motion to accept the Formal Challenge out-of-time due to technical difficulties outside the control of SMECO.

2019, and Pepco on March 21, 2019, as they have provided information that assisted us in our decision-making process.

B. Substantive Matters

1. Prepaid Pension Assets

a. Pepco's Treatment

11. In its 2018 Annual Update, Pepco records Prepaid Pension Assets in Account No. 186 (Miscellaneous Deferred Debits) and includes that amount in rate base. Specifically, Attachment 5, line 45 of the Formula Rate includes in rate base Account 165, Prepayments, plus "Prepaid Pensions if not included in Prepayments," which are to be "recorded in FERC account 186."[7]

12. In the 2018 Annual Update, Pepco included Prepaid Pension Assets of approximately $325.6 million, which increased its transmission rate base by approximately $34.5 million.[8] Pepco's Prepaid Pension Assets represent the amount of money (Cash Contributions) Pepco has deposited into the pension trust fund for its employees, and which exceeds Pepco's Accounting Cost[9] for pensions.[10] Pepco's affiant Allen explains that "[o]ver the long run, the cumulative employer Cash Contributions made to a plan and the cumulative Accounting Cost amounts should be equal. However, in the short and intermediate run, there can be significant differences" due to factors such as liability measurements and the period accounting for experience losses.[11] Furthermore, "[t]he Financial Accounting Standards Board (FASB) governs pension

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[7] *See* Pepco May 15, 2018 Informational Filing of 2018 Formula Rate Annual Update, Attachment 5 – Cost Support (2018 Annual Update).

[8] Pepco applies a wages and salary allocator to the Prepaid Pension Assets and includes a portion in rate base. *Compare id.* at Line 45, *with id.* at Attachment 5.

[9] "Under [Statement of Financial Accounting Standard] FAS 87, the annual 'Accounting Cost' for Pepco's pension can generally be thought of as the expected change in the pension benefit obligation ('PBO') funded status (*i.e.*, the difference between pension plan assets and the PBO) over the next year. The Accounting Cost is the amount included for pensions in Account 926. Accounting Cost includes the year's expected increase in liability due to active benefit accruals, but also includes certain interest, return and amortization costs." Pepco Answer at 20 (citing Allen Aff. ¶¶ 5-8).

[10] *Id.* at 18.

[11] *Id.*, Allen Aff. ¶¶ 19-24.

accounting" and federal tax and labor laws govern pension funding.[12] As Pepco's affiant Allen explains, "[t]he Employee Retirement Income Security Act of 1974 [ERISA] and the Internal Revenue Code ([IRC] – sections 430 and 436, enacted as part of the Pension Protection Act of 2006 [Pension Act]) mandate that pension plan contributions satisfy the fiduciaries' responsibility to prudently protect the interests of the plan participants and beneficiaries."[13]

13. Pepco and affiliates Atlantic City and Delmarva participate together in a consolidated pension plan (PHI Retirement Plan).[14] Exelon Corporation (Exelon), Pepco's parent company,[15] administers the PHI Retirement Plan as well as the pension plans of other affiliates.[16] Exelon has a pension funding policy that Exelon uses to determine the annual contributions to all of its pension funds.[17] As discussed in this policy, Exelon conducts an annual pension contribution study for all of its qualified pension plans, including the PHI Retirement Plan, and takes into account an analysis from a third-party actuary.[18] As of 2018, Exelon's current funding strategy "is to contribute the greater of (1) $300 million until all the qualified plans are fully funded on an [Accumulated Benefit Obligation (ABO)] basis, and (2) the minimum amounts under ERISA to meet minimum contribution requirements and/or to avoid benefit restrictions and at-risk status."[19] Once Exelon management determines the annual contributions for its qualified pension plans, it uses "specific legacy company allocation methodologies" to allocate contributions to the operating companies.[20] Pepco's affiant Allen explains that "PHI has generally targeted at least 90 [percent] utility funding levels for all years and

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[12] *Id.*, Allen Aff. ¶ 9; *id.*, Ex. JWA-4 at 2.

[13] *Id.*, Allen Aff. ¶ 9.

[14] *Id.* at 21; *id.*, Allen Aff. ¶¶ 16, 30.

[15] Pursuant to a March 2016 merger, PHI Companies Pepco, Delmarva, and Atlantic City are now Exelon subsidiaries. *See* Formal Challenge, Myers Aff. ¶ 4 n.1.

[16] Pepco Answer at 22.

[17] *Id.*; *see* Formal Challenge, Ex. TMM-5.

[18] *Id.*, Allen Aff. ¶ 13.

[19] *Id.*, Allen Aff. ¶ 15.

