

141 FERC ¶ 61,034  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Philip D. Moeller, John R. Norris,  
Cheryl A. LaFleur, and Tony T. Clark.

Pepco Holdings, Inc.

Docket No. EL12-75-000

ORDER ON REQUEST FOR WAIVER OF AFFILIATE PRICING RULES  
UNDER ORDER NOS. 707 AND 707-A

(Issued October 18, 2012)

1. On June 15, 2012, Pepco Holdings, Inc. (PHI), on behalf of certain of its affiliates (as described below), filed a petition seeking limited waiver of certain affiliate pricing rules as established under Order Nos. 707 and 707-A.<sup>1</sup> Specifically, PHI requests permission to use cost-based pricing for three categories of transactions involving: (1) non-power services provided by PHI's franchised public utilities to PHI's centralized service company for the benefit of PHI's franchised public utilities; (2) non-power services in the form of general and administrative corporate services provided by PHI's franchised public utilities to PHI's centralized service company; and (3) non-power services in the form of general and administrative corporate services provided by PHI's franchised public utilities to two real estate affiliates and other affiliates (including market-regulated power sales affiliates). PHI also requests clarification from the Commission that the same affiliate pricing rules in Order Nos. 707 and 707-A may be waived as they apply to future affiliate transactions with similar characteristics as the transactions in PHI's instant waiver petition. In this order, we grant the requested waiver, as it relates to the three categories of transactions described below, and grant PHI's waiver request insofar as it applies to future affiliate transactions that have the same characteristics as the three categories of affiliate transactions described below.

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<sup>1</sup> *Cross-Subsidization Restrictions on Affiliate Transactions*, Order No. 707, FERC Stats. & Regs. ¶ 31,264, *order on reh'g*, Order No. 707-A, FERC Stats. & Regs. ¶ 31,272 (2008).

## **I. Background**

### **A. Description of PHI**

2. According to its petition, PHI is a holding company that has three franchised public utilities within its multi-state holding company system. They are: Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (Delmarva), and Atlantic City Electric Company (Atlantic City Electric):

- Pepco is a direct wholly owned subsidiary of PHI. It provides service to retail customers in the District of Columbia and Maryland.
- Delmarva is an indirect wholly owned subsidiary of PHI. It provides service to retail customers in Delaware and on the eastern shore of Maryland.
- Atlantic City Electric is an indirect wholly owned subsidiary of PHI. It provides service to retail customers in southern New Jersey.

PHI describes these three franchised public utilities as state-regulated transmission and distribution utilities, providing transmission service pursuant to the PJM Interconnection, LLC open access transmission tariff. PHI represents that none of these three franchised public utilities sell wholesale power and that all of their retail customers have access to competitively priced retail power.

3. PHI also states that it owns non-utility affiliates within its multi-state holding company system: PHI Service Company (PHISCO), Atlantic Southern Properties (ASP), Conectiv Properties and Investments, Inc. (CPI), Pepco Energy Services, Inc. (PES), and Potomac Power Resources, LLC (Potomac Power Resources). PHI describes these affiliates as follows:

- PHISCO is a centralized service company that furnishes non-power goods and services to other companies within the PHI holding company system pursuant to a formalized service agreement. These non-power goods and services include: executive management, procurement and administrative services, financial services, human resources, legal and internal audit services, environmental and safety services, regulated electric and gas delivery, energy business services, and internal consulting services. While PHISCO serves all companies within PHI's holding company system, PHISCO performs close to 97 percent of its work for the benefit of PHI's franchised public utilities.
- ASP and CPI are real estate affiliates within PHI's holding company system. ASP owns and leases a building located in New Jersey that

accommodates administration and operations employees of Atlantic City Electric and PHISCO. CPI owns and leases office space in Delaware that accommodates administrative employees of PHISCO.

- PES offers deregulated energy and energy-related services to residential, small business, and large commercial customers. PES is authorized to sell power at market-based rates. Potomac Power Resources, a subsidiary of PES, is also authorized to sell power at market-based rates. It owns two generating facilities located in Washington, DC. PHI labels PES and Potomac Power Resources market-regulated power sales affiliates pursuant to Order No. 707.

