BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER AND LIGHT COMPANY FOR AN INCREASE IN ELECTRIC BASE RATES AND MISCELLANEOUS TARIFF CHANGES (Filed March 22, 2013)	]]]]	PSC DOCKET NO. 13-115

DIRECT TESTIMONY OF ANDREA C. CRANE
ON BEHALF OF THE
DELAWARE DIVISION OF THE PUBLIC ADVOCATE

FILED: August 16, 2013

TABLE OF CONTENTS

Appendix A - List of Prior Testimonies
Appendix B - Supporting Schedules
Appendix C - Referenced Data Requests

I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 90 Grove Street, Suite 211, Ridgefield, Connecticut 06877. (Mailing Address: PO Box 810, Georgetown, Connecticut 06829.)

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

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989. I became President of the firm in March 2008.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 350 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony since January 2008 is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On March 22, 2013, Delmarva Power and Light Company ("DPL" or "Company") filed an Application with the Delaware Public Service Commission ("PSC" or "Commission") seeking a base rate increase of $42.04 million. The Company's request was based on a Test Year and Test Period ending December 31, 2012. The Company stated in its Application that its request would result in an increase of approximately 7.38% in annual electric revenues. However, it is only the Company's base distribution revenues that are at issue in this base rate case. Revenues related to recovery of electric supply costs are not an issue in this case, since those costs are not addressed through the base rate case process. Therefore, DPL's request will actually result in an electric distribution revenue increase of approximately 23% on base distribution rates.

The Columbia Group, Inc. was engaged by The Delaware Division of the Public Advocate ("DPA") to review the Company's Application and to provide recommendations to the PSC regarding the Company's revenue requirement claim. In developing my recommendations, I have relied upon the cost of capital and capital structure testimony of David C. Parcell of Technical Associates. Testimony on behalf of the DPA is also being filed by David Dismukes of Arcadian Consulting on issues relating to reliability, class cost of service, and rate design.

Q. What are the most significant issues in this rate proceeding?

A. The most significant issues driving the rate increase request are the Company's claim for a cost of equity of 10.25%; the Company's proposals to include CWIP, post-test year plant additions and a prepaid pension asset in rate base; recovery of both prospective and deferred costs relating to Automated Meter Infrastructure ("AMI"), Dynamic Pricing, and Direct Load Control programs; and salary and wage increases through October 30, 2014. DPL's last electric base rate case was resolved by a settlement among the parties, whereby rates were increased by $22 million. That settlement was approved by PSC Order 8265 issued on

December 18, 2012. That case was based on a Test Year and Test Period ending December 31, 2011.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning the Company's revenue requirement and its need for rate relief?

A. Based on my analysis of the Company's filing, its responses to data requests, and other documentation in this case, my conclusions are as follows:

1. The twelve months ending December 31, 2012 is a reasonable Test Period to use in this case to evaluate the reasonableness of the Company's claims.
2. Based on the testimony of Mr. Parcell, the Company has an overall cost of capital for its electric operations of 7.09%.
3. DPL has pro forma rate base of $553.67 million (see Schedule ACC-3). [1]
4. The Company has pro forma electric operating income at present rates of $34.97 million (see Schedule ACC-16).
5. DPL has a pro forma electric base distribution revenue deficiency of $7.31 million (see Schedule ACC-1). This is in contrast to the Company's claimed revenue deficiency of $42.04 million.

[1] Schedules ACC-1 and ACC-39 are summary schedules, ACC-2 is a cost of capital schedule, ACC-3 to ACC-15 are rate base schedules, and ACC-16 to ACC-38 are operating income schedules.

IV. COST OF CAPITAL AND CAPITAL STRUCTURE

Q. What is the cost of capital and capital structure that DPL is requesting in this case?

A. The Company utilized the following capital structure and cost of capital in its filing:

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	50.78%	4.91%	2.49%
Common Equity	49.22%	10.25%	5.04%
Total	100.00%		7.53%

Q. What is the capital structure and overall cost of capital that DPA is recommending for DPL?

A. Based on the recommendation of Mr. Parcell, DPA is recommending an overall cost of capital for DPL of 7.09%, based on the following capital structure and cost rates:

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	50.78%	4.91%	2.49%
Common Equity	49.22%	9.25%	4.60%
Total	100.00%		7.09%

Mr. Parcell's recommendation reflects the Company's proposed capital structure and cost of debt. However, he is recommending a lower cost of equity than the 10.25% requested by DPL. I utilized Mr. Parcell's recommended overall cost of capital of 7.09% to determine the Company's pro forma required income based on my recommended rate base, as shown on summary Schedule ACC-1. I then compared this required income to pro forma income at present rates to determine the Company's need for rate relief. As shown on Schedule ACC-1, my recommendations indicate that the Company currently has an electric base distribution revenue deficiency of $7.31 million.

V. RATE BASE ISSUES

A. Utility Plant-in-Service

Q. How did DPL determine its utility plant-in-service claim in this case?

A. The Company began with its utility plant-in-service balances at December 31, 2012, the end of both the Test Year and Test Period in this case. DPL then made an adjustment to include "reliability" plant additions through December 31, 2013.

Q. Are you recommending any adjustment to the Company's claim for utility plant-in-service?

A. Yes, I am recommending that the PSC eliminate all post-test year plant additions from the Company's rate base. DPL's post-test year plant adjustment increases rate base by $66.79 million. This post-test year plant adjustment, including the associated depreciation expense adjustment, is responsible for approximately $9.17 million (or almost 22%) of the Company's total claim in this case. The Company's adjustment results in a mismatch of the components of the regulatory triad used to set rates in this case. While the Company included post-test year plant additions through December 31, 2013, neither its depreciation reserve claim nor its claim for the deferred income tax reserve include reserve additions through December 31, 2013. Nor did the Company include revenues associated with growth in either customers or usage after December 31, 2012 in its rate case claim.

Q. Please comment on Mr. Ziminsky's statement that his adjustment is consistent with the PSC's decision in PSC Docket No. 09-414.

A. While the PSC did permit the inclusion of post-test year plant in rate base in the last electric case, the Order in PSC Docket No. 09-414 states that the PSC's decision was issued "under the circumstances of this case."[2] In the past, DPL has traditionally used average plant balances to develop its rate base claim. In the current case, the Company's plant is based on end-of-test year balances and therefore are already more prospective than those used in prior cases. I have accepted the use of test year-end balances to determine rate base. But including additional post-test year adjustments would unfairly burden ratepayers with an additional $9.17 million in higher rates without consideration of other components that will offset the revenue requirement associated with DPL's plant additions.

For example, in the Test Year, DPL added $27.44 million of depreciation to its accumulated depreciation reserve, which is a reduction to rate base. In 2013, reserve additions are expected to be even higher. These reserve additions will serve to lower the Company's revenue requirement – but the Company did not make an adjustment to reflect this lower revenue requirement.[3] Similarly, increases to the deferred income tax reserve, another rate base deduction, also serve to offset the revenue requirement associated with

2 Order 8011 in PSC Docket No. 09-414, August 9, 2011, paragraph 60.

3 DPL did include additions to both its depreciation and deferred income tax reserves associated with its post-test year plant, but it failed to include reserve additions associated with the plant that was in service at 12/31/13.

utility plant additions – but the Company did not make an adjustment to reflect this lower revenue requirement. Increases in customers and usage would also help to offset increased revenue requirements associated with new plant – but the Company did not make any adjustments for increased customers or usage.

In addition, plant additions through December 31, 2013 are not known and measurable. This Commission has allowed post-test year adjustments that are reasonably known and measurable, but generally has drawn the line at those that are merely speculative.

Given the Company's use of a test year-end rate base, the fact that its post-test year additions are speculative rather than known and measurable, and the fact that the Company did not make similar adjustments to other components that serve to reduce its revenue requirement, I recommend that the PSC reject the Company's claim to include post-test year additions in rate base. My adjustment is shown in Schedule ACC-4.