[20] *Id.*, Allen Aff. ¶ 16 & n.3.

the contribution allocation to each PHI utility . . . is determined by each utility's funding status."[21]

b. Delmarva 2017 Order

14. In *Delmarva Power & Light Company*, the Commission rejected, in pertinent part, a formal challenge submitted by Delaware Municipal Electric Corporation, Inc. (DEMEC) as to the Prepaid Pension Assets in Delmarva's annual update in 2016.[22] First, the Commission explained that DEMEC impermissibly attacked the formula rate by arguing that Prepaid Pension Assets should not be included in rate base.[23] The Commission stated that "the formula rate has always contained a provision that explicitly allows these Prepaid Pension Assets as an adjustment to rate base."[24] Second, the Commission rejected DEMEC's argument that the prepaid pension amounts should be excluded from rate base because they "are 'voluntary' and therefore should be treated as imprudent expenditures."[25] The Commission found that Delmarva justified the Prepaid Pension Assets as prudent, agreeing with Delmarva that "ERISA and the Pension [] Act [] impose higher funding obligations than Delmarva's [Generally Accepted Accounting Principles (GAAP)]-based pension costs," and that "pre-paying pension costs to ensure the security of employees' pensions is a reasonable and prudent business decision."[26]

c. SMECO's Formal Challenge

15. SMECO challenges the reasonableness and prudence of Pepco's inclusion of $325,586,334 as the Prepaid Pension Assets balance in the 2018 Annual Update, which increased Pepco's transmission rate base by $34,563,961.[27]

16. SMECO first states that in the Delmarva 2017 Order the Commission found that prudence is demonstrated where the Prepaid Pension Assets are required by law or

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[21] *Id.*, Allen Aff. ¶ 16.

[22] 160 FERC ¶ 61,102, at P 19 (2017) (Delmarva 2017 Order).

[23] *Id.* P 20.

[24] *Id.*

[25] *Id.* PP 21-22.

[26] *Id.* P 22.

[27] Formal Challenge at 5.

needed to ensure the security of the pensions.[28] SMECO contends that Pepco has failed to make such a showing because it provided little to no supporting documentation for the Prepaid Pension Assets, its internal policies and funding strategy. SMECO contends that it is also difficult to determine whether the Prepaid Pension Assets are prudent and if Pepco's transmission customers are subsidizing other affiliates because of the nature of the pension plans at issue. SMECO states that the pension plans are consolidated plans, and their associated funding obligations are determined at the plan level, not by operating company. Therefore, SMECO alleges, Pepco's Prepaid Pension Assets are not based on Pepco's own qualified pension plan (i.e., the company's specific employee attributes), but are based on Exelon's allocation of each year's consolidated plan levels in which Pepco's employees participate. SMECO also argues that testimony filed in Docket No. ER17-1519 supports a finding of imprudence in this case.[29]

17. Second, SMECO argues that Pepco has not provided supporting documentation to demonstrate the transparency and prudence of the Exelon pension plan funding strategy, and therefore fails to comply with Commission precedent.[30] SMECO states that it is not relevant that contributions to PHI's qualified pension plans are made to achieve similar status at each operating company. SMECO maintains that Pepco's Cash Contributions should be reviewed for prudence on a standalone basis, not in comparison to PHI's two other operating companies, which would have other employee statistics and characteristics.[31] SMECO adds that Pepco only provided a high-level description of the factors Exelon considers for its funding strategy, but not the details. SMECO states that Pepco failed to provide a rationale for Exelon's funding strategy to contribute the greater of: (1) $300 million (including PHI), and (2) the minimum amounts under ERISA to avoid benefit restrictions and at-risk status.[32]

18. Third, SMECO alleges that there is no transparency into how the annual Cash Contributions are allocated to each of Exelon's operating companies. SMECO argues that Exelon can allocate as much or as little as it wishes to each operating company, so long as each pension plan is "properly" funded. SMECO maintains that the proper

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[28] *Id.* (citing Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22).

[29] In Docket No. ER17-1519-000, PECO Energy Co. proposed tariff revisions to replace its stated rate with a forward-looking formula rate, including Prepaid Pension Assets.

[30] Formal Challenge at 10 (citing *PPL Elec. Utils. Corp.*, 140 FERC ¶ 61,231, at P 69 (2012) (*PPL*)).

