PECO ENERGY COMPANY
STATEMENT NO. 2-R

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION
v.
PECO ENERGY COMPANY

DOCKET NO. R-2018-3000164

REBUTTAL TESTIMONY

WITNESS: PHILLIP S. BARNETT

SUBJECTS: PROPOSED ADJUSTMENTS REGARDING COMMON PLANT ADDITIONS; ACT 129 USAGE REDUCTIONS; FORFEITED DISCOUNT REVENUE; NUMBER OF GENERAL SERVICE CUSTOMERS; PENSION EXPENSE; STORM DAMAGE EXPENSE; RECOVERY OF MERGER COSTS TO ACHIEVE; AND TAX CUTS AND JOBS ACT OF 2017

DATED: JULY 24, 2018

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REBUTTAL TESTIMONY
OF
PHILLIP S. BARNETT

I. INTRODUCTION AND PURPOSE OF TESTIMONY

1. Q. Please state your name, professional position and business address.

A. My name is Phillip S. Barnett. I am employed by PECO Energy Company ("PECO" or the "Company") as Senior Vice President, Chief Financial Officer and Treasurer. My business address is PECO Energy Company, 2301 Market Street, Philadelphia, Pennsylvania 19103.

2. Q. Have you previously submitted testimony in this proceeding?

A. Yes. I submitted direct testimony that is marked as PECO Statement No. 2. My educational background and work experience are set forth in my direct testimony.

3. Q. What is the purpose of your rebuttal testimony?

A. I will respond to various plant in service, revenue, operation and maintenance expense and income tax-related adjustments proposed by Office of Consumer Advocate ("OCA") witness David J. Effron (OCA Statement No. 1), Bureau of Investigation & Enforcement ("I&E") witnesses Christine Wilson and Joseph Kubas, and Philadelphia Area Industry Energy Users Group ("PAIEUG") witness Jeffry Pollock.

4. Q. Have you prepared any exhibits to support your rebuttal testimony?

A. Yes, I have prepared PECO Exhibits PSB-4, PSB-5, PSB-6 and PSB-7, and I will describe those exhibits during the course of my response to the other parties.

II. UTILITY PLANT IN SERVICE

5. Q. Please summarize the adjustments to utility plant in service that Mr. Effron is proposing.

A. Mr. Effron is proposing two adjustments to reduce PECO's claims for utility plant in service. First, Mr. Effron proposes rejecting PECO's claim to include in its rate base for the Fully Projected Future Test Year ("FPFTY") utility plant additions as of the end of the FPFTY. Mr. Effron contends that PECO's FPFTY claim should be adjusted to reflect only the annual "average" of its 2019 additions to utility plant in service, which, in effect, represents PECO's utility plant in service as of the mid-point, not the end, of the FPFTY. This issue is being addressed by Mr. Benjamin Yin (PECO Statement No. 3-R), who explains why Mr. Effron's proposed adjustment to reduce PECO's FPFTY plant in service balances by $159.9 million is incorrect and should not be adopted.

Mr. Effron also proposed an adjustment to reduce the additions to electric distribution-related Common Plant that PECO projects will be placed in service in the Future Test Year ("FTY") in this case (2018) by $25 million, with corresponding reductions to annual depreciation expense and accumulated depreciation of $1.5 million each (OCA St. 1, p. 17).

6. Q. What does Mr. Effron contend is the alleged basis for his proposed adjustment to disallow $25 million of the Company's projected 2018 additions to Common Plant?

A. Mr. Effron offered two alleged bases for his proposed adjustment. First, he compared the Company's 2018 Common Plant additions ($92.8 million on a total-Company basis, of which $64.85 million was allocated to electric distribution operations) to its Common Plant additions placed in service by year for the period 2015 through 2017. The highest level of additions during the 2015-2017 period was $57.04 million, on a total-Company basis, of which approximately $39.31 million was allocated to electric distribution operations. Based on that comparison, Mr. Effron concluded that PECO would not place all of its projected 2018 Common Plant additions in service by December 31, 2018. Therefore, he proposed to reduce PECO's 2018 total-Company Common Plant additions to $57.04 million, of which $39.85 would be allocable to electric distribution based on PECO's 2018 allocation factor. This results in Mr. Effron's proposed adjustment of $25 million to the Company's claim for electric distribution-related Common Plant ($64.85 million less $39.85 million).

Second, Mr. Effron supported his proposed adjustment with the observation that PECO's actual additions to Common Plant for the first four months of 2018 were running approximately 40% below the amounts of PECO's monthly projected Common Plant closed to plant in service (OCA St. 1, p. 16). Despite having only four monthly data points, Mr. Effron assumed that data for only a portion of the year could be extrapolated to a full year. On that basis, he offered his hypothesized extrapolation as additional alleged support for his $25 million adjustment to PECO's 2018 Common Plant additions.

7. Q. Please address Mr. Effron's first contention.

A. There is no valid basis for capping the Company's 2018 Common Plant additions at the level of Common Plant additions placed in service in any prior year. The level of additions in a prior year do not impose a ceiling on the additions that are needed and that PECO will make in any subsequent year. As I explained in my direct testimony (PECO St. 2, pp. 9-10), PECO employs a sound, detailed and well-supported process to develop its operational plan, its long-range plan and, ultimately, its consolidated budget and capital expenditures plan. This is evidenced by the list of specific capital projects that PECO has identified and described in its response to OCA-III-14, which I am providing as PECO Exhibit PSB-4 to my rebuttal testimony. As shown on PECO Exhibit PSB-4, the projections for 2018 Common Plant reflect a detailed build-up of specific projects that are planned and implemented to meet specific needs and performance goals for the Company.