B. Construction Work in Progress ("CWIP")

Q. What is CWIP?

A. CWIP is plant that is being constructed but which has not yet been completed and placed into service. Once the plant is completed and serving customers, then the plant is booked to utility plant-in-service and the utility begins to take depreciation expense on the plant. Inclusion of CWIP in rate base creates a mismatch among the ratemaking components utilized for the Test Period, since it represents plant that was not actually serving customers during the Test Period. Thus, including CWIP in rate base overstates the plant necessary to provide service to those customers who were served during the Test Period and on whom the Company's revenue claim is based.

Q. What CWIP has the Company included in its rate base claim?

A. DPL included its December 31, 2012 CWIP balance of $70.15 million in its proposed rate base. This claim increases the Company's revenue requirement by approximately $7.71 million. Thus, the inclusion of CWIP in rate base is responsible for over 18% of the Company's claim in this case.

Q. Should CWIP be included in rate base?

A. No, I do not believe that CWIP is an appropriate rate base element. CWIP does not represent facilities that are used or useful in the provision of utility service. In addition, including this plant in rate base violates the regulatory principle of intergenerational equity by requiring current ratepayers to pay a return on plant that is not providing them with utility service and which may never provide current ratepayers with utility service.

One of the basic principles of utility ratemaking is that shareholders are entitled to a return on, and to a return of, plant that is used and useful in the provision of safe and adequate utility service. By its definition, CWIP does not meet these criteria. The Company should accrue an allowance for funds used during construction ("AFUDC") on projects until such time as the project is completed and placed into service. Since the Company is compensated for its costs in this manner, there is no need to make an exception to good ratemaking principles by allowing CWIP to be included in rate base.

The AFUDC methodology has two distinct advantages over permitting CWIP in rate base. First, it properly matches the benefits provided to ratepayers with the costs paid by those ratepayers, while allowing CWIP in rate base forces today's ratepayers to pay for plant that may never provide them with any benefit. Second, allowing CWIP in rate base transfers the risk during project construction from shareholders, where it properly belongs, to ratepayers. The shareholders will be compensated for that risk once the plant enters utility service and the AFUDC is appropriately included in rate base.

Q. Didn't the Company include an earnings offset to give ratepayers the benefit of the AFUDC earnings impact?

A. Yes; however, it should be noted that the AFUDC earnings included by DPL in this case are only a small fraction of the CWIP that the Company included in rate base. DPL is requesting inclusion of $70.15 million of CWIP but has offset that claim with only $965,309 of AFUDC. In Docket No. 09-414, one of the reasons stated by the PSC for its decision to eliminate CWIP from rate base was the wide variance between the Company's claim for CWIP and its claim for offsetting AFUDC. In the Order in Docket No. 09-414, the PSC stated that:

> In Delmarva's last electric distribution base rate case, Docket No 05-304, we exercised our discretion to exclude CWIP from rate base based on the evidence in that case that the amount of AFUDC as a percentage of CWIP was less than 2%. We concluded that including CWIP in rate base under those circumstances would have a "considerable adverse impact" on Delmarva's revenue

> requirement....
>
> The facts of this case are strikingly similar. The amount of AFUDC as a percentage of CWIP in this case is 0.2%; thus, including it in rate base would have a similar detrimental impact on Delmarva's revenue requirement as we found in Docket No. 05-304.[4]

In this case, we are once again faced with the situation where the Company's CWIP claim is significantly larger than the associated AFUDC offset. The Company's AFUDC is only 1.37% of its CWIP claim in this case, providing further support for my recommendation to eliminate CWIP from rate base.

Q. What do you recommend?

A. I recommend that the Commission reject DPL's claim to include CWIP in rate base. My adjustment to eliminate CWIP is shown in Schedule ACC-5.

C. <u>Cash Working Capital ("CWC")</u>

Q. What is CWC?

A. CWC is the amount of cash a utility needs in order to cover cash outflows between the time that revenues are received from customers and the time that expenses must be paid. For example, assume that a utility bills its customers monthly and that it receives monthly revenues approximately 30 days after the midpoint of the date that service is provided. If the Company pays its employees weekly, it will have a need for cash prior to receiving the

4 Order in Docket No. 09-414, paragraphs 67-68.

monthly revenue stream. If, on the other hand, the Company pays its interest expense quarterly, it will receive these revenues well in advance of needing the funds to pay interest expense.

Q. Do companies always have a positive CWC requirement?

A. No, they do not. The actual amount and timing of cash flows dictate whether or not a utility requires a CWC allowance. Therefore, one should examine actual cash flows through a lead/lag study in order to accurately measure a utility's need for CWC.

Q. Did the Company provide a lead/lag study in this case to support its CWC claim?

A. Yes, it did. The Company's claim is based on a lead/lag study that reflects the level of expenses being claimed in this case. The individual expense lag days are based on a review of invoices during the 2010 calendar year. Based on this study, DPL is requesting a CWC allowance of $10,911,605.

Q. Are you recommending any adjustments to the Company's CWC claim?

A. Yes, I recommend an adjustment to the expense lag used by DPL for payments to affiliated companies, including the Service Company. Expense lags are calculated based on three components: a service lag, a billing lag, and a payment lag. The service lag reflects the midpoint of the service period, so in the case of monthly billing the service lag would be 15.21 days (365 days/12/2). The billing lag is the amount of time after the end of the service period that a utility is billed, and the payment lag is the amount of time after receiving a bill that payment is made.

As shown in the response to PSC-RR-10, the Company calculated the net operating and maintenance ("O&M") expense lag by examining three types of O&M costs: payroll, affiliate transactions, and other O&M. It utilized an expense lag of 15.96 days for payroll, 14.43 days for affiliate transactions, and 35.19 days for other O&M. However, DPL is billed by affiliates monthly, on approximately the 15th business day of each month, for services provided in the preceding month. In its response to PSC-RR-94, the Company stated that:

> The intercompany billing, which would include transactions between DPL and the Service Company and other affiliates, is settled each month through the PHI Money Pool. Each month around the 15th business day, the settlement of the Intercompany Money Pool Balances (Intercompany Receivable and Payable Accounts) takes place for the preceding month.

Therefore, I am recommending that the Company's CWC claim be revised to reflect an expense lag for affiliate transactions that reflects the actual billing provisions for affiliated transactions. At Schedule ACC-6, I have made an adjustment to revise the expense lag associated with affiliated transactions to reflect an expense lag of 30.21 days. This lag is based on a service period of 15.21 days (365 days/12/2) and on a combined billing and payment lag of 15 days. The adjustment results in a $1.89 million decrease to DPL's CWC claim.

Q. Do you have any additional comments regarding CWC?

A. Yes. I have not attempted to reflect the impact of my recommended expense adjustments in my pro forma CWC recommendation. However, I recommend that the CWC requirement be updated to reflect the actual level of expenses, including interest expense, found by the PSC to be appropriate.

D. Prepayments

Q. What prepayments did the Company include in its rate base claim?

A. DPL's prepayment claim includes three components: Prepaid Pension Costs of $61,581,370, Accrued OPEB Liability of ($8,176,221), and Prepaid Insurance of $41,431. In addition, the Company's prepayment balance includes regulatory assets that the Commission approved in prior cases.

Q. Are you recommending any adjustments to the Company's claim?

A. Yes. My first two adjustments relate to the Company's claim for Prepaid Pension Costs and for Accrued OPEB Liability, both of which I recommend be eliminated from rate base. The Company first argued that Prepaid Pension Costs should be included in rate base in PSC Docket No. 05-304. In that case, the Company argued that it should be permitted to include an adjustment to rate base to compensate shareholders for the fact that the revenue requirement included a negative pension expense.

