PECO ENERGY COMPANY
STATEMENT NO. 7

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PECO ENERGY COMPANY – ELECTRIC DIVISION

DOCKET NO. R-2018-3000164

DIRECT TESTIMONY

WITNESS: MARK KEHL

SUBJECT: REVENUE ALLOCATION; RATE DESIGN; AND PROOF OF REVENUES

DATED: MARCH 29, 2018

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DIRECT TESTIMONY
OF
MARK KEHL

I. INTRODUCTION AND PURPOSE OF TESTIMONY

1. Q. Please state your name and business address.

A. My name is Mark Kehl. My business address is PECO Energy Company, 2301 Market Street, Philadelphia, Pennsylvania 19103.

2. Q. By whom are you employed and in what capacity?

A. I am employed by PECO Energy Company ("PECO" or the "Company") as a Principal Regulatory and Rates Specialist. In that capacity, I am responsible for issues regarding tariff administration, financial analysis, project management and regulatory affairs for electric and gas activities throughout PECO's operations and service territory.

3. Q. Please describe your educational background.

A. I received a Bachelor of Science in Accounting from DeSales University and Master of Business Administration from Lehigh University.

4. Q. Please describe your professional experience.

A. I began working for PECO in April of 2009 as a Senior Business Analyst primarily focused on forecasting Accounts Receivable, Write-offs and Bad Debt expense. In March of 2011, I was promoted to my current position within Regulatory Policy and Strategy. Prior to working at PECO, I was a financial analyst at Merrill Lynch.

5. Q. What is the purpose of your testimony?

A. The purpose of my testimony is three-fold. First, I will describe how PECO proposes to allocate its claimed revenue increase among rate classes. In so doing, I will explain the principles that guided PECO in developing its proposed revenue allocation. Second, I will identify the changes PECO is proposing in the rate design for certain rate classes, explain why PECO is proposing those changes and describe how the proposed new rates were developed. As part of that discussion, I will also describe changes to existing rates and riders that PECO is proposing. Finally, I will discuss PECO's proposal to recover a portion of the costs related to the Company's transition from a tiered-discount to a Fixed Credit Option ("FCO") Customer Assistance Program ("CAP").

6. Q. Please identify the exhibits you are sponsoring.

A. I am sponsoring the following PECO Exhibits:

Exhibit MK-1	Proposed Revenue Allocation, Proposed Increases by Class and Class Rates of Return and Relative Rates of Return under Proposed Rates
Exhibit MK-2	Relevant Tariff Pages (Blacklined to Show Changes)
Exhibit MK-3	Comparison of Residential Customer Charges for Pennsylvania Electric Utilities
Exhibit MK-4	Detail of the Universal Service Fund Charge Adjustment Calculation
Exhibit MK-5	Summary of Revenue at Present and Proposed Rates
Exhibit MK-6	Proof of Revenues at Present and Proposed Rates

II. REVENUE ALLOCATION

7. Q. Please state the principles that guided PECO in developing its proposed revenue allocation.

A. The proposed revenue allocation reflects a reasonable balance of accepted principles for designing utility rates. Specifically, PECO considered the following principles in developing its proposed revenue allocation:

a. The results of the class cost of service study ("COS Study"), prepared by Ms. Jiang Ding and discussed in PECO Statement No. 6, should be used as a guide in allocating the proposed revenue increase among rate classes;

b. The proposed revenue allocation should move all rate classes closer to the cost of service indicated by the COS Study; and

c. Customer impacts should be considered, and PECO should attempt to avoid increases in revenue for major rate classes that, on a percentage basis, are disproportionate relative to the system average increase.