To reiterate, all of PECO's projected plant additions (including its additions to Common Plant) for any given year are based upon PECO's operational, regulatory and financial plans, which, in turn, are focused on PECO achieving its operational and customer service goals. Contrary to the assumption implicit in Mr. Effron's testimony, the Company's projected plant additions are not a function of the level of plant additions PECO may have placed in service in prior years. The total levels of all annual plant additions that PECO has projected and successfully completed and placed in service in prior years clearly demonstrate that PECO has the financial, managerial, supervisory and operational capability to complete its 2018 Common Plant additions by the end of the FTY in this case. In any event, since the Company is relying upon supporting data for a FPFTY, even if the completion of some of its projected 2018 Common Plant additions extended into 2019 (and the Company does not anticipate that this will occur), that plant is still properly included in the Company's rate base in this case.

8. Q. Please address Mr. Effron's attempt to extrapolate Common Plant data for the first four months of 2018 to support his proposed adjustment.

A. As I previously explained, I am providing PECO Exhibit PSB-4, which shows that there are a number of unique projects (primarily related to information technology) that comprise the Company's Common Plant additions and are projected to be placed in service in 2018. While the Company endeavors to identify completed plant by month, plant completion can, and often does, exhibit variability from month-to-month. There are a number of reasons why this can occur, some of which relate to the timing of the work being done and some of which relate to the time it takes to close work orders and move costs recorded in construction work in progress ("CWIP") to completed plant. As a consequence, budget variances that arise in some months can (and do) turn around in one or more subsequent months. For that reason, it is not correct to extrapolate a full-year's budget-to-actual performance from the experience of a limited number of months early in a year, as Mr. Effron has done. The error in that approach is shown by the data in the table I am providing as PECO

Exhibit PSB-5, which shows PECO's monthly budgeted and actual plant additions with the additional information now available for May and June 2018.

As PECO Exhibit PSB-5 demonstrates, the difference between PECO's monthly projected and monthly actual total-Company 2018 Common Plant additions has been reduced to $4.97 million, or 24.4%, as of the end of June, as compared to the 40% variance cited in Mr. Effron's testimony as of the end of April (OCA St. 1, p. 16).[1] Thus, just two months of additional data has substantially reduced the budget-to-actual variance, and PECO anticipates that, over the remaining six months, its actual Common Plant additions will reach the Company's full 2018 projection. Additionally, and as also shown on PECO Exhibit PSB-5, the existing budget variance is a function of three factors – none of which suggest the Company will not place all of its projected 2018 Common Plant additions in service during the FTY. There is approximately $3.3 million in facility capital projects (of which $2.32 million is allocated to electric distribution) that has already been expended and is recorded in CWIP but has not been closed to plant in service yet. Additionally, the Company has revised the projected in-service dates from June 2018 to the fourth quarter of 2018 for two projects of $2.43 million and $1.74 million, respectively (of which $1.7 million and $1.22 million are allocated to electric distribution). Adjusting for these three factors, the entire budget variance as of June 2018 is eliminated.

[1] Mr. Effron calculated the 40% variance for the first four months of 2018 from data the Company provided in discovery. However, the budget data provided by the Company included estimated removal costs, while the actual data did not include any costs of removal. The Company's claims for the original cost of plant additions included in rate base in this case do not include any costs of removal. All of the cost data shown in PECO Exhibit PSB-5 exclude costs of removal.

9. Q. Is PECO on track to complete and place in service all of its electric distribution Common Plant 2018 additions by the end of 2018?

A. Yes, it is. Moreover, as I previously explained, even if some portion of the Company's 2018 additions were not completed until after December 2018 – which the Company does not believe will be the case, in any event – any minor delay in placing that plant in service would not be a valid reason to exclude those additions from rate base in this case, given that the Company is employing a FPFTY ending December 31, 2019.

III. REVENUES

10. Q. Messrs. Kubas and Pollock each contest PECO's recognition of the average decline in sales and associated loss of revenues over the years 2020 and 2021 that will result from PECO's compliance with the energy efficiency and conservation ("EE&C") provisions mandated by Act 129. What are the alleged bases for their opposition to PECO's claim?

A. Mr. Kubas argues that PECO should not be permitted to reflect changes in usage levels that occur beyond the end of the FPFTY (I&E St. No. 3, pp. 35-36). Mr. Pollack contends the same, and also asserts that the Company's approach constitutes piecemeal ratemaking "because it only recognizes a change in one ratemaking component: a reduction in throughput and the associated distribution revenues solely because of energy efficiency" and "fails to recognize potential offsetting adjustments to other ratemaking components such as "increased throughput and revenue from customer additions, lower rate base due to additional accumulated depreciation, and lower operating expenses due to continued productivity improvements" (PAIEUG St. No. 1, p. 7). Further, Mr. Pollock contends that PECO's approach violates the matching principle, i.e. using a consistent set of assumptions for all ratemaking components (e.g., sales, revenues, invested capital and operating expenses) and eliminates regulatory lag (PAIEUG St. No. 1, pp. 8-9).

11. Q. Do the witnesses for I&E and PAIEUG dispute that Act 129's legislative mandate requires PECO to achieve actual usage reductions in 2020 and 2021 in the amounts PECO has used to calculate its claim for lost revenues in those years?