Since the adoption of Financial Accounting Standards Board No. 87 and No. 106, pension and OPEB expense have been determined on an actuarial basis. This methodology seeks to recover the cost of pension and OPEB benefits over the working lives of the employees who receive such benefits, based on assumptions about salary levels, earnings on fund balances, mortality rates, and other factors. There is a separate calculation that determines funding requirements. This Commission has adopted the actuarial methodology for determining pension and OBEP costs. In any given year, the actuarial valuation may be negative or positive. If the Company's assumptions were always 100% accurate, there would be a positive pension and OBEP expense each year. Moreover, an employee's benefits would be recognized over their working life. However, assumptions are never 100% accurate. Thus, in some years, pension (and OPEB) costs can be negative, based on the fact that assumptions in prior years overstated costs. For example, if one assumes a 5% return on investment, and actual returns are 7%, a negative expense may be booked in a subsequent year.

In PSC Docket No. 05-304, DPL included a negative pension expense in its revenue requirement. However, the Company argued that it was entitled to include an offsetting regulatory asset in rate base in order to provide a return to investors who were providing the working capital associated with the negative expense. The PSC agreed, noting "...we believe that the pre-paid pension asset is appropriately included in rate base because it is caused by a negative pension expense, which reduces base rates, resulting in rates that are lower than they otherwise might be, and at the same time creates a cash working capital requirement."[5]

5 Order No. 6930, PSC Docket No. 05-304, page 27.

Q. Is the Company proposing to include a negative pension expense in its revenue requirement in this case?

A. No, it is not. The Company no longer has a negative pension expense included in its revenue requirement. Thus, the basis for the inclusion of the pension asset in rate base is no longer valid. Accordingly, I am recommending that the regulatory asset associated with Prepaid Pension Costs be excluded from rate base. My adjustment is shown in Schedule ACC-7.

Moreover, I am also recommending that the Accrued OPEB Liability be excluded from rate base, even though in this case the Company's adjustment reduces its rate base claim. If the PSC is using actuarial values in a utility's revenue requirement, then I do not believe that it is appropriate to include any rate base components relating to true-ups of accrued versus funded liabilities. The accrual methodology already takes into account funding status. Moreover, over time the amounts contributed to the Company's pension and OPEB funds will equal its calculated accrual costs. While there will be timing differences due to variations in assumptions from year to year, and due to actual versus projected results, these variations will all be accounted for in subsequent actuarial studies. In my opinion, including rate base adjustments relating to pension and OPEB costs inappropriately combines the accrual methodology used in the actuarial studies, and which this Commission has adopted for ratemaking purposes, with the cash funding approach used by some other regulatory commissions. Accordingly, at Schedule ACC-8, I have also made an adjustment to eliminate the rate base credit of ($8,176,221) included by DPL relating to its OPEB liability.

Q. Please address the argument that a pension asset should be included in rate base because the Company has made contributions to the pension fund that represent a prepayment of pension expense.

A. A review of the derivation of the Company's pension asset shows that the asset is largely unrelated to the amount of contributions made by DPL to the pension fund. Since FAS 87 was adopted, the Company has made a total of $135 million of contributions to the pension fund. In fact, no contributions were made to the fund from the time that FAS 87 was adopted until 2009. Net earnings on the pension fund have far outpaced contributions. Over the past ten years, market returns on the fund totaled almost $1.38 billion. Thus, over the past 10 years, 90% of additions to the fund were the result of market earnings, and not contributions. Since no contributions were made from the adoption of FAS 87 through 2008, an analysis of the fund since FAS 87 was originally adopted would indicate that far more than 90% of fund additions were the result of market earnings. Thus, there is no basis for any contention that contributions to the fund have resulted in a prepayment that should be recovered from ratepayers.

Q. Do you have any other adjustments to the Company's claim for prepayments?

A. Yes. DPL included $41,431 of prepaid insurance costs in its rate base claim. However, as noted in the Company's response to PSC-RR-12, DPL also included these costs in its CWC claim, resulting in a double-counting of the prepaid insurance costs. In its response to PSC-RR-12, DPL stated that the Company would remove its $41,431 claim for prepaid insurance during the rebuttal phase of this case. Therefore, at Schedule ACC-9, I have made an adjustment to remove these prepaid insurance costs from rate base.

E. Recovery of Deferred Costs

Q. Does the Company's claim include recovery of deferred costs associated with various activities?

A. Yes, it does. The Company's rate base claim includes regulatory assets for which the Company is seeking recovery in this case. The Company has included regulatory assets relating to deferrals of Integrated Resource Plan ("IRP") costs, Bluewater Wind Request for Proposal ("RFP") costs, Dynamic Pricing ("DP") program costs, and Direct Load Control ("DLC") program costs. In addition, the Company is seeking recovery of a deferral relating to a change in the Medicare tax law.

Q. Did you attempt to utilize consistent principles when evaluating the Company's claims with regard to deferred costs?

A. Yes, I did. In evaluating the Company's claims for recovery of a regulatory asset, I evaluated factors such as the magnitude of the underlying cost, whether the PSC has previously approved deferred accounting treatment for the cost at issue, and the extent to which the program that is the subject of the deferral is successful and is currently providing service to utility customers.

Q. What general principles did you utilize in analyzing the deferred costs included in DPL's rate base claim?

A. First, I examined whether the PSC had approved the use of deferred accounting for these costs. Because of the prohibition against retroactive ratemaking, utilities should not be permitted to recover defer costs unless a regulatory agency has agreed to permit the utility to defer such costs.

Second, assuming that a utility has received approval from the regulatory commission to defer certain costs, I then reviewed the magnitude of the costs to determine whether all such costs were reasonable and appropriate. In most cases, approval of deferred accounting treatment, does not guarantee recovery of the deferred costs; regulatory commissions generally state that deferred costs will be reviewed in a future case in order to determine if the deferral should be recovered in rates, and if so, how much should be recovered. Regulation is not intended to be a reimbursement system. Rather, utility rates are established based on a Test Period concept and remain in place until the utility seeks a rate change from the regulatory agency or until the regulatory agency initiates a rate review. In the interim, the utility is responsible for managing its business in such a way as to provide safe and reliable service and to meet the requirements of its investors. Because of the inherent risk assumed by a utility's shareholders, utility rates include a return on equity that reflects a premium over a risk-free rate. In return for this cost of equity premium, shareholders are supposed to assume the risk of managing the utility between base rate case proceedings, including the risk of the utility incurring costs that were not anticipated. In most cases, approval by a regulatory agency to permit the utility to defer certain costs does not automatically authorize future recovery, but only authorizes a review of such costs in the future to determine if recovery is appropriate.

Third, in reviewing the regulatory assets included in the Company's claim, I also considered the status of the underlying project or program giving rise to the regulatory asset. If the underlying project or program is not yet substantially complete and providing benefits to customers, then I generally recommend that costs continue to be deferred until such time as the project is completed and the costs of the project can be examined in relation to the associated benefits. These are the three general principles that I have employed in reviewing the Company's claims for inclusion of regulatory assets in rate base.

1. Deferred Integrated Resource Plan ("IRP) Costs

Q. Please describe the Company's claim associated with deferred IRP costs.

A. DPL included deferred costs of $96,847 in rate base related to its IRP. These costs were partially offset by associated deferred taxes, so the net rate base adjustment is $57,474. As stated by Mr. Ziminsky on page 16 of his testimony, these costs were incurred in August 2009 and were associated with the Company's initial IRP filing. The Company claims that only costs through July 2009 were included in rates resulting from Docket No. 09-414 and therefore it is seeking recovery of these costs in this case. Moreover, the Company contends that it is authorized to recover these costs pursuant to 26 *Del. C.* §1007(c)(1)d, which states: "The costs that DP&L incurs in developing and submitting its IRPs shall be included and recovered in DP&L's distribution rates." The Company is proposing a 10-year amortization period for these costs, with rate base treatment of the unamortized balance.