8. Q. Has an exhibit been prepared showing the cost of service by rate class?

A. Yes, a summary of class cost-of-service data is provided in PECO Exhibit JD-1, which was prepared by Ms. Ding and accompanies her direct testimony (PECO Statement No. 6). PECO Exhibit JD-1 shows, at page 1, line 25, the overall and class rates of return produced by the Company's current electric distribution base rates based on its supporting data for the twelve months ending December 31, 2019, which is the Fully Projected Future Test Year ("FPFTY") in this case. PECO Exhibit JD-1 shows, at page 2, line 70, the increase or decrease (in dollars and as a percentage of class electric distribution revenues under current rates) that each rate class would have to receive in order for its revenues to equal its indicated class cost of service. As indicated by the guiding principles I summarized above, while the results of the Company's COS Study are an important guide in evaluating its proposed revenue allocation, they are not the only factor that must be considered.

9. Q. What is the revenue allocation that PECO determined to be appropriate in this case?

A. The proposed revenue allocation is shown in PECO Exhibit MK-1. In order to allow for a comparison of underlying system allocations on an "apples-to-apples" basis with prior base rate cases, PECO Exhibit MK-1 first develops the system allocation that would be used in the absence of the 2019 effects of the Tax Cuts and Jobs Act ("TCJA"). It begins by showing: (1) the allocation of approximately $147 million electric distribution revenue that would be required on a system-wide basis absent the 2019 TCJA effects, plus the addition of Distribution System Improvement Charge ("DSIC") revenue above 2018 levels, for each rate class; (2) an adjustment to reach an approximately $143 million revenue increase based on the decreases in class distribution revenue under the Transmission Service Charge and Generation Supply Adjustment described by Ms. Ding in PECO Statement No. 6; (3) the proposed revenue increase as a percent of distribution revenues at current rates for each rate class; and (4) class rates of return and relative rates of return at present and proposed rates. Up to this point, PECO Exhibit MK-1 reflects the analysis that was used in prior base rate proceedings. PECO Exhibit MK-1 then shows the budgeted allocation of tax benefits to each rate class, including the net of the typical system-wide allocation, the effects of the return of 2019 TCJA tax benefits to customers, DSIC revenue and other adjustments that result in the $82 million revenue requirement increase over current levels being sought in this case, with that requested revenue increase allocated across each of the rate classes.

10. Q. Why is the proposed revenue allocation reasonable?

A. The proposed revenue allocation is reasonable because PECO Exhibit MK-1 shows that removing the effects of the tax benefits that will be returned to customers, DSIC revenue and other adjustments, and using the Company's COS Study as a guide, the proposed rates have been developed to make meaningful movement toward each class' cost of service, as evidenced by the relative rates of return shown on PECO Exhibit MK-1, while also mitigating the impact of the revenue increase on each major rate class.

11. Q. Please explain the significance of the relative rates of return shown in PECO Exhibit MK-1 to which you previously referred.

A. The relative rate of return is the ratio of the rate of return for a rate class to the system average rate of return. Relative rates of return are commonly used to test whether a proposed revenue allocation moves each rate class closer to, or at least no further from, the system average rate of return. A relative rate of return of 1.00 would mean the class rate of return equals the system average rate of return and, therefore, class revenues equal the class cost of service. Conversely, relative rates of return that depart from 1.00 indicate that the class rates of return are higher or lower than the system average rate of return and, therefore, the classes are providing revenues higher or lower than their indicated cost of service.

12. Q. Explain in general how PECO proposes to change the charges within each rate schedule to recover the revenue allocated to each rate class.

A. PECO proposes to increase or decrease each of the charges within each rate schedule in proportion to the revenue increase or decrease allocated to that rate class, subject to certain rate design changes, discussed below. PECO Exhibit MK-2 is a copy of the Company's Tariff Electric-Pa. P. U.C. No. 6 ("Tariff No. 6") that shows, by strike-out and blacklining, the proposed rate changes I discuss below as well as the proposed changes in rules, regulations, rate schedules and riders discussed by Richard A. Schlesinger in PECO Statement No. 8. Tariff No. 6 is being filed with the Secretary of the Pennsylvania Public Utility Commission ("PUC" or the "Commission") as part of PECO's base rate filing.