[31] *Id.*

[32] *Id.* at 11.

funding level is not based on ERISA or the Pension Act, but on Exelon management's judgment. SMECO states that Pepco has not explained how Exelon will exercise its discretion in allocating these annual Cash Contributions to each operating company, and thus fails to meet the Commission's transparency requirements.[33] SMECO also points to a recent decision from a FERC Administrative Law Judge (ALJ) as demonstrating a similar problem of a company's lack of discretion in funding prepaid pensions.[34]

19. Fourth, SMECO argues that Pepco violated Commission precedent by failing to demonstrate a quantifiable reduction in transmission rates due to its Prepaid Pension Assets.[35] SMECO states that its expert witness calculated the impacts to the revenue requirement based on four different assumptions regarding the prudency of the Prepaid Pension Assets.[36]

20. SMECO maintains that the Commission should disallow the entire Prepaid Pension Assets balance and require refunds. Alternatively, SMECO argues, the Commission should direct Pepco to provide the requisite information and establish hearing and settlement procedures to determine what amount of Prepaid Pension Assets should be disallowed.[37]

d. Pepco's Answer

21. Pepco argues that SMECO failed to submit any questions about the Prepaid Pension Assets during the time the protocols provide for serving information requests. Pepco also maintains that SMECO ignored the requirement in the protocols to refer an unresolved issue to the interested party's senior representative for resolution.[38] Pepco asserts that SMECO used the time allotments in the protocols not to resolve the

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[33] *Id.* at 12 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149, at P 18 (2013)).

[34] *Id.* (citing *Entergy Gulf States Louisiana, L.L.C.*, 165 FERC ¶ 63,010, at P 108 (2018) (*Entergy*)).

[35] *Id.* at 13 (citing *Southern Co. Servs., Inc.*, 122 FERC ¶ 61,218, at PP 21-22 (2008), *order on clarification and compliance filing*, 128 FERC ¶ 61,276 (2009), *order on compliance filing and request for reh'g*, 131 FERC ¶ 61,120 (2010) (*Southern*)).

[36] *Id.* at 14 (citing Ex. TMM-4).

[37] *Id.*

[38] *Id.* at 6-10 (citing PJM, Intra-PJM Tariffs, OATT ATT H-9B, OATT Attachment H-9B, Pepco (4.0.0), § 3(b), (e)).

Preliminary Challenge but instead to gather information to use in its Formal Challenge.[39] Pepco also argues that SMECO disingenuously and inaccurately accuses Pepco of failing to provide certain documents.[40]

22. Pepco maintains that the only issue in this case is whether Pepco's Prepaid Pension Assets amount is prudent.[41] Pepco argues that SMECO has ignored the information and explanations Pepco provided and that SMECO bases its challenge on its aim to exclude the Prepaid Pension Assets from rate base.[42]

23. Pepco argues that SMECO fails to meet its burden of raising a "serious doubt" about the prudence of the Prepaid Pension Assets amount.[43] Pepco maintains that, under Commission precedent, a utility enjoys a presumption that its expenditures are prudent. Pepco then argues that SMECO stands this Commission precedent on its head by asserting that this presumption does not apply in this case because Pepco failed to show the Prepaid Pension Assets amount was prudent.[44] Although Pepco maintains that the Commission need not decide the prudence issue in this case because SMECO failed to create a serious doubt, Pepco asserts that this amount is prudent.[45]

24. Pepco explains that PHI has reduced administrative costs by having Pepco and its affiliates participate together in the PHI Retirement Plan. Pepco clarifies that each affiliate's share of the pension fund is a separately tracked amount within the fund. Pepco also explains that Exelon administers PHI's and its affiliates' pension plans to achieve management efficiencies.[46]

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[39] *Id.* at 7-10 (citing PJM, Intra-PJM Tariffs, OATT ATT H-9B, OATT Attachment H-9B, Pepco (4.0.0), § 3(e)).

[40] *Id.* at 11-12.

[41] *Id.* at 14-15.

[42] *Id.* at 12-13.

[43] *Id.* at 15 (quoting Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22 n.34); *id.* at 17.

[44] *Id.* at 16.

[45] *Id.* at 18-19.

[46] *Id.* at 21-22 (citing Allen Aff. ¶ 30).

25. Pepco explains that, in determining how much money to contribute to the pension fund, Exelon and Pepco management follow a documented protocol, consult with nationally recognized experts in the actuarial field, take into account and balance relevant factors and information, examine alternative funding levels to develop the optimum funding strategy, and reach a reasoned and informed judgment that protects employee pensions and complies with federal law.[47]

26. Pepco explains that Exelon uses a formal policy to determine the annual contributions to all of Exelon's pension funds. Pepco explains that Exelon and its expert consultant, Willis Towers Watson, develop a funding strategy by engaging in detailed analyses, including considering potential alternatives. Pepco states that Exelon management ultimately decides the contributions to, and allocations among, the pension plans.[48] Pepco explains that its current funding strategy is to contribute the higher of (a) $300 million until all funds are fully funded on an Accumulated Benefit Obligation basis and (b) the minimum amounts under ERISA to meet contribution requirements and avoid benefit restrictions and at-risk status. Pepco argues that it has shown that its funding strategy is prudent. Pepco also maintains that Exelon determined that funding would be inadequate if Exelon only took into account ERISA and the Pension Act. Pepco further notes that, despite the contributions made to date, all of Exelon's qualified pension plans are less than 100 percent funded.[49]

