PECO ENERGY COMPANY

STATEMENT OF SPECIFIC REASONS FOR PROPOSED INCREASE IN GAS RATES

PECO Energy Company ("PECO" or the "Company") is filing to increase its annual gas distribution rates by approximately $68.7 million, or 8.9% on the basis of total Pennsylvania jurisdictional gas operating revenue. In accordance with Section 1308 of the Public Utility Code, the tariff setting forth the Company's proposed rates bears an effective date of November 29, 2020. However, the Company anticipates that its requested increase will be suspended and investigated by the Pennsylvania Public Utility Commission ("PUC" or the "Commission") and, therefore, the Company does not expect that new Commission-approved rates will become effective until approximately July 1, 2021.

The reasons for the Company's proposed increase are summarized below.

Rate Increase

PECO last filed for an increase in gas base rates in March 2010.[1] Since rates were established in that case, PECO has continued to make substantial investments in new and replacement gas utility plant to ensure that customers can continue to receive the safe and reliable service they have come to expect. PECO projects that it will need to invest approximately $1.2 billion in new and replacement gas utility plant between July 1, 2020 and June 30, 2024.

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[1] *PECO Energy Company General Base Rate Filing for Gas Operations*, Docket No. R-2010-2161592, filed on March 31, 2010.

Since its last gas base rate case, PECO has carefully managed its operation and maintenance ("O&M") expenses, including taking concrete steps that reduced its bad debt expense, pension costs and other post-employment benefit costs. Indeed, excluding increases in expenses since 2010 caused by PECO's enhancement of its gas-facility mapping system and a significant increase in PA One Call requests to locate and mark its underground facilities, PECO projects that the compound annual growth rate ("CAGR") in O&M expense from 2010 through June 30, 2022, will be 1.3%, which is well below the actual and expected average annual rates of inflation for the same period. Nonetheless, the CAGR in PECO's O&M expense would only be 1.9% even if the increases in gas mapping and PA One Call facility location expenses were included.

Notwithstanding PECO's aggressive efforts to manage its gas operations efficiently and contain O&M expenses, after ten years, based on PECO's review of its gas operations' current and projected financial results, an increase in gas distribution revenues is needed and cannot be achieved without an increase in rates. Significantly, the per-customer usage of PECO's residential class has generally declined year-over-year and currently remains below the levels experienced in 2011.

Absent rate relief, the Company's overall rate of return at present rates is projected to be only 5.73% for the fully projected future test year ("FPFTY"), as shown in Schedule A-1 of PECO Exhibit MJT-1. More importantly, the indicated return on common equity under present rates is anticipated to be only 7.26%, which is inadequate by any reasonable standard and far less than required to provide the Company with a reasonable opportunity to attract capital.

Without the requested rate relief, PECO's financial results would deteriorate even further following the FPFTY. This would jeopardize the Company's ability to appropriately invest in the infrastructure needed to maintain and improve its safety, reliability and customer-service levels. It would also have an adverse impact on PECO's credit-coverage ratios and negative implications with respect to maintaining the Company's current credit ratings, which would increase its financing costs.

The requested rates would produce a 7.70% return on the Company's claimed measures of value and a return on its common equity of 10.95%. These return levels are recommended by Mr. Paul R. Moul (PECO Statement No. 5), the Company's cost-of-capital consultant and an expert on the subject of rate of return. Mr. Moul's rate of return recommendations are set forth in PECO Exhibit PRM-1 and are summarized in the following table:

	Ratio	**Cost Rate**	**Weighted Cost**
Long-Term Debt	46.62%	3.97%	1.85%
Common Equity	53.38%	10.95%	5.85%
Total	100%		7.70%

Mr. Moul proposes a 10.95% return on common equity for this case based on his analysis of the Company's cost of capital and its superior management performance. The factors exhibiting PECO's superior management performance are described in the testimony of Mr. Ronald A. Bradley, PECO's Vice President of Gas (PECO Statement No. 1).

Supporting Data

PECO is filing all of the supporting data required by the Commission's regulations, including data for the historic test year ("HTY") ended June 30, 2020, the future test year ("FTY") ending June 30, 2021, and the FPFTY ending June 30, 2022. Because the Company is basing its claim principally on the level of operations for the FPFTY, the discussion that follows will address FPFTY data.

The revenue and expense claims for the FPFTY have been prepared in accordance with accepted practices of the Commission. Operating revenues at present rates were derived from budgeted revenues for PECO's gas operations for the twelve months ending June 30, 2022 and adjusted in the manner summarized on Schedule D-5 of PECO Exhibit MJT-1. Principal revenue adjustments include annualizing revenues for changes in the number of customers and the discounts provided to customers in PECO's Customer Assistance Program; eliminating revenues associated with off-system sales and PECO's asset-optimization initiatives; eliminating the margin on Rate IS sales that is accounted for in PECO's Purchased Gas Cost adjustment; and increasing revenue to reflect a normalized annual service period containing 365.25 days.

Pro forma FPFTY operating expenses were developed from PECO's budget for gas operations for the twelve months ending June 30, 2022. Budgeted expenses were prepared based on the business activities and related cost categories of PECO's gas division (e.g., payroll, pensions, employee benefits). The expenses were distributed to the accounts identified in the Federal Energy Regulatory Commission's Uniform System of Accounts for Natural Gas Companies based on the expense distribution experienced by the Company during the HTY. The budget data, as distributed to FERC accounts, were annualized or normalized in accordance with established Commission ratemaking practices, and other appropriate adjustments were made, all of which are set forth in Schedules D-6 through D-16 of PECO Exhibit MJT-1.