Currently, service is provided under the Company's Tariff Electric-Pa. P. U.C. No. 5 ("Tariff No. 5") and associated supplements. It is anticipated that Tariff No. 6, which was filed on 60 days' notice, will be suspended by operation of Section 1308(d) of the Public Utility Code pending an investigation by the Commission. Because it is possible and, in fact, likely, that changes will be made, via subsequently filed supplements, to Tariff No. 5 during the period Tariff No. 6 is suspended, any provisions of the current tariff that will continue beyond the end of the suspension period and have not already been incorporated in Tariff No. 6 will be merged into the tariff that will be filed as part of PECO's compliance filing at the conclusion of this proceeding.

13. Q. Is PECO proposing to increase each class' fixed distribution service charge by the same percentage as the average increase for the class?

A. No, it is not. As shown on PECO Exhibits MK-1 and MK-3, PECO is proposing to increase residential fixed distribution charges by a greater percentage than the proposed overall revenue increase for the class in order to reduce the disparity between its current fixed distribution service charge and the customer-related costs that properly should be recovered by that charge. PECO is proposing that the fixed distribution service charges for other classes should be increased in the same manner to better align with customer-related costs.

14. Q. Why is it important to increase fixed distribution service charges so that they will be closer to the customer-classified costs?

A. Customer-classified costs are, by definition, costs that vary in relation to the number of customers, not usage or demand. Such costs include, principally, but not exclusively, the cost of meters, customer service lines, billing and meter reading. As a consequence, customer-classified costs are, on average, the same amount for each customer within a rate class. Accordingly, customer-classified costs are appropriately recovered in the fixed distribution service charge, which is the same for each customer served under a given rate schedule. A utility should, to the extent practicable, avoid including customer-classified costs in variable distribution changes because to do so would make the recovery of customer-related costs a function of customers' electric demand and/or usage, which they are not.

Misplacing customer costs in variable distribution charges has three adverse consequences. First, it can create inappropriate intra-class subsidies, because some customers will pay more than their share of the customer-classified costs and others less, based on their relative levels of demand or usage each month. Second, because customer costs, which are a fixed amount per customer, would be recovered in a charge that applies to demand or usage, which varies, the Company could recover either too little or too much of its customer-related costs as a consequence of variations in customer demand or usage. Finally, with advances in new technologies increasing the potential for customer bypass, it is more important than ever that the appropriate levels of fixed costs are recovered through fixed charges to avoid intra-class subsidies.

In summary, putting customer costs in the wrong element of a rate can be unfair to both customers and the utility. For these reasons, among others, customer-related costs in a utility's cost-of-service should be charged to customers in a manner that appropriately reflects the nature of the costs incurred subject to consideration of the principle of gradualism.

III. RESIDENTIAL RATE CHANGES

15. Q. What residential rate change is PECO proposing?

A. PECO is proposing a residential fixed distribution service charge of $12.50 per month (including $0.01 for consumer education). As I previously explained, the fixed distribution service charge proposed by the Company will be closer to, but still less than, the customer-related costs identified by Ms. Ding in PECO Exhibit JD-5. Ms. Ding performed the Company's customer-cost analysis in the same manner as the customer-cost analysis presented by PPL Electric Utilities Corporation ("PPL Electric Utilities") in its 2012 electric base rate case, where its analysis was accepted and relied upon by the Administrative Law Judge and the Commission as the basis for the customer charges they approved in that case.[1]

Moreover, PECO's current residential fixed distribution service charge of $8.45 per month is lower than the residential customer charges of all but one of the six other major electric distribution companies in Pennsylvania, as shown on PECO Exhibit MK-3. PECO's proposed fixed distribution service charge is well within the range of the customer charges of other major Pennsylvania electric distribution companies and, in fact, is $4.61, or 36.9%, below PPL Electric Utilities' customer charge of $17.11.