27. Pepco states that, after the annual contributions to the plans are determined, the contributions are allocated to individual affiliates. Pepco explains that contributions to PHI's qualified pension plans are made to achieve similar funding status at the three utilities. Furthermore, Pepco states, PHI has generally targeted at least 90 percent utility funding levels for all years on a Pension Benefit Obligation basis and determines the contribution allocation to each PHI utility based on each utility's funding status.[50] Pepco alleges that its own allocation reflects reasonable utility management.[51]

28. Pepco emphasizes that 100 percent of its Cash Contributions are necessary, and that it is asking customers to reimburse Pepco for the time value of money that Pepco

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[47] *Id.* at 25-26 (citing Allen Aff. ¶¶ 13-17; Formal Challenge, Ex. TMM-5).

[48] *Id.* at 22-25, 36.

[49] *Id.* at 35-37.

[50] *Id.* at 25 (citing Allen Aff. ¶ 16).

[51] *Id.* at 37.

incurs making these contributions.[52] Pepco maintains that it has shown that its Prepaid Pension Assets represent the judgment of reasonable utility management.[53]

29. Pepco rejects SMECO's assertion that Pepco must show that customers benefit from its Prepaid Pension Assets through corresponding, quantifiable rate reductions. Nevertheless, Pepco maintains, customers benefit from its maintenance of the Prepaid Pension Assets. Pepco alleges that, although the Prepaid Pension Assets increase Pepco's revenue requirement, several related factors create a rate decrease that more than offsets the increase in costs to customers.[54]

30. Pepco next rejects SMECO's argument that Pepco may be subsidizing its affiliates' pension plans. Pepco explains that its Cash Contributions to its pension fund are separately tracked and credited to Pepco. Pepco further explains that Pepco's Cash Contributions take into account Pepco's funding levels even though the Exelon companies' total contributions are viewed holistically to achieve the most efficient funding level for the whole corporation.[55]

31. Finally, Pepco argues that SMECO inappropriately relies upon Commission precedent, and testimony from Docket No. ER17-1519.[56]

e. <u>SMECO's Answer</u>

32. SMECO argues that Pepco's assertions regarding the procedural appropriateness of its Formal Challenge have no merit. SMECO avers that its Formal Challenge fully complied with Pepco's protocols and legal precedent.[57] SMECO asserts that section 4(e) of the protocols demonstrates that SMECO can submit a Preliminary or Formal Challenge without having made data requests on an issue.[58]

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[52] *Id.* at 28.

[53] *Id.* at 33.

[54] *Id.* at 28-29 (citing Spanos Aff. ¶ 7).

[55] *Id.* at 33-34.

[56] *Id.* at 34-35, 38-40.

[57] SMECO Answer at 8.

[58] *Id.* at 4; *see id.* at 5 (citing *Am. Elec. Power Serv. Corp.*, 124 FERC ¶ 61,306, at P 36 (2008); *Midwest Indep. Transmission Sys. Operator, Inc.*, 139 FERC ¶ 61,127, at P 15 (2012) (*MISO*)).

33. SMECO asserts that Pepco has sole discretion under its protocols to extend the Formal Challenge deadline but declined to extend this deadline to have further discussions with SMECO's senior representatives.[59]

34. SMECO disputes Pepco's allegation that SMECO made a false claim about documents provided in this proceeding. SMECO further counters that based on the guidance of the Delmarva 2017 Order, the information that SMECO sought was clear.[60]

35. Next, SMECO asserts that it has sufficiently cast serious doubt on the prudence of the Prepaid Pension Assets that are included in Pepco's 2018 Annual Update.[61] SMECO maintains that it demonstrated that the limited information provided by Pepco does not directly tie the Prepaid Pension Assets amount to Pepco's ERISA and Pension Act obligations, to the security of Pepco's employees' pensions, and to benefits to ratepayers.[62]

36. SMECO further maintains that it challenged not only the prudence but also the reasonableness of Pepco's Prepaid Pension Assets.[63] SMECO also argues that Commission precedent clearly requires consideration of the amounts of discretionary contributions and benefits to customers of the associated Prepaid Pension Assets amount included in rate base.[64]

37. SMECO defends its reliance on testimony filed in Docket No. ER17-1519, and on *Entergy*, and asserts that the legal and accounting principles apply to its Formal Challenge. SMECO also argues that, despite Pepco's claims about the Delmarva 2017 Order, Pepco has not satisfied either of the two tests described in that case.[65]

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[59] *Id.* at 6.