A. No, they do not. And, I do not believe there is any basis for such a dispute, in any event. Section 2806.1(c), which was added to the Pennsylvania Public Utility Code by Act 129 of 2008, requires the Commission to establish "additional required incremental reductions" for the major electric distribution companies ("EDCs"). In its Implementation Order entered on June 19, 2015, the Commission set a usage reduction target for PECO of 5% of its 2010 forecast, or 1,962,659 MWh, for the Phase III EE&C period, which extends from June 1, 2016 to May 31, 2021. *Energy Efficiency and Conservation Program*, Docket No. M-2014-2424864 (Implementation Order, pp. 49 and 57). In so doing, the Commission adopted the findings of its Statewide Evaluator ("SWE") that the EE&C measures necessary to produce that level of usage reduction are cost-effective (i.e., will produce benefits that exceed costs), as measured by a Commission-approved Total Resource Cost ("TRC") test. Moreover, the metrics for determining such reductions and measuring PECO's compliance with the Commission-established usage reductions have also been established by the Commission. Finally, if PECO does not achieve the Commission-established usage reductions, measured on the basis of Commission-approved metrics, it faces penalties for non-compliance of up to $20 million, as set forth in Section 2806.1(f)(2)(i).

Given the legislative and regulatory mandates for usage reductions, which must be measured on the basis of Commission-approved metrics, there is no question that the usage reductions PECO has reflected are known and measurable. Furthermore, non-compliance with the Commission's mandates would leave PECO open to the possible imposition of significant penalties.

12. Q. What is PECO's track record when it comes to achieving Commission-mandated usage reductions?

A. PECO has a well-established track record of aggressively and successfully implementing its EE&C programs. In fact, as explained by Mr. McDonald in PECO Statement No. 1-R, PECO has been a strong advocate for advancing energy efficiency and has won multiple awards for its "Smart Ideas" energy efficiency programs. PECO is committed to the success of its existing Phase III EE&C programs and to providing customers the significant benefits that the SWE has forecasted for those programs.

13. Q. Why is PECO's aggressive pursuit of EE&C measures relevant to this issue?

A. PECO's strong commitment to delivering to customers the benefits of its EE&C programs should be matched by the Commission's authorization of a reasonable opportunity for PECO to recover the full range of costs it incurs to create those benefits. PECO is currently incurring approximately $85 million per year in implementation costs for its Phase III EE&C program. However, those costs do not reflect the effects on PECO's revenues of the usage reductions that must be achieved to comply with Act 129's and the Commission's mandates. With respect to both the direct costs of implementing its EE&C programs and the revenue losses that will necessarily flow from the success of those programs, PECO is not seeking any margin or profit; it is simply seeking a reasonable opportunity for cost recovery.

14. Q. What does Section 2806.1, which was added to the Public Utility Code by Act 129, provide with regard to reflecting EE&C costs and decreased revenues in an EDC's rates?

A. Section 2806.1(k)(1) allows an EDC to "recover on a full and current basis from customers, through a reconcilable adjustment clause under section 1307, all reasonable and prudent costs incurred in the provision or management of a plan provided under this section." Section 2806.1(k)(2), in turn, provides that "decreased revenues of an electric distribution company due to reduced energy consumption or changes in energy demand shall not be a recoverable cost under a reconcilable automatic adjustment clause." However, in recognition of the prohibition on Section 1307 recovery of decreased revenues, Section 2806.1(k)(3) provides as follows:

> Decreased revenue and reduced energy consumption may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding filed by an electric distribution company under section 1308 (relating to voluntary changes in rates).

15. Q. Messrs. Kubas and Pollock contend that reductions in customer usage caused by PECO's obligation to comply with the mandates of Act 129 and the Commission's orders issued pursuant to that Act should not be reflected in this case for any period beyond the end of the FPFTY. Do you agree?

A. No. While I am not a lawyer and am not providing a legal interpretation of the statutory language, I will discuss several important factors that must be considered in deciding what constitutes a reasonable approach to reflecting decreased revenues in an EDC's base rates.

First, Messrs. Kubas and Pollock appear to contend that the relevant statutory language (i.e., "may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding") must mean that usage reductions occurring beyond the test year an EDC employs in a base rate case should not be considered in setting that EDC's base rates in that case. Their position is not reasonable. While the legal interpretation of Section 2806.1(k)(3) will be addressed in the parties' briefs, it would appear unnecessary to add language to the Public Utility Code to specifically authorize the filing of another rate case for periods after the test year. In other words, it makes sense that "may be reflected in revenue and sales data used to calculate rates in a distribution-base rate proceeding" allows an EDC to do more than continue what pre-existing Commission practice would have permitted and, therefore, reductions in usage certain to occur when an EDC's rates are in effect should be taken into account in setting those rates.

Second, and closely related to my first point, above, the "decreased revenues" that will occur after the end of a test year employed in a base rate case are a product of a legislative mandate and Commission orders implementing those statutory requirements. In other words, an EDC will experience revenues that unquestionably will be lower than they otherwise would be, and that reduction is the direct result of a government mandate. Consequently, if the Commission were to "calculate rates in a distribution-base rate case" without recognizing the effects of EE&C measures that are certain to produce incremental reductions in customer usage in periods after the end of the test year, the rates established by the Commission will not produce the revenues that were assumed as the basis for setting those rates. Simply stated, the Commission would be setting rates on the basis of a future scenario that embodies a known error, specifically, an overstated level of customer usage.