Once the fixed distribution service charge was established, the revenue to be recovered from that charge was deducted from the total revenue target for the residential class to determine the revenue to be recovered in the variable distribution service charge. The variable distribution service charge was changed to recover the balance of the residential class revenue not recovered by the fixed distribution service charge.

[1] *Pa. P.U.C. v. PPL Elec. Util. Corp.*, Docket No. R-2012-2290597, Recommended Decision (Oct. 19, 2012), pp. 118-120, and Final Order (Dec. 28, 2012), p. 131.

16. Q. Was the same general approach to rate design that you explained above for residential rates employed for the other rate classes?

A. Yes, it was. Fixed distribution service charges were changed to better reflect customer-related costs, and the variable distribution service charges of each rate schedule were changed to recover the remaining revenue in order to reach the class revenue target. Like the fixed distribution service charge for the residential class, fixed distribution service charges for other classes were designed to recover a greater proportion of each class' customer-related costs that were identified in PECO Exhibit JD-5.

IV. PROPOSED CHANGES IN THE DESIGN OF RATE HT

17. Q. Is PECO proposing any changes in Rate HT other than increases in the fixed and variable distribution service charges?

A. Yes, PECO is proposing to increase the High Voltage Distribution Discount for customers on Rate HT that receive service at voltages of 69 kV and higher, which will further reduce their rates. For customers served at 69 kV, the High Voltage Distribution Discount would increase from $0.48 to $1.29 per kW for the first 10,000 kW of measured demand. For customers served at voltages higher than 69 kV, the High Voltage Distribution Discount would also increase from $0.48 to $1.29 per kW for the first 100,000 kW of measured demand.

18. Q. Why is PECO proposing to increase the High Voltage Distribution Discount?

A. As explained by Ms. Ding in PECO Statement No. 6, the Company analyzed the configuration of customers served at 69 kV or higher to more clearly define the portion of substation facilities serving a distribution function they are using. PECO is proposing to increase the High Voltage Distribution Discount to provide an offset to those customers to reflect an appropriate allocation of distribution substation costs.

19. Q. How was the proposed increase to the High Voltage Distribution Discount calculated?

A. The proposed increase to the High Voltage Distribution Discount for customers served at 69 kV and higher is based on the level of distribution substation costs, including administrative and general expense and common and general plant. Those costs were isolated in the COS Study for Rate HT. Additional detail showing the calculation of the High Voltage Distribution Discounts is provided in PECO Exhibit JD-10.

V. EXISTING RIDERS BEING REVISED

20. Q. What existing riders does PECO propose to revise?

A. PECO is proposing to revise the Night Service GS Rider, the Night Service PD Rider and the Night Service HT Rider (collectively, the "NSRs").

21. Q. What are the NSRs?

A. The NSRs are riders that apply to eligible customers served on Rates GS, PD and HT for demand registered in off-peak hours that exceeds their demand during on-peak hours (as defined in the NSRs). Off-peak demand in excess of on-peak demand is billed at a demand charge that is lower than the Variable Distribution Service Charge under the customer's applicable rate schedule. A customer that qualifies for an NSR would, however, still be billed the Variable Distribution Service Charge for the demand it registers during on-peak periods. The NSRs recognize that peak demands registered by an eligible customer during off-peak hours do not drive the size – and, therefore, the cost – of certain facilities in the distribution system. Consequently, as explained in more detail by Ms. Ding in PECO Statement No. 6, the demand charges under the NSRs were calculated by excluding costs associated with facilities the size of which is not affected by a customer's off-peak demand, such as substations, which are sized to meet on-peak demand.