[60] *Id.* at 8 n.32.

[61] *Id.* at 8.

[62] *Id.* at 7, 9.

[63] *Id.* at 8 (citing Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22; *MISO*, 139 FERC ¶ 61,127 at P 9).

[64] *Id.* at 10 (citing *Southern*, 122 FERC ¶ 61,218 at PP 21, 23).

[65] *Id.* at 11.

38. Additionally, SMECO states that Pepco fails to explain how the amount allocated to Pepco is calculated.[66] SMECO further criticizes Pepco for failing to provide the funding levels for Pepco and more details about Exelon's determination of the annual Cash Contributions.[67]

39. Finally, SMECO argues that Pepco's answer contains information which was not provided during the Preliminary Challenge process and which contains unrealistic calculations purporting to show rate reductions.[68]

f. Pepco's Second Answer

40. Pepco replies that it did not claim that SMECO's challenge was procedurally invalid, or that SMECO's failure to serve data requests acts as a bar to bringing a formal challenge. Rather, Pepco asserts that SMECO's conduct fails to address its own disregard for its obligations in key provisions of the protocols, while at the same time forcefully alleges that Pepco failed to provide information to SMECO's detriment. Thus, Pepco states, it intended in its answer to rebut SMECO's assertions that Pepco had acted inappropriately. Pepco maintains that it went beyond the requirements of the protocols to provide information to SMECO.[69]

41. Pepco explains that it extended the deadline for submitting a formal challenge to allow for time to answer questions posed by SMECO after the December meeting and to provide helpful information aimed at resolution. Pepco maintains that it has no obligation to postpone this date indefinitely. Pepco stresses that if the protocols are ignored, Pepco will increasingly be in the position of devoting resources and extending the update process beyond the reasonable, established limits.[70]

g. Commission Determination

i. Claims

42. SMECO claims the Prepaid Pension Assets balance in the 2018 Annual Update is unreasonable and imprudent because Pepco did not provide requisite information based

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[66] *Id.* at 13.

[67] *Id.* at 14.

[68] *Id.* at 15-17.

[69] Pepco Second Answer at 3-4.

[70] *Id.* at 5-6.

on the Delmarva 2017 Order, or show quantifiable reductions in rates associated with the Prepaid Pension Assets.[71] We construe these claims as distinct. That is, SMECO raises a prudence challenge relating to alleged ERISA and Pension Act requirements, based primarily on the Delmarva 2017 Order, and a reasonableness claim about alleged customer benefits, based primarily on *Southern*. As discussed below, we reject both claims. We turn first to SMECO's prudence challenge.

ii. Prudence

43. Pepco's formula rate protocols state that "[n]othing herein is intended to alter the burdens applied by FERC with respect to prudence challenges."[72] Under the Commission's well-established prudence standard, "[t]he Commission will not disallow costs as imprudent if they are costs 'which a reasonable utility management . . . would have made, in good faith under the same circumstances, and at the relevant point in time.'"[73] "The regulated entity has the burden of proof to establish prudence."[74] However, as the Commission stated in the Delmarva 2017 Order, "in order to ensure that rate cases are manageable, the Commission presumes that all expenditures are prudent so the utility need not justify in its case-in-chief the prudence of all of its costs. Parties challenging the prudence of an expenditure have to raise 'serious doubt' as to the prudence of an expenditure."[75] The Commission has said that "[s]erious doubt must be more than a 'bare allegation of imprudence,' but this threshold may not be so demanding that it effectively reverses the statutory burden of proof."[76] Once a party raises serious doubts, "the company has 'the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.'"[77] Because we do not find that SMECO

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[71] Formal Challenge at 6-7.

[72] PJM, Intra-PJM Tariffs, OATT ATT H-9B, OATT Attachment H-9B, Pepco (4.0.0), § 4(c).

[73] *Columbia Gas Transmission, LLC*, 158 FERC ¶ 61,092, at P 8 (2017) (quoting *New England Power Co.*, 31 FERC ¶ 61,047, at 61,084 (1985)).

[74] *Potomac-Appalachian Transmission Highline, LLC*, Opinion No. 554, 158 FERC ¶ 61,050, at P 100 (2017) (*PATH*).

[75] Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22 n.34.

[76] *PATH*, 158 FERC ¶ 61,050 at P 100 (quoting *BP Pipelines (Alaska) Inc.*, Opinion No. 544, 153 FERC ¶ 61,233, at P 13 (2015)).