Q. Do you agree with DPL's adjustment to include these costs in rate base?

A. No, I do not, for several reasons. First, there is nothing in the Order in PSC Docket No. 09-414 addressing additional IRP deferrals. The Order in that case indicates that rates include two uncontested adjustments, one relating to deferred IRP costs for the initial IRP and one relating to ongoing prospective IRP costs. Nor was there any authorization for deferral of these August 2009 IRP costs in the Order or Settlement Agreement in the Company's last electric case, PSC Docket No 11-528. Thus, there is no specific authority for a continuation of the deferral. Rather, the rates authorized in PSC Docket No. 11-528 were intended to include prospective costs associated with IRP activities. Moreover, in its Order in PSC Docket No. 06-241, which addressed the Company's initial IRP, the PSC stated that "the other initial costs incurred by Delmarva Power & Light Company in developing and submitting its IRP under the Act shall be included and recoverable in its next distribution rate case...In all subsequent cases, such costs shall be normalized as an expense in accordance with Commission practice."[6] (emphasis added). Thus, the Company was not authorized to continue a deferral of costs associated with its initial IRP. Instead, the Commission determined that recovery of such costs, to the extent required pursuant to statute, would be through normalizing annual IRP costs in future rate proceedings.

6 Order 7003 in PSC Docket No. 06-241, paragraph 7.

In addition, the magnitude of these costs does not justify a regulatory asset or the 10-year recovery period proposed by DPL. The Company's total distribution revenues in this case, at present rates, amount to $176.5 million and earnings amount to almost $30 million. The net $57,474 regulatory asset does not have a material impact on the Company's financial condition. Given the small magnitude of these costs, and the fact that the Company was not authorized to continue deferring these costs, I recommend that the Company's claim for recovery of this regulatory asset be denied. My adjustment is shown in Schedule ACC-10.

2. Deferred Bluewater Wind Request for Proposal ("RFP") Costs

Q. Please describe the Company's claim associated with deferred RFP costs.

A. DPL has included deferred costs of $48,469 in rate base related to its Bluewater Wind RFP process, which was part of its initial IRP. Given the associated offset of deferred taxes, the net rate base claim is $28,764. Similar to its claim for deferred IRP costs, DPL seeks recovery of deferred costs incurred in August 2009. Once again, the Company proposes a 10-year amortization period and rate base treatment of the unamortized balance.

Q. Do you agree with DPL's adjustment to include these deferred RFP costs in rate base?

A. No, I do not, for the same reasons expressed above with regard to IRP costs. A continuation of the deferral for RFP costs was not authorized in the Orders in either PSC Docket No. 09-414 or Docket No. 11-528. Moreover, the $28,764 rate base adjustment associated with the RFP is even smaller than the claim for other IRP costs. This cost certainly does not justify the use of deferred accounting, or recovery over a 10-year period. Asking ratepayers to pay a return on these costs for ten years ignores the fact that shareholders are supposed to take some risks associated with their investment. Given that these costs do not have a material impact on the Company's financial integrity and given the fact that the Commission did not specifically authorize a continuation of deferred accounting treatment, I recommend that the PSC deny the Company's claim for inclusion in rate base of $28,764 relating to the Bluewater Wind RFP. My adjustment is shown in Schedule ACC-11.

3. Deferred Dynamic Pricing Program Costs

Q. Please describe the Company's rate base claim relating to the DP deferral.

A. DPL has included $6,699,487 of deferred costs in rate base relating to its DP program. These costs are offset by deferred taxes of $2,632,887, for a net rate base claim of $3,843,284. This claim includes actual costs incurred by DPL as well as anticipated deferrals through December 31, 2013. The Company's claim includes costs related to customer education, outbound calls for DP events, costs for overflow customer call handling related to those events, and amortization expense associated with related systems.

Q. Did the Company receive PSC authorization to defer these costs?

A. DPL relies on Order No. 7420 for authorization to defer these costs. In that case, the Commission adopted the recommendation of the Hearing Examiner, who found that "Delmarva should offer its proposal to permit it to establish a regulatory asset to cover recovery of costs associated with the deployment of Advanced Metering Infrastructure and demand response equipment in its next base rate case. The Commission, the Staff, and other parties remain free to challenge the level or any other aspects of the asset's recovery in rates when Delmarva seeks recovery of the regulatory asset in base rates." I believe that the language of Order No. 7420 is broad enough to encompass the DP costs that are the subject of the Company's adjustment. However, the Order is also broad enough to permit the parties in this case to make a variety of recommendations with regard to cost recovery.

Q. How large was the regulatory asset associated with DP at the end of the Test Year?

A. At December 31, 2012, the regulatory asset had a balance of $413,576. However, in January 2013, the Company reclassified certain costs from the AMI regulatory asset to the DP regulatory asset. I understand that this reclassification was done in conjunction with a review by Staff. According to the response to AG-RR-165, DPL had incurred a total of $2,456,025 of costs relating to the DP program by December 31, 2012.

Q. What is the status of the DP program?

A. According to Mr. Ziminsky's testimony, DP was offered to a group of 6,904 Field Acceptance Test participants in the summer of 2012, and the Company is currently in the process of rolling it out to all of its Standard Offer Service customers. Thus, while the program is in the process of being deployed, it is my understanding that deployment is not yet complete and therefore the parties have not had the opportunity to fully assess the success of the program relative to the proposed costs.

Q. What do you recommend?

A. Since the DP program did begin during the Test Year with the field tests conducted last summer, I believe it is reasonable to permit DPL to reflect some cost recovery in the rates resulting from this case. With regard to deferred costs, I am recommending that the Company's rate base claim be limited to actual costs incurred through December 31, 2012, the end of the Test Year. My adjustment is shown in Schedule ACC-12. Additional costs that are deferred through December 31, 2013 should be evaluated once implementation is complete and the parties have more data on which to evaluate the program. Thus, the Company should continue to defer future DP program costs until the effective date of new rates in this proceeding.

As discussed in more detail later in my testimony, I am recommending that a normalized level of prospective costs associated with DP programs be included in rates resulting from this proceeding. Therefore, any deferral should end when new rates from this case become effective.

4. Deferred Direct Load Control ("DLC") Program Costs

Q. Please describe the Company's rate base claim relating to the DLC program costs.

A. The Company has included deferred costs of $9,616,281 in rate base relating to DLC program costs. These costs were offset with a deferred income tax adjustment of $3,909,499, resulting in a net rate base increase of $5,706,782. DPL did not have any deferred costs related to DLC programs at the end of the Test Year. Thus, the Company's entire claim relates to estimated costs in the post-Test Year period. DPL requests a 15-year amortization of these costs, with inclusion of unamortized costs in rate base. Once again, DPL is relying upon the Commission's approval of AMI costs in Order No. 7420 for its authority to defer these costs. In addition, Mr. Ziminsky points to the language in Order No. 8253, issued December 18, 2012, which stated:

> 5. That the Commission confirms that the language of Order No. 7420, in which the Commission "permit[ted] Delmarva to establish a regulatory asset to cover recovery of and on the appropriate operating costs associated with the deployment of Advanced Metering Infrastructure and demand response equipment," authorized Delmarva to establish a regulatory asset for costs incurred in implementing and monitoring the Cycling Program.
>
> 6. That, as stated in Order No. 7420 in Docket No. 07-28, "the Commission, Staff, and other parties remain free to challenge the level or any other aspects of the asset's recovery in rates when Delmarva seeks recovery of the regulatory asset in base rates." The burden of proof regarding any Cycling Program costs for which Delmarva may later seek recovery shall remain with Delmarva and shall not transfer to any other party as a result of our approval of the creation of the regulatory asset as set forth in Order No. 7420 (dated September 16, 2008).[7]

Q. What is the status of the DLC program?

A. According to Mr. Ziminsky's testimony, "[i]mplementation of the Direct Load Control program started late in 2012 and will continue through 2016...." Per the response to PSC-

7 Order No. 8253, PSC Docket No. 11-330, paragraphs 5-6.

RR-44, actual deployment did not begin until April 2013, well after the end of the Test Year in this case.