In this regard, it is significant that the Company has proposed normalizing its rate case expenses over three years as a period that is reasonably predictive of how long the rates established in this case will remain in effect. And, at the same time, the witness for I&E contends that a four-year normalization period should be adopted. In either case, the usage reductions that will occur during 2020 and 2021, which the Company proposes to recognize, are within the period that rates established in this case would most likely remain in effect.

Third, while setting rates on the basis of sales levels that overstate future customer usage is not a fair or reasonable outcome under any circumstances, it is particularly inappropriate where: (1) the future usage reductions are required by governmental mandate; and (2) the EDC must comply with that mandate or be subject to penalties of up to $20 million. This is not a situation where one of several contingent future events is singled out as the basis for adjusting sales levels. PECO must achieve the level of usage reductions specified by the Commission or face severe penalties for non-compliance. At the same time, under the approach advocated by I&E and PAIEUG, PECO's diligent, good faith compliance with the Commission's mandate would nonetheless subject it to a financial penalty of nearly equal magnitude by denying it a reasonable opportunity to reflect known and measurable usage reductions directly caused by that governmental mandate. It would not be fair or reasonable for the legislature (or the Commission) to put EDCs in this "lose/lose" situation – fail to comply with Act 129's mandate and face a penalty or fully comply with that mandate and still face a penalty of substantial revenue decreases that are not reflected in setting base rates.

16. Q. Mr. Pollock contends that PECO's approach constitutes piecemeal ratemaking "because it only recognizes a change in one ratemaking component: a reduction in throughput and the associated distribution revenues solely because of energy efficiency" and "fails to recognize potential offsetting adjustments to other ratemaking components such as "increased throughput and revenue from customer additions, lower rate base due to additional accumulated depreciation, and lower operating expenses due to continued productivity improvements" (PAIEUG St. No. 1, p. 7). Please respond.

A. Mr. Pollock's position is unreasonable because he tries to put on one side of the balance scale future usage reductions that are mandated by statute and Commission orders, measured by Commission-approved metrics and enforced by the possibility of severe penalties, while, on the other side of the scale, he posits unspecified, unquantifiable and contingent factors that he speculates might – if they occur at all – offset the Act 129-mandated reductions.

Mr. Pollock's allegation of piecemeal ratemaking in choosing to reflect Act 129-mandated usage reductions occurring in 2020 and 2021 ignores a fundamental principle of ratemaking, namely, that only known and measurable changes are properly considered for recognition in the rate setting process. For the reasons I explained previously, the 2020 and 2021 usage reductions that PECO has reflected in its pro forma revenues are known and measurable; indeed, if they were not "known and measurable," it would be unreasonable to expose PECO to statutory penalties for failing to achieve them. Thus, PECO is not being arbitrarily selective. To the contrary, it is adhering to the well-accepted ratemaking principle that requires utilities and their regulators to "select" as reasonable for adoption only those adjustments that are known and measurable. Mr. Pollock cannot say the same for the unquantified and contingent factors that he speculates might occur and might offset the effects of Act 129-mandated usage reductions.

PECO proposes to reflect known and measurable changes that will occur in 2020 and 2021 (because if they do not, PECO will face significant penalties), while Mr. Pollock argues that those changes should be ignored based solely on conjecture about unknown and contingent future events. Moreover, from the perspective of this point in time, the unknown, contingent events that Mr. Pollock hypothesizes may not come to fruition. However, the unknown and unmeasurable future forces that might drive future outcomes will occur irrespective of the known and measurable reductions that Act 129 will require. The fact that PECO's revenues change because of future unknowns does not provide any valid basis for ignoring the effects of changes that are certain to occur and can be measured on the basis of Commission-approved metrics. In other words, there is no question that PECO's revenues in 2020 and 2021 will be lower than they otherwise would be solely because of the governmental mandate to comply with Act 129 and the Commission's Implementation Orders.

17. Q. In addition to his proposal to reject the Company's Act 129 adjustments for 2020 and 2021, Mr. Kubas recommends that the $14,590,000 Act 129 reduction for 2019 be reduced by 50% because he believes that the decline in sales over the year 2019 have been annualized to reflect the end-of-year level of sales decline. Is Mr. Kubas's assumption correct?

A. No, it is not. The FPFTY sales used to calculate the Act 129 revenue reduction for 2019 reflect the budgeted sales level and, as such, they are the sales that will be lost during 2019. In other words, the Company's adjustment reflects only the actual decline in sales that is projected to be experienced in each month over the year. The Company did not annualize the decline in sales to reflect, for a full year, the sales decline to be experienced in the last month of the year, as Mr. Kubas assumed. Revenues based on the reduced sales calculated by PECO correspond to its actual lost revenues in each month of the FPFTY. Consequently, there is no valid basis for Mr. Kubas' proposed adjustment.

18. Q. Turning to another issue, Mr. Effron proposes an adjustment to increase PECO's pro forma level of forfeited discounts (i.e., late payment charge revenue) by $797,000. Please address Mr. Effron's proposed adjustment.