[77] *Id.* P 101 (quoting *Anaheim, Riverside, Banning, Colton, & Azusa, Cal. v. FERC*, 669 F.2d 799, 809 (D.C. Cir. 1981)).

has created a serious doubt about the prudence of Pepco's Prepaid Pension Assets,[78] we deny the Formal Challenge.

44. Relying upon the Delmarva 2017 Order, SMECO argues that Pepco does not directly tie the Prepaid Pension Assets to Pepco's ERISA and Pension Act obligations.[79] SMECO's argument is flawed because SMECO misreads the Delmarva 2017 Order, on which its argument stands. In that order, the Commission agreed with Delmarva that ERISA and the Pension Act impose higher funding obligations than Delmarva's pension costs under GAAP.[80] The Commission effectively rejected DEMEC's contention that Delmarva's pension expenses were voluntary.[81] However, the Commission did not say that an expenditure is imprudent if it exceeds the minimum funding requirements established by federal pension laws, or that there is a serious doubt about the prudence of an expenditure just because it is not required by federal pension laws. SMECO's argument runs contrary to the Commission's prudence standard because it suggests that Pepco was limited to a single correct act—making Cash Contributions that matched minimum funding obligations under federal law—rather than having discretion in its decision-making.[82] Thus, SMECO is misguided in attempting to raise a serious doubt about the prudence of Pepco's Prepaid Pension Assets by focusing primarily on whether Pepco has shown or documented that its contributions were required by federal pension laws.[83]

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[78] *See* SMECO Answer at 8.

[79] Formal Challenge at 6; SMECO Answer at 8-10.

[80] Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22.

[81] *See supra* Part V.B.1.b.

[82] *See Entergy Servs., Inc.*, Opinion No. 505, 130 FERC ¶ 61,023, at P 51 (2010) ("[T]he Commission has held that this prudence standard 'permits considerable latitude, in that the Commission, in reviewing a decision . . ., does not look for a single correct result or require that every possible alternative be evaluated." (quoting *Dakota Gasification Co.*, Opinion No. 410, 77 FERC ¶ 61,271, at 62,153-54 (1996))).

[83] We decline to address the testimony SMECO refers to in Docket No. ER17-1519. *See* Formal Challenge at 9-10. No final decision was issued in this proceeding, and an offer of settlement was filed on July 22, 2019. *See* PECO Energy Company, Settlement Agreement, Docket No. ER17-1519-002 (filed July 22, 2019). An ALJ certified the settlement as uncontested on September 18, 2019. *PJM Interconnection, L.L.C.*, 168 FERC ¶ 63,038 (2019).

45. In addition, SMECO's primary argument presumes that ERISA and Pension Act funding requirements apply to Pepco specifically. Importantly, Pepco and the other two PHI affiliates participate together in the PHI Retirement Plan.[84] As Pepco explains, "[m]inimum funding obligations under the ERISA and Pension [] Act requirements are determined at the plan level, not by operating company. It is not possible to calculate the minimum funding obligations by operating company with certainty without splitting up the consolidated PHI Retirement Plan."[85] Thus, the ERISA and Pension Act funding requirements apply to the consolidated PHI Retirement Plan, not to Pepco.[86] Consequently, a fundamental premise of SMECO's argument is inconsistent with the record in this proceeding.

46. SMECO's argument remains that Pepco has not provided sufficient information about the Prepaid Pension Assets or Exelon's funding strategy to demonstrate prudence. We disagree. We first acknowledge here Pepco's argument that SMECO ignores Commission precedent by stating that "Pepco has not provided requisite information or demonstration to enjoy a presumption of prudence."[87] Indeed, the party raising a prudence challenge must create a serious doubt about the prudence of an expenditure before the utility must justify it.[88] But, importantly, we also agree with SMECO that it needs to have enough information to evaluate the prudence of an expenditure in order to present more than bare allegations.[89] However, in this case we find that Pepco has provided sufficient explanation and information to show the prudence of the Prepaid

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[84] *See, e.g.*, Pepco Answer, Allen Aff. ¶ 30; *id.* Ex. JWA-2.

[85] Formal Challenge, Ex. TMM-2 at 6.

[86] *Id.*, Ex. TMM-2 at 6-7; *see* 26 U.S.C. § 430 (2018) (minimum funding standards for single-employer defined benefit pension plans under Title 26, Internal Revenue Code); 26 U.S.C. § 436 (2018) (funding-based limits on benefits and benefit accruals under single-employer plans); 29 U.S.C. § 1083 (2018) (minimum funding standards for single-employer defined benefit pension plans under Title 29, Chapter 18, Employee Retirement Income Security Program).

[87] Pepco Answer at 16 (quoting Formal Challenge at 6).

[88] Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 22 n.34; *PATH*, 158 FERC ¶ 61,050 at P 101.