Q. What do you recommend?

A. Given the fact that the DLC program is still in its infancy, it is premature to provide for recovery of any of these costs at this time. Therefore, I recommend that the PSC exclude all deferred DLC program costs from the Company's rate base claim. Instead, the Company should continue to defer these costs. The parties should review these costs, either in the Company's next base rate case or in some other proceeding, to determine how much, if any, of these costs should be recovered from ratepayers and whether the Company should recover carrying costs on any deferral approved for recovery. This analysis should not occur until the DLC program is well along and the parties have the information necessary to review the success of the DLC program when they evaluate the reasonableness of the associated costs. My adjustment to remove from rate base the Company's claim for deferred DLC costs is shown in Schedule ACC-13.

5. <u>Deferred Medicare Tax Subsidy Costs</u>

Q. Please explain the Company's rate base claim for deferred Medicare subsidy costs.

A. This adjustment relates to a change in the law regarding Medicare Part D that resulted in a one-time charge to DPL of $110,507. The applicable legislation was enacted in March 2010. The Company has deferred these costs on its books of accounts. In this case, DPL is seeking a three-year recovery of these costs and to include the unamortized balance in rate base. The Company's proposed adjustment increases rate base by $54,650.

Q. Do you believe that the Company's claim is appropriate?

A. No, I do not. DPL did not request or receive Commission authorization to defer these costs when the legislation was enacted and it became known that the Company would be liable for an associated charge. Therefore, there is no basis to include these past costs in prospective rates. Permitting recovery of these costs would constitute retroactive ratemaking, given that the Company never received approval for a deferral. In addition, the magnitude of these costs is small. Shareholders should expect that from time to time they will be required to absorb unanticipated cost increases resulting from changes in tax laws or other factors. In my opinion, the net rate base costs of $54,650 and associated amortization expense does not justify the use of deferred accounting. Moreover, since the Company never received deferred accounting authorization, there is no basis to now permit the Company to include these costs in its revenue requirement. Accordingly, at Schedule ACC-14, I have made an adjustment to eliminate deferred Medicare Tax Subsidy costs from the Company's rate base claim.

F. Credit Facility Costs

Q. Please explain your recommended adjustment relating to the Company's rate base claim for credit facility costs.

A. DPL included a rate base adjustment of $520,111 and an operating expense adjustment of $337,108 relating to a short-term credit facility operated by PHI. The Company's claim includes annual recurring costs associated with the facility, as well as amortization of start-up costs. DPL requests that the average balance of unamortized costs be included in rate base and to allow shareholders to earn a return on this balance at DPL's overall cost of capital.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending that these costs be eliminated from the Company's revenue requirement. The credit facility is a source of short-term debt for DPL. According to Mr. Ziminsky's testimony at page 30, "PHI's credit facility is vital for serving the day-to-day cash needs of its companies, such as Delmarva. These costs are recorded as interest expense for financial reporting purposes of the Company; however, they are not reflected in the cost of capital for ratemaking purposes and thus would otherwise not be recovered."

Q. Has the Company given ratepayers the benefit of lower cost financing associated with the credit facility?

A. No, it has not. Neither commercial paper nor short-term debt from the PHI credit facility is included in the Company's capital structure. Therefore, there is no way for ratepayers to benefit from the short-term financing provided by the credit facility through the ratemaking process. If ratepayers are not benefitting from this credit facility, then it is unreasonable to require them to pay the associated credit facility costs.

In addition, ratepayers are already paying for the "working capital" needs that the Company claims are being funded by the credit facility. The Company's working capital requirements, including CWC, materials and supplies, and prepaid insurance, are all rate base components. Ratepayers will be paying for this working capital through rates. Thus, the Company is asking ratepayers to fund its working capital needs, and it is also asking ratepayers to fund the credit facility, without providing ratepayers with any benefit from the lower cost financing associated with the credit facility. Ratepayers pay carrying costs for the working capital included in the Company's rate base at the overall weighted average cost of capital approved by the PSC. However, the Company admits that this working capital is being financed through the credit facility, at rates that are significantly lower than the overall weighted cost of capital. According to the response to PSC-COC-9, the Company's cost of short-term debt at December 31, 2012 was 0.38%, while the Company's proposed capital structure reflects a debt cost of 4.91% and an equity cost of 10.25%.

If the Company wants to exclude short-term debt from the capital structure, then it should either: (a) exclude all credit facility costs from its revenue requirement; or (b) exclude all working capital components from rate base. It should not be permitted to recover credit facility costs while at the same time excluding this low cost financing from the capital structure and charging ratepayers for its working capital requirements. Accordingly, at Schedule ACC-15, I have made an adjustment to eliminate the unamortized PHI credit facility costs from the Company's rate base. If the Commission permits DPL to recover any of these credit facility costs from ratepayers, then the Company's capital structure should be amended to reflect the inclusion of short-term debt.

Q. If the PSC believes that the Company should recover these credit facility costs in some manner, is there a better ratemaking treatment than including credit facility costs in DPL's regulated revenue requirement, as proposed by the Company?

A. Yes, there is. In PSC Docket No. 12-546, Staff witness Peterson testified that "the proper treatment of these costs is to recognize them as an increase in the effective costs of short-term debt in the calculation of Delmarva's AFUDC rate." As Mr. Peterson noted, the Company's AFUDC rate is based on the assumption that all short-term debt is used to finance CWIP. Therefore, if short-term debt is not included in the capital structure as a permanent source of financing, then DPL could recover credit facility costs through the short-term debt rate used in the AFUDC calculation. This method would better match the costs to ratepayers with the benefit resulting from the use of short-term debt.

G. Summary of Rate Base Issues

Q. What is the impact of all of your rate base adjustments?

A. My recommended adjustments reduce the Company's rate base claim from $754,706,868, as reflected in its filing, to $553,669,028, as summarized on Schedule ACC-3.

VI. OPERATING INCOME ISSUES

A. Salary and Wage Expense

Q. How did the Company determine its salary and wage claim in this case?

A. The Company's claim is based on projected payroll costs for the twelve months from November 2013 through October 2014. As shown in the Company's workpapers, DPL began with its Test Year costs for each month of the Test Year, separately identifying union and non-union employee costs. For IBEW Local 1238 employees, the Company annualized a Test Year increase of 2.0%, and reflected annual increases of 2% effective February 2013 and March 2013. For IBEW Local 1307 employees, the Company annualized a 2.0% increase effective June 2012 and included additional 2% increases effective June 2013 and June 2014. For non-union employees, the Company annualized a payroll increase of 3.00% that was effective during the Test Year. DPL reflected an additional non-union increase of 3.0%, effective March 1, 2013, and an additional non-union increase of 3.0% effective March 1, 2014. These adjustments resulted in an increase of $1,782,036 to the Company's Test Year Delaware Distribution expense.

Q. Are you recommending any adjustment to the Company's claim for salaries and wages?

A. Yes, I am recommending that only Test Year salary and wage increases be included in the Company's revenue requirement. I recommend that these increases be annualized, to reflect what the Company's costs would have been had these increases been in effect for a full twelve months. I recommend that the Commission exclude all post-test year increases from the Company's revenue requirement.