### **B. The Commission's Affiliate Pricing Restrictions**

4. Section 35.43(a)(3) of the Commission's regulations defines franchised public utilities as "public utilit[ies] with . . . franchised service obligation[s] under state law."<sup>2</sup> Order No. 707 was issued "to ensure that customers of franchised public utilities do not inappropriately cross-subsidize the activities of 'non-regulated' affiliates, and are not otherwise financially harmed as a result of affiliate transactions and activities."<sup>3</sup> As codified in section 35.44(b)(1) of the Commission's regulations and as relevant here, Order No. 707 provides that, "[u]nless otherwise permitted by Commission rule or order, . . . sales of any non-power goods and services" *from* franchised public utilities that own or provide transmission service over jurisdictional transmission facilities "to a market-regulated power sales affiliate or non-utility affiliate must be at the higher of cost or market price."<sup>4</sup> For the purposes of section 35.44(b)(1), the term "non-utility affiliates" includes centralized service companies.<sup>5</sup> A franchised public utility "that owns or provides transmission service over jurisdictional transmission facilities . . . may only

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<sup>2</sup> 18 C.F.R. § 35.43(a)(3) (2012).

<sup>3</sup> Order No. 707, FERC Stats. & Regs. ¶ 31,264 at P 2.

<sup>4</sup> 18 C.F.R. § 35.44(b)(1) (2012) (emphasis added).

<sup>5</sup> A centralized service company is defined in the Commission's regulations as "a service company that provides services such as administrative, managerial, financial, accounting, recordkeeping, legal or engineering services, which are sold, furnished, or otherwise provided (typically for a charge) to other companies in the same holding company system." *Id.* § 367.1(a)(7).

purchase or receive non-power goods and services *from* a centralized service company at cost.”<sup>6</sup>

5. In Order No. 707, the Commission stated that “[a] public utility that has no captive customers but that owns or provides transmission service over Commission-jurisdictional facilities may seek a waiver of the affiliate restrictions if it can demonstrate that transmission customers are adequately protected against inappropriate cross-subsidization.”<sup>7</sup> In Order No. 707-A, the Commission mandated that before waiver of affiliate pricing restrictions is granted to a franchised public utility providing transmission service over Commission-jurisdictional facilities, assurance must be given “that the transmission customers of these franchised public utilities that do not have captive customers do not bear the costs of inappropriate cross-subsidization.”<sup>8</sup> The Commission stipulated that where transactions of goods and services conducted between franchised public utilities include intermediate transactions with a centralized service company, it would evaluate such waiver requests on a case-by-case basis.<sup>9</sup>

### **C. PHI’s Waiver Request**

6. PHI seeks waiver of the Commission’s affiliate pricing restrictions in 18 C.F.R. 35.44(b)(1) in order to allow its franchised public utilities to make sales, at cost, of non-power services to non-utility affiliates within the PHI holding company system. PHI asserts that it has priced these transactions at cost in accordance with prior guidance from the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. It states that it seeks this waiver as a result of a recent audit by the Commission’s Office of Enforcement, Division of Audits, which suggested that PHI either price these services at the higher of cost or market price or seek waiver from the Commission.<sup>10</sup>

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<sup>6</sup> *Id.* § 35.44(b)(3) (emphasis added).

<sup>7</sup> Order No. 707, FERC Stats. & Regs. ¶ 31,264 at P 48 n.46. Captive customers are defined in the Commission’s regulations as “any wholesale or retail electric energy customers served by a franchised public utility under cost-based regulation.” 18 C.F.R. § 35.43(a)(2) (2012).

<sup>8</sup> Order No. 707-A, FERC Stats. & Regs. ¶ 31,272 at PP 68-69.

<sup>9</sup> *Id.* P 42.

<sup>10</sup> Petition at 4 (referencing Office of Enforcement, Division of Audits, Final Audit Report of Pepco Holdings, Inc., Docket No. FA10-1-000 (May 2, 2011)).

7. PHI argues that if waiver is granted, the transmission customers of its franchised public utilities (Pepco, Delmarva, and Atlantic City Electric) will be protected against inappropriate cross-subsidization and economies of scale would result from the application of cost-based pricing to these transactions. PHI divides the transactions for which it seeks waiver of affiliate pricing restrictions into three categories.

1. **Non-Power Services Provided by Franchised Public Utilities to a Centralized Service Company for the Benefit of Franchised Public Utilities**

8. The first category of transactions for which PHI seeks a waiver is non-power services provided *by* PHI's franchised public utilities *to* PHISCO which, PHI asserts, are ultimately for the benefit of PHI's franchised public utilities.