A. Mr. Effron recommends calculating forfeited discount revenue for the FPFTY by applying the actual ratio of forfeited discounts to total revenues for the years 2015-2017 to FPFTY distribution revenues.[2] Mr. Effron contends that his recommended approach should be adopted because it is similar to the manner in which the Company calculated normalized uncollectible accounts expenses and it is reasonable to use similar methods for both because uncollectible accounts and forfeited discounts "tend to be influenced by the same factors." (OCA St. No. 1, p. 22). I do not agree. The method used by the Company to calculate pro forma forfeited discount revenue provides a better indication of that revenue than the method Mr. Effron endorses.

19. Q. Please explain the methodology the Company used to forecast forfeited discount revenue.

A. PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for 2015-2017 as a percentage of average past due accounts receivable balances for the same period. The percentage derived from that calculation was applied to PECO's forecast of past due accounts receivable for the

[2] Mr. Kubas (OCA St. 3, pp. 40-42) proposed an adjustment to increase forfeited discount revenues by approximately $156,000. However, Mr. Kubas's proposed adjustment is a concomitant adjustment related to other adjustments he proposed to the Company's claimed level of revenue. Because Mr. Kubas's other proposed adjustments should not be adopted, for the reasons set forth in my rebuttal testimony and in the rebuttal testimony of Mr. Yin, there is no basis for adopting Mr. Kubas's adjustment to forfeited discount revenue either, and it should be rejected as well.

FPFTY to develop FPFTY forfeited discount revenue. PECO's approach is reasonable because forfeited discounts (late payment charges) are imposed based on past due balances of accounts receivables. Past due balances are forecasted to decline in 2019 as compared to the average of such balances during the recent historical period.

20. Q. Have you prepared an analysis to compare the relationship of forfeited discounts to past due accounts receivable and total revenues?

A. Yes, I have. PECO Exhibit PSB-6 consist of two pages. The first page plots the indexed monthly values for: (1) revenue; (2) past due accounts receivable; and (3) forfeited discounts for the period January 2012 through December 2017.[3] The second page provides "best fit" trend lines which clearly show that forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues. In short, PECO Exhibit PSB-6 confirms that forfeited discounts should properly be projected for the FPFTY based on their relationship to past due accounts receivable, as the Company has done, and not on the basis of total revenues, as Mr. Effron erroneously proposes to do.

21. Q. I&E witness Kubas also proposed an adjustment to increase the Company's revenues at present rates by $1,013,644 based on his contention that the number of GS customers the Company has projected it will serve in 2018 and 2019

[3] The values shown on PSB-6 are indexed so they are equal to each other in a given starting time period (in this case, January 2012). By convention, the index value is usually 100. From there on, every value is normalized to the start value, maintaining the same percentage changes as in the nonindexed data.

should increase from 474 to 609 customers. Do you agree with Mr. Kubas's proposal?

A. No, I do not. Mr. Kubas's projection of 609 additional customers relies upon an average of new GS customers in December of each calendar year ("terminal" customers), which he then uses to project the associated revenue for <u>each month</u> of the same calendar year. Using the number of terminal customers instead of an average number of customers during a calendar year overstates the amount of revenue the Company receives from GS customers. While Mr. Kubas states that he believes a five-year average of customers at the end of a calendar year is "the best predictor" of the number of new customers PECO will serve (p. 29), he provides no authority to support his use of a five-year average or to establish why the number of customers in December is the appropriate basis for projection of monthly revenue.

Notably, as shown in I&E Exhibit No. 3, Schedule 8, Mr. Kubas's five-year average calculation of 609 customers is only a <u>four-year</u> average despite his recommendation of a five-year average. If an actual five-year average was used as he proposes, the number of additional GS customers is reduced to 551 – much closer to the Company's projection of 474 additional customers. A calculation that uses the annual average (non-terminal) customer growth of the last five years would yield 410 additional customers for each of the next two years – a number that is significantly lower (with resulting lower revenue) than the Company's projection. In light of this overstatement of customers, both Mr. Kubas's projection methodology and his increase in the number of GS customers and revenue should be rejected.

IV. OPERATION AND MAINTENANCE EXPENSE

22. Q. Mr. Effron and Ms. Wilson have proposed adjustments to PECO's FPFTY claim for pension expense. Before addressing these proposed adjustments, please review PECO's claim for pension expense in this case.

A. In order to reasonably reflect the future pension contributions that PECO is likely to incur during the years in which PECO's proposed rates will be in effect, PECO has calculated a five-year average of pension contributions using three years of actual contributions (2015-2017) and two years (2018-2019) of contributions projected by Towers Watson, PECO's actuaries.[4] Use of the five-year average results in an average pension contribution of $28.28 million. Approximately 72.98% of this amount, or $20.6 million, relates to the Company's electric distribution operations. The portion of that amount that is assigned to electric distribution operation expenses (i.e., $28.28 million less the amount deemed to be capitalized) is $13.1 million, which is the amount PECO claimed in operating expenses for the FPFTY.

23. Q. Why are Mr. Effron and Ms. Wilson proposing an adjustment to that claim?

A. Both Mr. Effron and Ms. Wilson recommend the use of a multi-year average pension contribution calculation. However, Mr. Effron believes that a four-year average of actual and projected contributions should be used, which would have the effect of eliminating an actual 2015 PECO contribution of $40.4 million from the FPFTY pension expense calculation. For her part, Ms. Wilson recommends a five-year

[4] After PECO's initial filing in this proceeding, PECO made its actual contribution for 2018. The actual contribution of $24 million, when compared to the budgeted contribution of $23.9 million, resulted in a difference in the five-year average of approximately $20,000.

average but contends that the average should only include historical contributions (i.e., contributions in years 2013-2017) because PECO cannot say with certainty that investment returns in future years will not reduce the level of contributions that may actually be required.