It should be noted that the Company selected the Test Year in this case. Most of the salary and wage increases reflected in its claim reach too far beyond the end of the Test Year to be included in rates resulting from this case, especially when one considers that the Company's claim is based on the number of customers at December 31, 2012. The Company has included post-test year increases reflecting salary and wage levels through October 2014, or almost two years beyond the end of the Test Year. Its adjustments distort the regulatory triad of synchronizing rate base, revenues, and expenses. Therefore, I recommend that the PSC limit salary and wage increases to the increases that occurred during the Test Year, annualized to reflect a full year of costs. My adjustment is shown at Schedule ACC-17.

B. Incentive Compensation Program Expense

Q. Please describe the Company's incentive compensation program.

A. The Company has included $1,993,802 of non-officer incentive compensation costs in its revenue requirement claim. The majority of these costs relate to the Company's Annual Incentive Plan ("AIP"), a copy of which was provided in the response to PSC-RR-54. This plan is available to all PHI management employees that do not participate in any other incentive plan. The plan has an earnings threshold, i.e., no payments are made unless earnings meet certain targeted levels. According to the 2012 AIP Plan, "[f]or Power Delivery employees, the Power Delivery's earnings [sic] must reach a 90% threshold to qualify for any potential payout. Corporate Services employees are eligible to receive a payout only to the extent that Power Delivery and/or Non-Regulated earnings meet or exceed threshold levels and such awards shall not exceed 50% of target if PHI corporate earnings do not meet or exceed threshold levels." In 2013, the structure of the AIP plan was changed slightly, so that the awards are now funded from an Enterprise Incentive Pool ("EIP"). Starting in 2013, actual earnings per share must exceed the 2013 budgeted earnings; otherwise no awards will be made. Thus, the program requires that financial goals be reached prior to any awards being made.

If the earnings threshold is met, an individual's award is then based on a combination of business unit goals and individual goals. Award percentages increase as pay scales rise. Thus, the highest paid employees are eligible for a proportionately greater incentive award. For example, while the target award for pay grades 1-4 is 5% of base pay, employees in pay grades 15-16 are eligible for awards of up to 15% of base pay. Thus, not only do more highly paid employees receive larger nominal awards, but they receive larger proportional awards as well.

Q. Did the Company include officer incentive program costs in its revenue requirement claim?

A. No, the Company made an adjustment to eliminate $2,175,633 in incentive program costs relating to officers.

Q. Do you believe that the incentive compensation program costs are appropriate costs to pass through to ratepayers?

A. No, I do not. I have several concerns about these types of programs, especially as designed and implemented by DPL. The Company's incentive plan is heavily weighted toward financial objectives in that no payout is made unless certain financial goals are met. Providing employees with a direct financial interest in the profitability of the Company is an objective that benefits shareholders, but it does not benefit ratepayers. In addition to the earnings thresholds that are in place, the individual goals, at both the Corporate level and Power Delivery level, also contain significant financial components.[8]

Incentive compensation awards that are based largely on earnings criteria or other financial variables may violate the principle that a utility should provide safe and reliable utility service at the lowest possible cost. This is because these plans require ratepayers to pay higher compensation costs as a consequence of high corporate earnings, a spiral that does not directly benefit ratepayers, but does directly benefit shareholders and the management to whom such awards are granted.

Incentive compensation plans tied to financial performance result in greater enrichment of company personnel as a company's earnings reach or exceed targets that are predetermined by management. It should be noted that it is the job of regulators, not the shareholders or company management, to determine what constitutes a just and reasonable rate of return award to shareholders in a regulated environment. Regulators make such a

8 The specific components are confidential but were provided in response to AG-RR-151.

determination by establishing a reasonable rate of return award on rate base in a base rate case proceeding.

Allowing a utility to charge for additional return that is then distributed to employees as part of some plan to divide extraordinary profits violates all sense of fairness to the ratepayers of the regulated entity. It is certain to result in burdensome and unwarranted rates to its ratepayers, and it also violates the principles of sound utility regulation, particularly with regard to the requirement for "just and reasonable" utility rates.

Q. What would be the appropriate response by the Commission if DPL's earnings were in excess of its authorized rate of return?

A. If the Commission determined that these excess earnings were expected to continue, the appropriate response would be to initiate a rate investigation, and, if appropriate, to reduce the utility's rates.

Q. Are DPL employees being well compensated separate and apart from these employee incentive plans?

A. Yes, they are. Since 2010, non-union employees have consistently been awarded annual payroll increases of at least 3.0%. Moreover, the Company has provided no evidence that its employees are underpaid or that it would have difficulty attracting qualified employees in the absence of these programs.

Q. Has the PSC previously addressed this issue?

A. Yes, in Docket No. 09-414, the Commission found that "...Delmarva has not met its burden of proving the amount of non-executive incentive compensation expense that is attributable to the achievement of safety, reliability or customer service goals...Consequently, we reject Delmarva's proposal to include any non-incentive executive compensation in its cost of service, based on the facts presented in this case."[9] While Mr. Ziminsky provided testimony in this case arguing that the incentive awards themselves are based on customer service criteria and should be included in cost of service, he ignored the fact that no awards are made unless certain financial goals are attained.

Q. What do you recommend?

A. Given that the underlying structure of the incentive compensation program has not changed, I recommend that the PSC deny the Company's request for recovery of incentive plan compensation costs, consistent with its finding in PSC Docket No. 09-414. My adjustment is shown in Schedule ACC-18.

C. <u>Payroll Tax Expense</u>

Q. What adjustment have you made to the Company's payroll tax expense claim?

A. Since I am recommending a reduction to the Company's claims for salaries and wages and incentive compensation costs, it is necessary to make a corresponding adjustment to

9 Order in PSC Docket No. 09-414, paragraphs 195-196.

eliminate certain payroll taxes from the Company's revenue requirement claim. At Schedule ACC-19, I have eliminated payroll taxes associated with my recommended salary and wage and incentive compensation plan adjustments. To quantify my adjustment, I utilized the average Social Security and Medicare tax rate of 5.37% reflected in the Company's filing and applied it to my recommended adjustments for salaries and wages and for incentive compensation program costs.

D. Relocation Expense

Q. Are you recommending any adjustment to the Company's claim for relocation expenses?

A. Yes, I am. A review of the Company's relocation expenses over the past several years indicates that the actual Test Year costs were significantly above costs for the prior three years, as shown below:

Year	Relocation Cost[10]
2012	$130,447
2011	$31,794
2010	$37,450
2009	$20,482

Therefore, it does not appear that the actual Test Year cost represents a normal, ongoing level of relocation expense. In addition, the Test Year cost is so much higher than the 2009-2011 costs that it does not appear to fall into the range of normal variations that can occur from

10 Per the response to AG-RR-20.

year to year in relocation costs. Including it in a calculation of a normalized expense level would skew the resulting average. For this reason, I am reluctant to include the 2012 cost in any calculation of a normalized prospective level of relocation costs.

Given these concerns, I am recommending that the PSC utilize a normalized cost of $37,450, reflecting the highest cost during the period 2009-2011. At Schedule ACC-20, I have made an adjustment to reduce the Company's cost claim for relocation expenses to reflect my recommended pro forma relocation cost.

E. <u>Supplemental Executive Retirement Program ("SERP") Expense</u>

Q. What are SERP costs?

A. These costs relate to supplemental retirement benefits for key executives that are in addition to the normal retirement programs provided by the Company. These programs generally exceed various limits imposed on retirement programs by the IRS and therefore are referred to as "non-qualified" plans. According to the Company's 2012 Proxy Statement at page 44:

> The PHI 2011 Supplemental Executive Retirement Plan, or the 2011 SERP, provides retirement benefits to participating executives in addition to the benefits a participate is entitled to receive under the Pepco Holdings Retirement Plan to supplement benefits which participants forego due to certain limitations on benefit calculations imposed by the Code. If the benefit payment that otherwise would have been available under the applicable benefit formula of the Pepco Holdings Retirement Plan is reduced due to a contribution or benefit limit imposed by law, the participant in the Pepco Holdings Retirement Plan is entitled to a compensating payment. In addition, a participant in the Pepco Holdings Retirement Plan is entitled to either or both of the following enhancements to the calculation of the participant's retirement benefit:
>
> ➢ the inclusion of compensation deferred under the Company's

executive deferred compensation plans; and

- to the extent not permitted by the Pepco Holdings Retirement Plan, the inclusion of annual cash incentive compensation received by the participant.