[89] Formal Challenge at 10; *see PPL*, 140 FERC ¶ 61,231 at P 69 (setting for hearing and settlement judge procedures the issue of the reasonableness of costs of certain plant additions, "including the prudency of any cost overruns," after finding that there were sufficient doubts about the utility's "explanation of and/or support for" the plant additions).

Pension Assets in its 2018 Annual Update. Pepco provided a sufficient explanation of Exelon's funding strategy and submitted Exelon's pension funding policy.[90] As part of that strategy, Exelon and a third-party actuary engage each year in a multi-factor study to determine the pension funding strategy for all of Exelon's pension plans.[91] Pepco's affiant Allen, who explains this strategy, works for Willis Towers Watson, Exelon's pension actuary.[92] This strategy takes into account reasonable factors such as the "[v]olatility of future cost and contribution."[93] SMECO criticizes such information as lacking detail. But Exelon considers other factors in its annual contribution study too, such as the discount rate and credit balance, which are specific.[94] And importantly, with respect to the current funding strategy that SMECO challenges as lacking a rationale,[95] Pepco explains that, after running a detailed analysis, "$300 million was determined to be the most appropriate annual amount that allows all of the qualified pension plans to attain 100 [percent] funded status in the long-term (assuming specific market and plan assumptions)."[96] We find that Exelon's pension funding strategy reflects reasonable utility management decision-making and is prudent.

47. SMECO avers, however, that Exelon has unfettered discretion in allocating Cash Contributions to the Exelon family of companies. Pepco acknowledges that "the final decision on how much to contribute to the pension plans, and how those amounts are allocated among the plans, is made by Exelon management."[97] But SMECO's allegation of unfettered discretion is unfounded. We find that Pepco's explanation of how Exelon/PHI has allocated contributions to the PHI Retirement Plan, including Pepco, demonstrates a reasonable exercise of discretion. As Pepco affiant Allen states,

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[90] *See* Pepco Answer at 22-26; Formal Challenge, Ex. TMM-5.

[91] Pepco Answer, Allen Aff. ¶¶ 13, 15; Formal Challenge, Ex. TMM-5 at 1.

[92] Pepco Answer at 19; *id.*, Allen Aff. ¶¶ 13-16.

[93] *Id.*, Allen Aff. ¶¶ 13-16; *see id.*, Allen Aff. ¶¶ 9-12 (explaining that recent legislation "had the effect of temporarily reducing some pension plan contribution requirements" and "lowering actual contributions to the 'lower limit' as calculated under these acts during the funding relief period [2012-2022] would likely result in spikes in contributions after the funding relief period ends").

[94] Formal Challenge, Ex. TMM-5 at 1-2; Pepco Answer, Allen Aff. ¶ 14.

[95] Formal Challenge at 11.

[96] Pepco Answer, Allen Aff. ¶ 15.

[97] *Id.* at 25; *see* Formal Challenge, Ex. TMM-5 at 3.

"[d]espite the contributions made to date, all of Exelon's qualified pension plans still continue to be under 100 [percent] funded."[98] Once Exelon determines the annual contributions for each qualified pension plan, allocations to the PHI Retirement Plan are made with the aim of achieving a 90 percent utility funding level for each PHI affiliate.[99] We find that it is prudent for a company like Exelon that administers a consolidated plan to aim to fund employee pensions of the affiliates in the plan at a consistently high level. Moreover, Exelon/PHI made Cash Contributions to Pepco in 2017 consistent with this goal.[100]

48. SMECO further argues that it is irrelevant as to the prudence of Pepco's Prepaid Pension Assets that Exelon/PHI aims to achieve a similar funding status at each PHI affiliate. SMECO maintains that Pepco's Cash Contributions should be reviewed "on a stand-alone basis" and in light of "its own employee statistics and characteristics."[101] But as Pepco explains, "[t]he funding status for each [PHI] affiliate takes into account that affiliate's own employee statistics and characteristics."[102] When Exelon/PHI made Cash Contributions to Pepco in the PHI Retirement Plan in 2017, for example, Pepco's funding status was relevant.[103] And Pepco's funding status reflects its pension obligations to its own employees.[104]

49. We are also not persuaded by SMECO's argument that it cannot determine if Pepco is subsidizing the affiliates' costs because Pepco and the other two PHI affiliates participate together in the PHI Retirement Plan.[105] Exelon/PHI takes into account each PHI affiliate's funding levels in determining the Cash Contribution to allocate to that

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[98] Pepco Answer, Allen Aff. ¶ 15.

[99] *Id.*, Allen Aff. ¶ 16.

[100] *Id.* at 34; *id.*, Allen Aff. ¶ 16 (showing the funding status of the PHI affiliates as of January 1, 2017, which impacted the allocation of contributions to Pepco).