Annual depreciation expense for gas and common plant in service at June 30, 2022, was calculated using the remaining life method, which the Commission has previously approved for PECO's gas operations. PECO's claim for the estimated annualized depreciation accrual associated with gas plant in service at June 30, 2022 is set forth in Schedule D-17 of PECO Exhibit MJT-1. The manner in which PECO developed its claimed annual accrual is described by Caroline Fulginiti in PECO Statement No. 4.

Income taxes were calculated using procedures commonly accepted by the Commission and reflect the tax rates and other tax changes enacted by the Tax Cuts and Jobs Act, which became effective on January 1, 2018. The interest expense deduction was synchronized with the Company's measures of value and claimed weighted average cost of long-term debt. The normalization method was used to reflect the tax-book timing differences associated with the use of accelerated methods of tax depreciation to the extent permitted by the Commission and appellate precedent. In addition, there are adjustments to other tax-book differences and flow-through amounts. Tax expense was reduced to reflect the amortization of the unamortized investment tax credits and to flow back "excess" accumulated deferred tax liabilities created by the reduction in the federal corporate income tax rate as of January 1, 2018. The income tax expense claims for the FPFTY at present rate and proposed rate revenue levels are shown on PECO Exhibit MJT-1, Schedule D-18.

PECO's measures of value reflect the Company's balances of gas plant at June 30, 2022, including common plant used in, and appropriately allocated to, gas operations, as shown in Schedules C-1, C-2, C-3 and C-8 of PECO Exhibit MJT-1. The estimated original cost of gross plant at June 30, 2022 was developed by taking the original cost of gross plant at June 30, 2020, and adding the estimated plant additions during the 12 month period ending June 30, 2021 and June 30, 2022, and subtracting the estimated plant retirements during the 12 month period ending June 30, 2021 and June 30, 2022. The estimated accumulated book reserve at June 30, 2022 was calculated in similar fashion. Specifically, the accumulated book reserve at June 30, 2020 was brought forward to June 30, 2022 by adding the estimated annual depreciation accrual for the 12 month period ending June 30 2021 and June 30, 2022; subtracting the estimated plant retirements during the 12 month period ending June 30, 2021 and June 30, 2022; and adding the estimated cost of removal net of salvage that is closed to the accumulated book reserve at June 30, 2021 and June 30, 2022. The depreciated original cost of utility plant in service, cash working capital, pension asset, materials and supplies, and gas storage inventory were included in the determination of the measures of value, while accumulated deferred Federal income taxes, a 13-month average of customer advances, and a 13-month average of customer deposits were deducted from measures of value.

As is evident from the foregoing and the extensive supporting data filed by the Company, the proposed increase is just and reasonable and is the minimum increase necessary to enable the Company to earn a reasonable return on the fair value of its property that is used and useful in the public service, to maintain the integrity of its existing capital, and to attract new capital.

Rate Structure and Rate Design

As Mr. Joseph A. Bisti (PECO Statement No. 7) explains, in developing its rate-structure proposal, the Company considered the results of a cost of service study performed by Ms. Jiang Ding (PECO Statement No. 6). While the cost of service study was used as a guide, the Company also considered the principle of gradualism that has traditionally been applied in Pennsylvania. Accordingly, the proposed rates were designed to mitigate the impact on each major rate class, to the extent practicable, while still making meaningful movement toward the system average rate of return.

PECO proposes certain changes in rate design, which include principally aligning fixed distribution/customer charges with, or closer to, customer-classified costs. Certain other changes in rate design and in the rules, regulations and riders set forth in the Company's tariff are described in the testimony of Mr. Bisti and Mr. Richard A. Schlesinger (PECO Statement No. 8).

Energy Efficiency Programs

As part of this case, PECO is proposing to spend up to $4.5 million on expanded and enhanced energy efficiency programs for residential customers. The Company estimates that the expanded programs will provide rebates and appliance upgrade opportunities for up to three times more residential customers than the existing programs and provide up to ten times the existing level of natural gas savings. The greater level of participation will be driven by increased customer awareness of rebate opportunities due to enhanced marketing, the significant number of new rebate opportunities, and the implementation of a Safe and Efficient

Heating Program for qualifying low-income customers. Ms. Doreen L. Masalta discusses the program changes in detail in PECO Statement No. 9.

Community Involvement

PECO also has a strong and continuing tradition of community involvement. The Company's corporate citizenship efforts are designed to improve the quality of life for the people who live and work in PECO's service territory, and include support for education and the environment, sponsorships, employee volunteer activities, and executive involvement on outside nonprofit boards.

Summary

The requested increase in revenues is the minimum necessary to enable the Company to appropriately invest in the infrastructure needed to maintain and improve its safety, reliability and customer-service levels; to maintain the integrity of PECO's existing capital; to attract additional capital at reasonable costs; and to have an opportunity to achieve a fair rate of return on its investment in property dedicated to public service. The Company's proposed revenue allocation and rate design are just, reasonable and non-discriminatory. Accordingly, the Company's proposed rates, rules and terms of service should be permitted to become effective as filed.

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