9. PHI provides two examples of such services from its franchised public utilities to PHISCO. First, in projects undertaken by PHISCO for the benefit of PHI's franchised public utilities, PHISCO uses a franchised public utility's employees' specialized labor skills in the subject matter area of these projects and pays the franchised public utility for these services at cost. In the second example, a franchised public utility charges PHISCO at cost for the time during which its employees provide government affairs services (i.e., lobbying) that benefit other franchised public utilities within the PHI holding company system. In such cases, PHISCO allocates that cost to PHI's other franchised public utilities that benefit from such lobbying.

10. PHI asserts that this category of services benefits PHI's franchised public utilities and pricing it at cost ultimately leads to lower prices benefitting PHI's franchised public utility customers. Therefore, PHI requests permission to provide this category of transactions at cost, rather than at section 35.44(b)(1)'s prescribed higher of cost or market price.

2. **Non-Power Services Provided by Franchised Public Utilities to a Centralized Service Company in the Form of General and Administrative Corporate Services**

11. The second category of transactions for which PHI seeks waiver of the affiliate pricing restrictions is non-power services in the form of general and administrative corporate services that are provided *by* PHI's franchised public utilities *to* PHISCO. According to PHI, these include (1) employee labor for facility services, information technology services and other support services (such as building maintenance services); (2) provision of office space; (3) vehicle services; and (4) storeroom overhead.

12. PHI states that none of the above-mentioned general and administrative corporate services are provided by PHI's franchised public utilities to non-affiliated third parties. Therefore, PHI reasons that providing these services at cost to PHISCO does not cause its

franchised public utilities to forego any profits; on the contrary, PHI maintains instead that at-cost pricing would benefit these franchised public utilities' customers and PHI's other affiliates through economies of scale. In this regard, as previously noted, PHI states that since close to 97 percent of the work performed by PHISCO is for the benefit of PHI's franchised public utilities, the provision of general and administrative corporate services by the franchised public utilities to PHISCO predominantly benefits PHI's franchised public utilities.

**3. Non-Power Services Provided by Franchised Public Utilities to Real Estate Affiliates and Other Affiliates**

13. The third category of transactions for which PHI seeks waiver of affiliate pricing restrictions is non-power services in the form of general and administrative corporate services that are provided *by* PHI's franchised public utilities *to* two PHI real estate affiliates (ASP and CPI) and other affiliates (PES and its subsidiary, Potomac Power Resources). These general and administrative corporate services performed by franchised public utility employees take the form of: (1) stock handling by franchised public utility employees in shared storerooms with market-regulated power sales affiliates; (2) building maintenance and repair services by franchised public utility employees to ASP and CPI in buildings that these affiliates own and that are occupied by employees of PHI's franchised public utilities and PHISCO; (3) storeroom overhead charges to market-regulated power sales affiliates, which entail operation of the storeroom and labor needed to obtain materials for storerooms; and (4) monthly fees charged to a market-regulated power sales affiliate (Potomac Power Resources) for access to data points on a franchised public utility's (Pepco's) energy management system (EMS).<sup>11</sup> While the average monthly cost per customer of providing access to data points on Pepco's EMS amounts to \$1,783 per month for access to the entire system, PHI states that Pepco charges Potomac Power Resources \$1,500 per month for access to just two points on that system, which PHI asserts is "close to the average cost per user to access the entire system."<sup>12</sup>

14. PHI portrays most of the services provided by franchised public utilities to real estate affiliates and other affiliates within the PHI holding company system at cost as yielding economies of scale and efficiency to benefit the franchised public utilities and

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<sup>11</sup> PHI points out that its franchised public utility employees who provide building maintenance and stock handling services to its non-utility affiliates are union employees, and that these employees are paid at negotiated rates in the union contract.

<sup>12</sup> Petition at 14 n.22; *id.*, attach. A, tbl. 3.

ultimately these utilities' transmission customers. PHI states that these services are not provided to non-affiliated third parties. Therefore, PHI reasons that permission to price these types of transactions at cost does not cause these franchised public utilities to forego any profits.