22. Q. How does PECO propose to change the NSRs?

A. In general, the demand charge of each NSR will be increased to better reflect the cost of off-peak demand calculated by Ms. Ding in the Company's COS Study. The off-peak demand cost calculated for the Night Service GS Rider is materially higher than the current Night Service GS Rider's demand charge. Therefore, to mitigate the impact on customers that use the Night Service GS Rider, PECO is proposing to continue the phase-in of the demand charge for that Rider, which was begun in its 2015 base rate case. Specifically, as part of the Company's last rate case, PECO increased the demand charge for the Night Service GS Rider from $1.03 per kW to $2.39 per kW of off-peak billing demand to implement that phase-in. As proposed, the demand charge for the Night Service GS Rider will be $3.00 per kW of off-peak billing demand versus an indicated cost of $4.79 per kW.

The off-peak demand cost calculated for the Night Service PD Rider is also materially higher than the current Night Service PD Rider's demand charge. As a result, PECO is proposing a demand charge for the Night Service PD Rider of $3.00 per kW of off-peak billing demand even though the indicated cost is $4.01 per kW. The demand charge proposed for the Night Service HT Rider aligns with the costs of providing off-peak service indicated by the Company's COS Study as shown on PECO Exhibit JD-6.

VI. CUSTOMER ASSISTANCE PROGRAM FIXED CREDIT OPTION TRANSITION COST RECOVERY

23. Q. Please briefly describe the genesis of PECO's CAP in-program arrearage forgiveness program.

A. On July 8, 2015, the Commission approved a settlement of the Company's CAP Design Proceeding at Docket No. M-2012-2290911. As part of that settlement, PECO agreed to propose an arrearage forgiveness program for its CAP customers. In broad terms, the program recognizes that PECO's CAP customer population has accumulated significant arrearages since entering the CAP program (known as "in-program arrearages" or "IPA"). In Docket No. M-2012-2290911, the parties also agreed that PECO would move to a new CAP design, known as the FCO, beginning in October 2016. The FCO is closely aligned with the Commission's affordability guidelines and is designed to provide affordable bills to PECO's CAP customers. However, large IPAs are an obstacle to achieving the goal of affordability because FCO bills plus payments required under payment arrangements to eliminate a large arrearage will impose financial obligations that are not affordable for CAP participants. Therefore, as part of the CAP design settlement, PECO agreed that, in its 2015 base rate case, it would propose an arrearage forgiveness program for its CAP customers.

24. Q. Did PECO implement a CAP arrearage forgiveness program under the terms of the 2015 rate case settlement?

A. Yes. The arrearage forgiveness provisions of the settlement divide financial responsibility for the accumulated IPAs by PECO's CAP customer population among three groups: (1) the CAP customers; (2) PECO – and, more specifically, PECO's shareholders; and (3) other residential customers. Each will be responsible for one-third of the accumulated arrearage, on a pro forma basis.

For each customer who was a CAP participant when PECO transitioned to the FCO program in October 2016, PECO determined the amount, if any, of that customer's IPA balance (the "Final IPA Balance"). PECO entered into a 60-month payment arrangement for an amount equal to one-third of that customer's Final IPA Balance. For each dollar of the customer's Initial IPA Balance that the customer pays via its payment arrangement or otherwise, the customer's Initial IPA balance will be reduced by an additional $2.00.

25. Q. Please describe the cost recovery mechanism for IPA forgiveness set forth in the 2015 base rate case settlement.

A. PECO guaranteed that it will not seek rate recovery of an amount equal to one-third of the collective final IPA balances of all CAP customers ("System Final IPA

Balance") in October 2016. As noted above, responsibility for that balance will be shared three ways and CAP customers will be assigned a share. The charge to recover the share for which a CAP customers is responsible is placed on the CAP customer's bill pursuant to the 60-month payment arrangement described above. The share borne by other residential customers is to be recovered through a $2 million base rate allowance ("2015 Base Rate Case Allowance") and a Universal Service Fund Charge ("USFC") matching amount. In particular, whenever a CAP customer makes a payment of $1.00 toward its IPA payment arrangement balance, PECO includes $1.00 for recovery through the USFC (the "USFC Matching Amounts"). PECO will forgive the remaining one-third as the share borne by it and its shareholders.