[101] Formal Challenge at 10.

[102] Pepco Answer, Allen Aff. ¶ 31.

[103] *Id.*, Allen Aff. ¶ 16.

[104] *Id.*, Ex. JWA-2 (January 1, 2017 Actuarial Valuation) (showing the obligations and assets of each PHI affiliate).

[105] Formal Challenge at 8.

utility.[106] "[T]he contribution allocation to each PHI utility . . . is determined by each utility's funding status," and the utility's funding status is determined by the relationship between that utility's net benefit obligation and the fair value of the plan assets.[107] The contributions to Pepco and the other PHI affiliates are thus based on each company's funding level, and Exelon/PHI does not subsidize costs of one utility when determining the allocation of Cash Contributions.

50. We ultimately find that the pension funding strategy and methodology that informed Exelon/PHI's Cash Contribution to Pepco in 2017 were prudent. This is relevant as the cumulative Cash Contributions in excess of cumulative Accounting Costs constitute Pepco's Prepaid Pension Assets.[108] We therefore find that SMECO has not created a serious doubt about the prudence of the Prepaid Pension Assets in Pepco's 2018 Annual Update.

iii. Reasonableness of Prepaid Pension Assets

51. Although Pepco argues that prudence is the only issue in this proceeding,[109] SMECO also challenges the reasonableness of the Prepaid Pension Assets balance.[110] As the Commission stated in the Delmarva 2017 Order, "[t]he formula rate protocols specify that Formal Challenges are limited to whether costs are reasonable, prudent, and properly recorded, and whether the formula rate has been applied according to its terms."[111] SMECO argues that the Prepaid Pension Assets balance is not reasonable because Pepco did not show benefits to transmission customers that correspond to the prepaid pension amounts it seeks to recover.[112] Relying primarily on *Southern*, SMECO argues that

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[106] Pepco Answer at 34.

[107] *Id.*, Allen Aff. ¶ 16; *id.*, Ex. JWA-2.

[108] *Id.*, Allen Aff. ¶ 19.

[109] *Id.* at 13.

[110] Formal Challenge at 7.

[111] Delmarva 2017 Order, 160 FERC ¶ 61,102 at P 19 (citing PJM, Intra-PJM Tariffs, OATT, OATT Attachment H-3E, § 3(d)).

[112] Formal Challenge at 13; SMECO Answer at 10.

Pepco must show that its recorded pension expenses contributed to transmission rate reductions.[113]

52. SMECO misunderstands the Commission's holding in *Southern* as it relates to Pepco's formula rate. The Prepaid Pension Assets in Pepco's formula rate, for which Pepco seeks recovery, comprise the Cash Contributions that Pepco has already financed.[114] However, in *Southern*, it was critical to show a reduction in rates resulting from pension income in order to show that the utility financed the amounts it sought to include in rate base.[115]

53. Exelon's current funding strategy—encompassing Pepco—is "to contribute the greater of (1) $300 million until all the qualified plans are fully funded on an [Accumulated Benefit Obligation (ABO)] basis, and (2) the minimum amounts under ERISA to meet minimum contribution requirements and/or to avoid benefit restrictions and at-risk status."[116] The Prepaid Pension Assets amount of $325.6 million in the 2018 Annual Update thus reflects payments Pepco has made over the years to fulfill its ongoing pension obligations. We find that Pepco's Cash Contributions reflect necessary costs, and that it was reasonable for Pepco to include a portion of the $325.6 million Prepaid Pension Assets amount in rate base in the 2018 Annual Update.

54. Finally, in light of our findings in this order, we deny SMECO's alternative request to establish hearing and settlement judge procedures.[117]

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[113] Formal Challenge at 13 (citing *Southern*, 122 FERC ¶ 61,218 at PP 21-22). SMECO also relies on a recently-issued initial decision. *Id.* (citing *Entergy*, 165 FERC ¶ 63,010). The parties in that proceeding have timely filed exceptions to the initial decision and thus it is not a final Commission decision. *See* 18 C.F.R. § 385.708(d) (2019).

[114] Pepco Answer, Allen Aff. ¶ 19 (explaining the calculation of the Prepaid Pension Assets); *id.* at 28 ("Pepco is asking customers to reimburse Pepco for the time value of money that Pepco incurs in making these contributions.").

[115] *Southern*, 122 FERC ¶ 61,218 at P 21 (finding that "when a utility's rates have been reduced by pension income, but the utility has not received such income from the external trust, it will have to finance such amount, and is entitled to include the pension income in rate base").

[116] Pepco Answer, Allen Aff. ¶ 15.

[117] Formal Challenge at 14.

The Commission orders:

The Formal Challenge is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.