15. As for access to data points on Pepco's EMS, PHI points out that Potomac Power Resources will be closing down two generating sources that use this service within the next year. According to PHI, it costs \$1,783 per month to provide access to the entire system. PHI charges Potomac Power Resources \$1,500 per month for access to two data points on that system. Thus, due to the narrow time window of such use and the fact that the disparity between the "average cost" for access to the entire system and the price charged to Potomac Power Resources for access to two data points on that system is less than \$300 per month, PHI urges the Commission to find this practice "reasonable."<sup>13</sup>

#### **D. Proposed Extension of Waiver Request to Other Transactions**

16. If the Commission grants PHI's waiver petition as it relates to the above-described categories of transactions, PHI also asks that the Commission waive affiliate pricing rules for future transactions with non-utility affiliates containing characteristics similar to the above-described transactions. PHI contends that extending such a waiver to a broader category of transactions will save PHI from having to return to the Commission with additional waiver petitions and will conserve the Commission's resources in processing any similar future waiver petitions.

#### **II. Notice of Filing**

17. Notice of PHI's filing was published in the *Federal Register*, 77 Fed. Reg. 38,050 (2012), with interventions and protests due on or before July 6, 2012. None was filed.

#### **III. Discussion**

18. We grant PHI's waiver request inasmuch as it covers the categories of transactions specified in its petition. As noted above, absent a Commission rule or order, Commission regulations provide that if a franchised public utility that provides transmission service over jurisdictional transmission facilities furnishes non-power goods or services to a market-regulated power sales affiliate or a non-utility affiliate, then the franchised public utility must sell those services to such affiliate at the higher of cost or market price.<sup>14</sup> We

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<sup>13</sup> *Id.* at 14 & n.22.

<sup>14</sup> 18 C.F.R. § 35.44(b)(1) (2012).

evaluate requests for waiver of such restrictions on a case-by-case basis and look to ensure that the customers of such franchised public utilities do not bear the costs of inappropriate cross-subsidization.<sup>15</sup>

19. Regarding the first category of transactions in PHI's petition, PHISCO's use, on an as-needed basis, of franchised public utility employees for their specialized skills in connection with the performance of specific projects for franchised public utilities, where the costs charged by the providing franchised public utility are allocated directly to the franchised public utility which requested the specialized services, produces a result that is essentially the same as if the providing franchised public utility provides services directly for itself.<sup>16</sup> As PHI notes, in such cases, if the franchised public utility providing the specialized services were required to charge a market price that is higher than cost, it would ultimately result in increased costs to the requesting franchised public utility and its transmission customers when PHISCO re-allocates those costs back to the requesting franchised public utility. Moreover, since all the utilities involved charge cost-based rates to their transmission customers, the charge would be the same if the employee worked for the requesting affiliate. PHI's re-allocation of government affairs services (i.e., lobbying) from franchised public utilities to PHISCO at cost, rather than at the higher of cost or market price, for such services that ultimately benefit other franchised public utilities within PHI's holding company system would also lead to minimal cross-subsidization for these franchised public utilities' customers. This is because such services ultimately benefit other franchised public utilities within PHI's holding company system and a price higher than cost could serve to harm these franchised public utilities' customers by making it more costly for franchised public utilities to sustain PHISCO and to benefit from the lobbying of their co-affiliated franchised public utilities.

20. Turning to the second group of transactions in PHI's waiver petition, general and administrative corporate services from its franchised public utilities to PHISCO and for

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<sup>15</sup> See Order No. 707-A, FERC Stats. & Regs. 31,272 at PP 42, 68-69.

<sup>16</sup> The affiliate transaction restrictions do not apply to sales of non-power goods and services by a franchised public utility to another franchised public utility in the same holding company system. In such cases, there is no bar to use of at-cost pricing, and no waiver is necessary. *But see id.* P 42 n.24 (acknowledging the possibility that harm could result from franchised public utility-to-franchised public utility transactions and stating that "[t]he Commission will address such issues on a case-by-case basis, as appropriate, in the context of a section 205 filing, a section 206 complaint, or a section 203 merger application.").

PHISCO's benefit,<sup>17</sup> we find that because PHI represents that PHISCO exists almost entirely for the benefit of these franchised public utilities and other affiliates within PHI's holding company system, franchised public utility profits are not likely to be foregone if such services are priced at cost rather than at the higher of cost or market price. Because a lower price for these services paid by PHISCO to the franchised public utilities reduces the expenses incurred by PHI's franchised public utilities in supporting PHISCO, this transaction price can avoid inappropriate cross-subsidization and would likely inure to the benefit of PHI's transmission customers across its holding company system.