24. Q. Does Mr. Effron explain why he believes a four-year average is preferable to a five-year average?

A. No, he does not. He claims only that a four-year average is "reasonable," and that PECO's inclusion of its actual contribution in 2015 is inappropriate because that contribution is significantly higher than the other years included in PECO's five-year average.

25. Q. Why do you believe use of a 5-year average is preferable to a 4-year average?

A. The pension contribution amounts vary year-to-year due to multiple factors including market interest rates, investment performance, and changes in funding rules. Although there are some limited opportunities to mitigate that volatility, there is still variability in the size of the annual contributions from one year to the next. Given the variability in pension contributions from one year to another, using a 5-year average is better than using a 4-year average. A 5-year average better smooths out the high and lows in pension contributions to reflect more gradualism in rate making process.

26. Q. How do you respond to Ms. Wilson's assertion that only historical contributions should be used?

A. Projections of PECO's future pension contributions reflect future legal requirements, current market conditions, and anticipated earnings, and are prepared by professional actuaries (Towers Watson). Reliance solely on historical projections would effectively require PECO to ignore this professional guidance as to the expected pension contribution that will be required when rates are likely to go into effect. While PECO differs with the OCA with respect to the number of years that should be used in calculating a multi-year average, I note that the OCA also endorses the use of both historic and projected contributions.

27. Q. Ms. Wilson and Mr. Effron have each recommended adjustments to the Company's claim for normalized storm expense. Initially, please summarize the Company's claim for normalized storm expense and describe the conditions that affected PECO's storm expense in the first quarter of 2018.

A. The Company's claim for normalized storm expense is based on an average of storm expense experienced during a sixty-month (five-year) period ended March 31, 2018, as adjusted for inflation. The Company's original claim, as set forth in its rate filing made on March 29, 2018, totaled $43.83 million.

The sixty-month period ended March 31, 2018 included the Company's costs for winter storm Riley, which occurred on March 2, 2018, and winter storm Quinn, which occurred on March 6 – only four days after PECO was hit by Riley. These storms dropped heavy, wet snow across the Company's service area and brought with them high winds, which at times exceeded 50 miles per hour. More than 750,000 of PECO's customers lost power as a result of these storms. Over 2,600 of PECO's employees and 2,800 employees of contractors and other utilities were deployed to repair PECO's facilities and restore service to PECO's customers. The storm repair and service restoration effort required PECO to replace 2,803 cross arms, 18,911 fuses, 631 utility poles, 347 transformers and 163 miles of wire and cable. Service was restored to virtually all of PECO's customers by Saturday March 10, while the few remaining pockets of customers without power had service restored by Sunday March 11. Collectively, Riley and Quinn were the third largest storm event in the Company's history.

28. Q. What is the nature of the adjustments that Ms. Wilson and Mr. Effron propose to the Company's claim for normalized storm expense?

A. Ms. Wilson and Mr. Effron have proposed adjustments that would reduce the Company's claim for normalized storm expense. While both witnesses propose to use a sixty-month (i.e., five-year) average, they employ data for the five calendar years ended December 31, 2017. By using an average for five annual periods that ended on December 31, 2017, Ms. Wilson and Mr. Effron eliminate from the Company's normalized storm expense the effects of winter storms Riley and Quinn.

29. Q. What reasons did Ms. Wilson and Mr. Effron offer for proposing to use five calendar years ended December 31, 2017 to calculate the Company's normalized storm expense?

A. Ms. Wilson and Mr. Effron each offered different reasons for their proposed adjustments. Ms. Wilson proposed using a five calendar year average, which excludes costs incurred in the first quarter of 2018, "because the Company has not provided actual expenses associated with the first three months of 2018 (which are likely to become available during the course of this instant proceeding) . . . " (I&E St. 1. p. 14). I will respond to Ms. Wilson's direct testimony and provide the Company's actual cost data.

Mr. Effron proposed a five calendar year average because the Company used a historic five calendar year average to calculate its claims for normalized storm expense in its 2010 and 2015 cases (which were resolved by "blackbox" settlements) and PECO should therefore be foreclosed from deviating, even by one calendar quarter, from that methodology. In short, Mr. Effron wants to select a period that assures the costs of winter storms Riley and Quinn cannot be recognized in this case. Mr. Yin will address this aspect of Mr. Effron's direct testimony in PECO Statement No. 3-R. Mr. Effron also tried to support his proposed adjustment by contending that the amount of normalized storm cost PECO allegedly recovered in base rates in 2016 and 2017 (the two years since the conclusion of its last (2015) base rate case) exceeded its actual storm cost for that period. I will address this contention by presenting data for the entire period since 2010, when PECO first claimed normalized storm expenses based on a historical five-year average, and show that Mr. Effron's contention is wrong.

30. Q. Please address Ms. Wilson's concern that the Company has not provided actual costs for winter storms Riley and Quinn.