Q. What are the test year SERP costs that the Company has included in its claim?

A. As shown in the response to AG-RR-25, the Company incurred total SERP expense of $1,101,782 in the Test Year. The vast majority of these costs were allocated from the Service Company.

Q. Do you believe that these costs should be included in utility rates?

A. No, I do not. The officers of the Company are already well compensated. In 2012, Mr. Rigby's salary was $985,000, which represents an increase of almost 12% over his 2011 salary. Total compensation for the Named Executive Officers ("NEOs") ranged from $1.5 million for the new General Counsel, Mr. Fitzgerald, to over $11.3 million for Mr. Rigby. Moreover, the officers that receive SERP benefits are also included in the normal retirement plans of the Company, so ratepayers are already paying retirement costs for these executives. If DPL wants to provide further retirement benefits to select officers and executives then shareholders, not ratepayers, should fund these excess benefits. Therefore, I recommend that the Company's claim for SERP costs be disallowed. My adjustment is shown in Schedule ACC-21.

F. Medical Benefit Expense

Q. How did the Company determine its medical benefits expense claim in this case?

A. Mr. Ziminsky states on page 14 of his testimony that DPL's claim is based on a projected 8.0% increase in medical costs and on a projected 5.0% increase in dental and vision benefit costs. However, the actual increases shown on Schedule JCZ-9 amount to 12.0% for medical costs and 7.5% for dental and vision costs. The Company indicated that its projections were based on a study performed by Lake Consulting, its benefit plan consultant. That study was provided as an attachment to Mr. Ziminsky's testimony.

Unfortunately, the referenced study provides no data that is specific to DPL or PHI. Instead, the study is based on trends in medical premiums by several major insurance companies. Moreover, the study is based on trends in Virginia, Maryland, and the District of Columbia. Thus, there is no information about trends in medical premium costs in Delaware. However, even if the Commission found that cost trends in this state are similar to those in the areas included in the study, the Lake study still fails to support a post-test year adjustment for DPL's electric operations. The use of general cost trends does not rise to the level of a known and measurable change. DPL is self-insured for its medical benefit costs and therefore actual costs will vary depending on the specific amount of services required each year.

Q. What do you recommend?

A. Since the Company's adjustment is not based on data that is specific to DPL's medical benefits programs or to DPL's employees, I am recommending that the Commission reject the medical benefit adjustment. The use of general cost trends in neighboring states does not rise to the level of a known and measurable change for ratemaking purposes. Therefore, I recommend that the Company's revenue requirement be reduced to eliminate this post-test year cost adjustment. My recommendation is shown in Schedule ACC-22.

G. IRP Expense

Q. In addition to the rate base adjustment discussed earlier with regard to deferred IRP costs, did DPL also include an operating expense adjustment relating to the IRP?

A. Yes, it did. As discussed in Mr. Ziminsky's testimony, DPL included two operating expense adjustments relating to the IRP. First, DPL included an adjustment to revise the amount of prospective IRP costs from the level that is currently reflected in rates. As discussed earlier, the Commission stated in its Order in PSC Docket No.06-241 that IRP costs, other than those for the initial IRP filing, should be normalized. The Company's first adjustment is an attempt to normalize the operating costs associated with the IRP. Second, DPL made an adjustment to reflect the amortization of the deferred IRP costs over ten years. I am recommending adjustments to both of these expense claims.

Q. Please explain your first adjustment.

A. As shown in Schedule JCZ-13 to the Company's testimony, DPL is proposing a significant increase in prospective normalized IRP costs relative to the costs incurred in the Test Year. The Company claims that the IRP cycle covers a period of two years. Therefore, it has estimated IRP costs over a projected biennial IRP cycle of $1,745,000 and then included one year of those costs, or $872,500, in its revenue requirement claim.

The Company's cost claim with regard to the IRP cycle is speculative and does not represent a known and measurable change to the actual Test Year results. Nor is the Company's claim supported by reliable and quantifiable data. For example, over 50% of the Company's claim relates to consultants, outside legal counsel, and "special studies." These types of costs can vary greatly from budgeted amounts, especially when the parameters of the underlying project are not well defined.

Instead of relying upon the Company's speculative claim, I recommend that the Commission normalize these costs based on actual past experience. As shown in the response to PSC-RR-33, the costs claimed by DPL in this case are significantly higher than those that the Company has incurred since the IRP regulations were approved in Regulation Docket No. 60.

Year	IRP Costs
YTD 2013	$14,526
2012	$302,062
2011	$46,909
2010	$927,875
2009 (after Regulation Docket No. 60 approval)	$213,440
2009 Full Year	$367,373

Given the magnitude of the Company's claim relative to historic costs, and the speculative nature of the prospective costs claimed by DPL, I recommend that the PSC reject the Company's claim and instead utilize a three-year average (2010-2012) of actual costs to normalize prospective IRP costs. My adjustment is shown in Schedule ACC-23.

Q. What is your second adjustment?

A. My second adjustment eliminates the amortization expense associated with the Company's incremental deferred IRP costs. As addressed in the Rate Base Section of my testimony, DPL has included a deferral consisting of costs incurred in August 2009. The Company's claim is based on total deferred costs of $101,994. The Company is proposing a ten-year amortization period for these costs. For the reasons expressed earlier in the Rate Base section of my testimony, I recommend that this claim be denied. Therefore, at Schedule ACC-24, I have made an adjustment to eliminate the amortization expense associated with these deferred costs from the Company's revenue requirement.

H. <u>Bluewater Wind RFP Expense</u>

Q. Please explain the Company's adjustment relating to amortization expense associated with deferred RFP costs.

A. As discussed earlier, DPL has included a rate base adjustment relating to deferred costs incurred in August 2009 associated with the Bluewater Wind RFP. The Company is proposing to recover $51,020 in deferred costs. DPL included an amortization expense associated with recovering these costs over a 10-year period. Since I am recommending that the Company's claim for deferred accounting treatment be denied, it is necessary to make a corresponding expense adjustment to eliminate the amortization expense associated with these costs. My adjustment is shown in Schedule ACC-25.

I. <u>Dynamic Pricing Expense</u>

Q. How did the Company determine its expense claim associated with DP programs?

A. The Company's claim includes three components. First, DPL made an adjustment to reflect the amortization of deferred costs over 15 years. Second, the Company proposed an adjustment to reflect ongoing operating expenses in base rates. These costs are not currently included in rates but are being deferred. Similarly, DPL included an adjustment to reflect ongoing annual amortization costs associated with systems that are utilized to provide DP programs. The Company is also currently deferring these costs.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending one adjustment. As noted earlier, I am recommending that recovery of deferred costs in this case be limited to actual costs incurred through December 31, 2012, the end of the Test Year. My revenue requirement recommendation therefore reflects deferred costs of $2,456,025 instead of the $6,699,487 included in the Company's filing. I have accepted DPL's proposal to amortize these costs over 15 years, resulting in an annual amortization of deferred costs of $163,735 instead of the $446,632 proposed by the

Company. My recommendation is shown in Schedule ACC-26.

Q. Are you recommending any adjustment to the Company's claim for ongoing operating expenses and amortization expense associated with systems used to provide DP?