21. In sum, the transactions in these two categories of transactions, which entail services provided by franchised public utilities to PHISCO which are not otherwise provided by the franchised public utility to non-affiliated parties and where almost 97 percent of PHISCO's work is performed for franchised public utilities in the PHI holding company system, are unlikely to result in foregone profits or inappropriate cross-subsidization.<sup>18</sup> Because these services largely benefit PHI's franchised public utilities, pricing at cost here is also appropriate because services provided by PHISCO to the franchised public utilities will ultimately have to be priced at cost.<sup>19</sup>

22. The third set of transactions for which PHI seeks waiver involves transactions *from* PHI's franchised public utilities *to* certain non-utility affiliates, including real estate affiliates (ASP and CPI) and market-regulated power sales affiliates (PES and its subsidiary, Potomac Power Resources). These transactions differ from other transactions in PHI's waiver petition in that they do not involve a centralized service company that is almost completely devoted to serving PHI's franchised public utilities.

23. Although these transactions differ somewhat from the other two categories, we find that granting the waiver is appropriate. These services consist of general and administrative corporate services performed by franchised public utility employees and take the form of: (1) stock handling by franchised public utility employees in storerooms shared with market-regulated power sales affiliates; (2) building maintenance and repair services to ASP and CPI in buildings these affiliates share with PHI's franchised public

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<sup>17</sup> As mentioned *supra* P 11, these are facility services, building maintenance services, information technology services, provision of office space, vehicle services, and storeroom overhead.

<sup>18</sup> *Cf.* Order No. 707-A, FERC Stats. & Regs. 31,272 at P 25 ("where a utility is not making sales of a service to a non-affiliate, it cannot be said with certainty to be foregoing any profit").

<sup>19</sup> *See* 18 C.F.R. § 35.44(b)(3) (2012).

utilities and PHISCO; (3) storeroom overhead charges to market-regulated power sales affiliates, which entail operation of the storeroom and labor needed to obtain materials for the storeroom; and (4) monthly fees charged to a market-regulated power sales affiliate (Potomac Power Resources) for access to data points on a franchised public utility's (Pepco's) EMS. We find that charging a cost-based fee for these purely "general and administrative corporate services" shared by franchised public utilities and non-utility affiliates is reasonable given that the market price for these services would be hard to determine on a stand-alone basis separate from the franchised public utilities' own use of these services. Moreover, the services to non-utility real estate affiliates described in PHI's petition serve to benefit the franchised public utilities. We will grant waiver with respect to the rate for Potomac Power Resources' access to data points on Pepco's EMS. Even though these services are not priced at cost, within the next year, Potomac Power Resources will retire the two generators that use these data points and the costs involved are de minimis.<sup>20</sup>

24. We grant PHI's request for waiver regarding future affiliate transactions into which PHI's affiliates may enter that fit into the same categories as the transactions in this petition: (1) non-power services provided by PHI's franchised public utilities to PHISCO that are for the benefit of PHI's franchised public utilities; (2) non-power services involving general and administrative corporate services that are provided by PHI's franchised public utilities to PHISCO; and (3) non-power services involving general and administrative corporate services that are provided by PHI's franchised public utilities to non-utility non-service company affiliates.<sup>21</sup>

25. We caution that we follow our exhortation in *National Grid USA* that the conclusion we reach here "does not preclude complaints in specific instances alleging that an at-cost price for a specific service supplied to a franchised public utility exceeds the market price and leads to effects on rates that are unjust and unreasonable."<sup>22</sup>

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<sup>20</sup> See Petition at 7 n.7, 14 n.22.

<sup>21</sup> Because our grant of waiver of affiliate pricing restrictions for access to EMS data points is predicated on the fact that these transactions will not continue and that the costs are de minimis, we decline to grant a waiver for future transactions involving the EMS. PHI can apply on an individual basis if it believes such a waiver is necessary in the future.

<sup>22</sup> *National Grid USA*, 133 FERC ¶ 61,241, at P 35 n.19 (2010). *National Grid USA* also involved a request for waiver of affiliate pricing restrictions in Order Nos. 707 and 707-A.

The Commission orders:

(A) PHI's request for waiver of the affiliate pricing restrictions under section 35.44(b)(1) is hereby granted for the three categories of transactions identified above, as discussed in the body of this order.

(B) PHI must inform the Commission within 30 days of any material change in circumstances that would reflect a departure from the facts, policies, and procedures the Commission relied upon in granting the waiver herein.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.