A. When the Company's rate filing was being developed for filing on March 29, 2018, it did not have all of the actual cost data for March 2018, which included the costs of winter storms Riley and Quinn. Therefore, the Company used a preliminary estimate of $68 million in calculating the sixty-month average in its filing, subject to updating when actual costs became known. When all of the actual cost data for the first quarter of 2018 became available, the Company provided those actual costs in a revised discovery response which I have attached as Exhibit PSB-7. As shown in that response, the actual storm costs incurred in the first quarter of 2018 are $55.88 million. By its careful management of its workforce, the Company was able to release storm crews earlier than expected, which allowed it to reduce work time and travel expense and drive down overall storm costs to below its initial estimates. Reflecting the actual first quarter storm costs in the Company's sixty-month average reduces its claim for normalized storm expense from $43.83 million to $41.29 million, as shown in an exhibit to the rebuttal testimony of PECO witness Benjamin S. Yin (PECO Exhibit BSY-5, Schedule D-13).

31. Q. Does the Company's presentation of actual cost data for March 2018 address Ms. Wilson's concerns?

A. Yes, it does. The reduction to the Company's claim to reflect actual cost data for March 2018 has been incorporated into the Company's revised revenue requirement set forth in PECO Exhibit BSY-5 and eliminates the basis for Ms. Wilson's proposal to employ a five calendar year average for normalized storm expense.

32. Q. Please address Mr. Effron's contention that the Company had recovered more than its actual storm expense in 2016 and 2017, which should compensate it for the costs it incurred for winter storms Riley and Quinn.

A. Mr. Effron's analysis is incomplete and, therefore, seriously flawed. Mr. Effron acknowledged that the Company began using a five-year historical average as the basis for its claims for normalized storm expense in its 2010 rate case (OCA St. 1, pp. 29-30). However, he only looked at the years 2016 and 2017, assumed that the blackbox settlement of the Company's 2015 rate case resulted in PECO getting its entire storm expense claim, and then compared the Company's claim for normalized storm expense to its actual storm expense. That approach ignores the Company's experience during the period 2011 through the present. I prepared an analysis for the entire period from 2011 through June 2018 based on the same assumption Mr. Effron made, namely, that the Company's rates that went into effect on January 1, 2011 and January 1, 2016 reflected its claims for storm expense in its 2010 and 2015 rate cases. The comparison of PECO's claims for normalized storm expense to its actual storm expense for that period shows that the Company did have a substantial under recovery of $69.79 million as of June 2018 (all costs are in millions of dollars):

Storm Costs
(in millions)

Year	Actual Storm Expense	PECO Claims for Normalized Storm Expense	Recovery Over/(Under) Annual	Recovery Over/(Under) Cumulative
2011	43.1	20.9	(22.3)	(22.3)
2012	51.6	20.9	(30.7)	(53.0)
2013	3.8	20.9	17.0	(35.9)
2014	88.6	20.9	(67.7)	(103.7)
2015	21.3	20.9	(0.4)	(104.1)
2016	16.1	46.1	30.0	(74.1)
2017	9.0	46.1	37.1	(37.0)
2018 (June YTD)	55.9	23.0	(32.8)	(69.8)

As the table above shows, there is no basis for Mr. Effron's contention that the Company has recovered more than its actual storm expense.

33. Q. Please address the adjustments proposed by Ms. Wilson and Mr. Effron to the Company's claim to amortize costs incurred to achieve savings generated by the merger of Pepco Holdings with Exelon.

A. In my direct testimony (PECO St. No. 2, p. 19), I explained that the Company's costs are lower because of the on-going level of merger-related savings generated by the merger of Pepco Holdings with Exelon that occurred in 2016. I also explained that those savings are reflected in lower costs for services provided by Exelon Business Services Company ("EBSC") – savings that flow through to customers in the Company's claims in this case. I explained further that costs had to be expended to achieve the merger-related savings; a portion of those costs were allocated to PECO; and PECO has made a claim in this case to recover its allocable share of the cost-to-achieve by a three-year amortization. Ms. Wilson and Mr. Effron have proposed adjustments to disallow the Company's claim for costs-to-achieve.

34. Q. What is the alleged basis for Ms. Wilson's and Mr. Effron's proposed adjustments?

A. Ms. Wilson asserts that the Company's claim should be disallowed because PECO did not petition the Commission to defer the costs-to-achieve; most of the costs to achieve were incurred in 2016 and 2017; and merger savings PECO experienced since the Exelon/Pepco merger have exceeded its share of the costs to achieve. Similarly, Mr. Effron asserts that PECO's share of the merger savings realized to date should be deemed to have offset the costs-to-achieve.

35. Q. Please respond to Ms. Wilson's and Mr. Effron's proposed adjustments.

A. Ms. Wilson's contention that PECO is precluded from claiming an amortization of costs incurred during the FTY, the historic test year ("HTY") and one prior year in this case unless it first obtained permission to "defer" such costs is a legal issue that will be addressed in the parties' briefs. I understand, however, that there are exceptions to the rule against retroactive and single-issue ratemaking that could permit PECO to make its claim without having to rely upon a pre-approved "deferral" of historic period costs. Furthermore, two of the three years in which the costs-to-achieve were incurred by PECO are the HTY and FTY in this case, in any event. In other words, they are not "out-of-period" costs relative to the test years in this case.

