PECO ENERGY COMPANY

STATEMENT OF SPECIFIC REASONS FOR PROPOSED INCREASE IN ELECTRIC RATES

PECO Energy Company ("PECO" or the "Company") is filing to increase its electric delivery rates by approximately $82 million, or 2.2% on the basis of total Pennsylvania jurisdictional 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 May 28, 2018. 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 January 1, 2019.

PECO's proposed rate increase reflects $71 million savings in 2019 from changes in federal income tax law made by the Tax Cuts and Jobs Act (the "TCJA"), which became effective on January 1, 2018. PECO is also proposing to refund the amount of PECO's reduced tax expense in 2018 which PECO projects to be approximately $68 million under its existing rates. The 2018 refund would be returned to customers expeditiously through a reconcilable surcharge mechanism proposed as part of these proceedings.

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

Rate Increase

PECO last filed for an increase in electric base rates in March 2015.[1] Since rates were established in that case, PECO has continued to make substantial investments in new and replacement utility plant to ensure that customers can continue to receive the safe and reliable service they have come to expect. Between January 1, 2016 and December 31, 2019, the end of the fully projected future test year, PECO will have invested over $1.9 billion in additional electric distribution plant.

PECO has carefully managed bad debt expense, post-employment benefits and other operation and maintenance ("O&M") expenses. Indeed, when adjusted for major storms, PECO projects a 0.4% compound annual growth rate in O&M expense from 2016 through the end of 2019. These annual increases are well below the expected rate of inflation for the same period. The projected compound annual growth rate would increase to 1.7% if the variable expenses associated with major storms (using PECO's five-year average of historic storm damage expense) were included.

Notwithstanding PECO's aggressive cost-containment and management efforts, after three years, based on PECO's review of current and projected financial results, an increase in electric-delivery revenues is needed and cannot be achieved without an increase in rates. In fact, load growth from 2016 to 2017 has declined by 0.5%, notwithstanding the fact that the number of customers has increased by 0.8% during the same period. Load growth from 2017-2019 is expected to remain relatively flat with a compound annual growth rate of 0.1%

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[1] *PECO Energy Company General Base Rate Filing for Electric Operations*, Docket No. R-2015-2468981, filed on March 27, 2015.

notwithstanding customer growth of 0.8%.

Absent rate relief, the Company's overall rate of return at present rates is projected to be only 5.84% for the fully projected future test year, as shown on Schedule A-1 of PECO Exhibit BSY-1. More importantly, the indicated return on common equity under present rates is anticipated to be only 7.30%, 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 in 2020 and thereafter. 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 7.79% 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	46.61%	4.16%	1.94%
Common Equity	53.39%	10.95%	5.85%
Total	100%		7.79%

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, as described in the testimony of Mr. Michael A. Innocenzo, PECO's Senior Vice President and Chief Operating Officer (PECO Statement No. 1).[2]

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 December 31, 2017, the future test year ("FTY") ending December 31, 2018, and the fully projected future test year ("FPFTY") ending December 31, 2019. 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 electric operations for the year ending December 31, 2019, adjusted in the manner shown on Schedule D-5 of PECO Exhibit BSY-1. Principal revenue adjustments include the removal of revenues related to portions of the Company's

[2] Effective March 31, 2018, Mr. Innocenzo will become President and Chief Executive Officer of PECO.

business that are not subject to the jurisdiction of the Commission, decreased revenues resulting from the implementation of Act 129 energy efficiency programs, the removal of revenues billed under the surcharges (i.e., non-base rate revenue) that recover the cost of implementing the Company's energy efficiency and conservation programs pursuant to Act 129, and the annualization of changes in number of customers.

Pro forma FPFTY operating expenses were developed from PECO's 2019 budget for electric operations. Budgeted expenses, which were prepared based on business activities and related cost elements such as payroll, employee benefits, etc., were distributed to FERC accounts based on the 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 included in Schedule D of PECO Exhibit BSY-1. The necessary adjustments were made to the appropriate FERC accounts.

Annual depreciation expense for electric and common plant in service at December 31, 2019, was calculated using the remaining life method, which the Commission has previously approved for PECO's electric operations. PECO's claim for the estimated annualized depreciation accrual is set forth in Schedule D-17 of PECO Exhibit BSY-1 and is described in PECO Statement No. 3.

Income taxes were calculated using procedures commonly accepted by the Commission and reflect the tax rates and other tax changes enacted by the TCJA. 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 BSY-1, Schedule D-18.

PECO's measures of value reflect the Company's balances of electric plant at December 31, 2019, including common plant used in, and appropriately allocated to, electric operations, as shown in Section C of PECO Exhibit BSY-1. The estimated original cost of gross plant at December 31, 2019 was developed by taking the original cost of gross plant at January 1, 2018, and adding the 2018 and 2019 estimated plant additions and subtracting the 2018 and 2019 estimated plant retirements. The estimated accumulated book reserve at December 31, 2019 was calculated in similar fashion. Specifically, the accumulated book reserve at December 31, 2017 was brought forward to December 31, 2019 by adding the 2018 and 2019 estimated annual depreciation accrual; subtracting the 2018 and 2019 estimated plant retirements; and adding 2018 and 2019 estimated cost of removal net of salvage that is closed to the accumulated book reserve. The unamortized balance of Automated Meter Reading ("AMR") investment, a pension asset, materials and supplies and cash working capital 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. Mark Kehl (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: (1) aligning fixed distribution/customer charges with, or closer to, customer-classified costs; and (2) increasing the voltage discounts for customers served at 69 kV or higher to provide an offset to those customers to reflect an appropriate allocation of distribution substation 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. Kehl and Mr. Richard A. Schlesinger (PECO Statement No. 8).

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.