26. Q. Has PECO determined the System Final IPA Balance in the manner set forth in the 2015 rate case settlement?

Yes. As of October 14, 2016, when the FCO CAP design was implemented, the System Final IPA Balance amounted to approximately $30.1 million. In accordance with the 2015 rate case settlement, commencing with its USFC filing effective date, PECO applied a USFC correction factor to the 2015 Base Rate Case Allowance equal to the System Final IPA Balance divided by PECO's 2015 rate case IPA claim of $44.5 million. This formula was used to calculate an adjustment as shown on Exhibit MK-4 (the "USFC Adjustment") to ensure that the net sum of the 2015 Base Rate Case Allowance and the USFC Adjustment are the same ratio as the 2015 Base Rate Case Allowance divided by the 2015 base rate claim of $44.5 million.

27. Q. What expense adjustment is being proposed to reflect the implementation of the IPA forgiveness program?

A. PECO has made a pro forma adjustment of $3.6 million to add to the annual base rate expense in its FPFTY revenue requirement. This adjustment is reflected in PECO Exhibit BSY-1, Schedule D-11, and represents a three-year amortization of the portion of the System Final IPA Balance that PECO may recover from all residential customers as explained by Mr. Yin in PECO Statement No. 3. The amount being amortized, $10.9 million, is equal to two-thirds of the System Final IPA Balance, net of the following: (1) all revenues received through the 2015 Base Rate Case Allowance, as adjusted by the USFC correction factor; (2) all amounts paid by CAP customers toward their IPA payment arrangement balances; and (3) the USFC Matching Amounts. If PECO recovers more than two-thirds of the System Final IPA Balance, PECO will credit any accumulated over-collections back through its annual USFC filing. Additional detail showing the basis of the pro forma adjustment for the System Final IPA Balance is provided in PECO Exhibit BSY-1, Schedule D-11.

28. Q. Will the Company's proposed expense adjustment change the low-income customer experience with CAP in-program arrearage forgiveness?

A. No. The IPA forgiveness program will continue to operate just as it has been operating. Low-income customers who have a Final IPA Balance will continue to owe 1/60th of that balance on each monthly bill, and as they pay those amounts they will receive forgiveness of $2.00 for each $1.00 paid toward the Final IPA Balance. PECO's proposal only affects recovery of program costs; it does not affect the operation of the CAP IPA forgiveness program or the customer experience with the program.

VII. REVENUE EFFECT BY RATE SCHEDULE, PROOF OF REVENUES, AND SCALE-BACK

29. Q. Have you prepared a summary of revenue at present and proposed rates for each rate class?

A. Yes. PECO Exhibit MK-5 shows the revenue at both present rates and proposed rates, as well as the percentage increases each class will experience on an overall basis (cost of generation included).

30. Q. Have you prepared proofs of revenue with respect to PECO's present and proposed rates?

A. Yes. PECO Exhibit MK-6 is a proof of revenue with respect to PECO's present and proposed rates, based on pro forma billing determinants for the FPFTY. This exhibit is tied to the portion of PECO Exhibit MK-1 that addresses the increased revenue that would be required.

31. Q. How does PECO propose to scale-back the proposed rates if it is granted less than the revenue increase it requested?

A. In the event it is granted less than its requested increase, PECO proposes that:

(1) The revenue increases proposed for all rate classes be reduced in proportion to the proposed increase for each class; and

(2) The fixed distribution charges for all rate classes and location charges for street lighting rate classes remain as proposed, and all other rates and charges for all rate schedules be reduced proportionately to produce the revenue target for each rate class.

VIII. CONCLUSION

32. Q. Please summarize your conclusions.

A. PECO's proposed rates reflect a reasonable allocation of the Company's proposed revenue increase and a reasonable rate design for each rate schedule. The proposed rate design changes provide for a more accurate allocation of cost recovery and reduces intra-class and cross-subsidization.

33. Q. Does this complete your direct testimony at this time?

A. Yes, it does.