Additionally, there is a fundamental unfairness in trying to seize upon merger-related savings to offset all of the merger-related costs-to-achieve that PECO has incurred. Merger-related costs-to-achieve are a discrete and limited amount, and they represent an investment that has and will produce significant merger-related savings in every year after the Exelon/Pepco merger occurred – savings that will continue for years into the future. Those merger-related savings flow through to customers by reducing the cost of Exelon's distribution utilities, including PECO. When a specific cost (like the merger-related costs-to-achieve) is incurred in a given accounting period and produces substantial benefits that extend into future accounting periods, it is entirely appropriate to recognize those costs over periods that match, to some reasonable extent, when the benefits will accrue. Given the benefits that customers will experience from the merger-related savings that flow through to them as a result of the Exelon/Pepco merger, it is only fair that customers bear the costs incurred to produce those savings. PECO has tried to produce an equitable result by proposing to amortize the costs-to-achieve over three years, which corresponds to the period that rates established in this case are anticipated to be in effect. Significantly, however, customers will continue to benefit from the merger-related savings produced by the costs-to-achieve for many years after the three-year amortization is completed. Under these circumstances, asking customers to bear, through a multi-year amortization, the costs to achieve future merger savings is fair and reasonable.

36. Q. I&E witness Zalesky also proposes to reduce PECO's proposed $719,060 claim for employee activity costs to $265,340, asserting that costs for employee

activities other than awards for length of service and outstanding work should be excluded. Do you agree with Mr. Zalesky?

A. I do not. PECO's claim is based upon a range of activities that are relatively modest cost expenditures which have significant benefits in terms of employee morale and productivity – in this case, an annual employee picnic in PECO's service territory and smaller employee celebrations that are an important part of PECO's workplace culture. Mr. Zalesky contends that the Commission has "historically distinguished" between awards to individual employees (which he supports) and general activities for all employees, but counsel has informed me that the Commission has also recognized the importance of general employee events in contributing to a utility's workplace environment. I believe our annual gathering of employees and the other events in which we celebrate our workforce, their accomplishments and strategic goals and initiatives for the upcoming year, are appropriate expenses that help make PECO an attractive workplace for the many talented professionals PECO wants to recruit and retain to continue to provide the high level of service to our customers described by Mr. McDonald.

V. TAX CUTS AND JOBS ACT OF 2017

37. Q. Please address the concern expressed by PAIEUG witness Pollock with regard to the Company's calculation of the impact of the Tax Cuts and Jobs Act of 2017 ("TCJA") on its revenue requirement for 2018, which the Company is proposing to credit to customers through its proposed Federal Tax Adjustment Charge ("FTAC").

A. The Company provided a calculation of the change in its revenue requirement for 2018 that results from the changes in federal tax law made by the TCJA, as shown on PECO Exhibit BSY-4. Only PAIEUG witness Pollock has taken issue with the Company's calculation. PECO Exhibit BSY-4 shows that the changes made by the TCJA produce an overall reduction in the Company's 2018 revenue requirement (including the effects of Gross Receipts Tax) of $68.34 million. That reduction is the summation of various changes, some of which reduce the Company's revenue requirement and others that increase it, while, on a net basis, the result is the aforementioned $68.34 million reduction. Mr. Pollock has expressed concerns about line 42 of PECO Exhibit BSY-4, which shows that TCJA related changes cause PECO's 2018 rate base to increase by $78 million. Mr. Pollock – alone among the opposing party witnesses in this case – claims that PECO has not "substantiated" the basis for the $78 million rate base increase shown in its calculation (PAIEUG St. No. 1, p. 15).

38. Q. Will you please explain the components of the $78 million increase in rate base Mr. Pollock is questioning?

A. Yes, I will. To that end, I have prepared the following table showing the components of the $78 million rate base increase:

		(a) **After TCJA**	(b) **Before TCJA**	(c) = (a) - (b) **Difference**
(1)	Beginning Balance ADIT	$932,456,515	$936,183,762	$(3,727,247)
(2)	Property-Related Tax-Book Timing Differences	13,555,215	19,754,296	(6,199,081)
(3)	Depreciation	6,137,857	46,893,215	(40,755,357)
(4)	Amortization of Excess ADIT	(16,983,890)	-	(16,983,890)
(5)	Net Operating Loss		9,605,493	(9,605,493)
(6)	Other Post-Employment Benefits (OPEBs)	2,263,667	3,305,411	(1,041,744)
(7)	Ending Balance ADIT	$937,429,364	$1,015,742,176	$(78,312,812)

39. Q. Please explain the components shown in the table above.

A. The largest component of the rate base increase is related to depreciation (line (3)). Prior to the TCJA, "bonus" depreciation of 50% was available for qualified property in 2017 and 40% on qualified property in 2018. The TCJA eliminated bonus depreciation on utility property placed in service after September 28, 2017. This change, as well as the reduction in the federal corporate income tax rate from 35% to 21%, reduced deferred taxes, which in turn, reduced the offset to rate base (i.e., increased rate base) for accumulated deferred taxes. Line (2) relates to property-related tax-book timing differences apart from depreciation that generate deferred taxes. The reduction in the tax rate caused a reduction in these deferred taxes as well. The same is true for OPEBs, as shown on line (6). Line (4) reflects the amortization of "excess" ADIT regulation liability created by the reduction in the federal income tax rate (the creation of the regulatory liability and its flow-back to customers was explained by Mr. Yin in PECO Statement No. 3, pp. 29-30). The Net Operating Loss (Line (5)) prior to the TCJA would be higher because of the availability of bonus depreciation.

40. Q. Does the information you provided above substantiate the $78 million?

A. Yes, it does. The table shows the components of the $78 million increase, which is a product of the changes caused by the TCJA that I previously explained.

VI. CONCLUSION

41. Q. Does this complete your rebuttal testimony?

A. Yes, it does.

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