A. No, I am not. I am not opposed to the Company's request to begin to recover prospective costs associated with the DP program in its base rates. I have reviewed the Company's claim relative to historic costs and I believe that DPL's claim represents a normalized level of prospective operating costs. Therefore, I am not recommending any adjustment to the Company's claim. Once new rates are effective, then DPL should stop deferring costs associated with DP programs. The balance of costs deferred between the end of the Test Year and the implementation date of new rates in this case should be addressed in the Company's next base rate case or in some other regulatory venue.

J. <u>DLC Costs</u>

Q. Please describe the Company's claim relating to expenses associated with the DLC program.

A. As discussed earlier, DPL is seeking to include in rate base its estimated deferred costs through December 31, 2013 relating to its DLC program. The Company also included an expense adjustment to reflect annual amortization costs associated with amortizing this projected deferral over 15 years, for a an annual amortization expense of $663,192.

The DLC program is still in its infancy. No costs had been deferred by the end of the

Test Year. In addition, DPL only recently started to implement this program and full implementation is not expected for several years. Therefore, I am recommending that all costs associated with this program continue to be deferred. Amortization of deferred costs should not begin until the DLC program is much further along and the parties can better evaluate the benefits and costs of the program. Therefore, at Schedule ACC-27, I have made an adjustment to eliminate the Company's proposed annual amortization expense associated with the DLC program.

K. Medicare Tax Subsidy Expense

Q. Please explain the Company's adjustment relating to amortization of the Medicare Tax deferral.

A. DPL is proposing to defer and amortize costs $110,507 of costs incurred in March 2010 relating to a change in the law regarding Medicare taxes. The Company is requesting a three-year amortization of these costs, with the unamortized balance included in rate base. Earlier I addressed the Company's rate base adjustment. Since I am recommending that the Company's claim for deferred accounting treatment of these costs be denied, it is necessary to make an adjustment to eliminate the annual amortization expense. My adjustment is shown in Schedule ACC-28.

L. Regulatory Expense

Q. How did the Company develop its regulatory expense claim?

A. DPL's regulatory expense claim is based on total estimated costs for the current rate case of $632,600. This includes $315,000 in external legal costs, $92,600 for a cost of capital witness, $25,000 for a court reporter and notice costs, and $200,000 for PSC costs. The Company is proposing to amortize this amount over 3 years. In addition, DPL included non-rate case related costs of $53,316 in its claim, based on a three-year average of such costs.

Q. Are you recommending any adjustment to the Company's claim for regulatory costs?

A. Yes, I believe that the Company's claim is excessive. This is especially true of the claim for cost of capital services, considering that the same witness was engaged to provide testimony in multiple Pepco Holdings, Inc. ("PHI") jurisdictions, as well as in multiple cases in the same jurisdiction.

In order to determine a normalized level of rate case costs, I recommend that the PSC utilize an average of DPL's costs in its last three base rate electric proceedings. As shown below, this results in a pro forma cost of $426,432:

Case No.	Rate Case Expense
Docket No. 11-528	$634,054
Docket No. 09-414	$245,241
Docket No. 05-304	$400,000
Average	$426,432

I have accepted the Company's proposal to use a three-year normalization period for rate case costs associated with the current proceeding. Accordingly, at Schedule ACC-29, I have made an adjustment to reflect prospective annual costs of $142,144 ($426,432/3), based on the average costs over the last three electric rate cases and on a three-year normalization period.

M. Credit Facility Expense

Q. Has DPL requested recovery of operating costs associated with a PHI credit facility?

A. Yes, it has. As noted earlier, DPL included a rate base adjustment of $502,111 and an operating expense adjustment of $337,108 relating to a short-term credit facility operated by PHI.

Q. Are you recommending any adjustment relating to the Company's claim for credit facility costs?

A. Yes, I am. Since the Company excludes short-term debt from its capital structure, then these costs should not be recovered in base rates. It is unreasonable to permit these costs to be recovered in base rates unless ratepayers are receiving the benefit of the lower short-term debt rates. Ratepayers should not be paying for the credit facility unless the associated benefits are also reflected in rates. Therefore, at Schedule ACC-30, I have made an adjustment to eliminate the prospective operating expenses associated with the credit facility from base rates. This is similar to my earlier recommendation to eliminate the start-up costs of the credit facility from rate base.

N. Corporate Governance Expense

Q. What level of corporate governance costs has DPL included in its claim in this case?

A. In the Test Year, the Service Company billed DPL (total company) $21.08 million for corporate governance costs. These costs have increased significantly over the past few years, as shown below:

Year	DPL's Share of Corporate Governance Costs
2012	$21,079,148
2011	$17,147,292
2010	$13,477,978
2009	$12,036,573
2008	$12,208,583

In addition to general increases in the level of costs being incurred, two other factors have contributed to this increase. First, in 2010, PHI sold Conectiv Energy. This sale resulted in fewer entities over which corporate governance costs could be allocated. Second, the Company changed its methodology for allocating corporate governance costs, which resulted in a significant decline in the percentage of costs charged to PHI, and a corresponding increase in the percentage of costs allocated to subsidiaries such as DPL. In the response to AG-RR-172, DPL stated that this change in methodology was due to a new allocation ratio adopted "as part of the extension and modification of the PHI Service Agreement as of January 1, 2011." While approximately 5.0% of corporate governance costs was billed to PHI prior to the change in allocation, in 2011 only 0.23% of such costs was billed to PHI and the allocation fell even further, to 0.06%, in the Test Year.

Q. Are you recommending any adjustments to the Company's claim for corporate governance costs?

A. Yes, I am recommending that costs associated with certain External Affairs activities be disallowed unless the Company can demonstrate that such costs have a direct benefit to customers or have been removed elsewhere from the Company's filing. External Affairs costs generally relate to interaction with legislators and/or community organizations and are designed to promote the company's political agenda and/or corporate image. While it appears from the Company's response to AG-RR-146 that costs that are clearly identifiable as lobbying have been booked below-the-line, there are several categories of External Affairs costs that appear to relate to these activities and which have been billed to DPL. These include public relations, corporate citizen social responsibility, strategic communications, PAC committee, and corporate contributions. I am recommending that these costs be disallowed. Just as ratepayers should not be required to pay direct lobbying costs, they should not be required to pay for "soft" lobbying either. Unless a cost is directly related to the provision of utility service and provides a benefit to ratepayers, it should not be included in regulated rates. The costs that I recommend be disallowed are the types of costs that promote shareholder and corporate interests. If the Company wants to incur these costs, they should be borne by the Company's shareholders and not its ratepayers. My adjustment to eliminate certain External Affairs costs is shown in Schedule ACC-31.

Q. Didn't the Company indicate in Schedule No. 3-F to the Minimum Filing Requirements

("MFRs") that no charitable contributions were included in its cost of service?

A. Yes, it did. However, the corporate contributions identified as External Affairs costs from the Service Company were not identified as being booked below-the-line in the Company's discovery response. Therefore, I was unable to ascertain if these specific costs were actually excluded from the Company's revenue requirement. If the Company can demonstrate that it has already excluded from its revenue requirement corporate contributions or other portions of the External Affairs costs that I recommend be disallowed, then I will revise my recommendation accordingly.

O. Meals and Entertainment Expense

Q. Are you recommending any adjustment to the Company's meals and entertainment expense claim?

A. Yes, I am. According to the response to AG-RR-55, the Company has included in its filing approximately $298,182 of meals and entertainment expenses that are not deductible on its income tax return. These are costs that the IRS has determined are not appropriate deductions for federal tax purposes. If these costs are not deemed to be reasonable business expenses by the IRS, it seems appropriate to conclude that they are not reasonable business expenses to include in a regulated utility's cost of service. Accordingly, at Schedule ACC-32, I have made an adjustment to eliminate these costs from the Company's revenue requirement.

Q. Did the Company provide any additional information about these costs?

A. No, it did not. However, in its most recent Proxy Statement, PHI acknowledged that the Company incurred costs for a variety of sporting and entertainment events. Moreover, it stated that such perquisites were made available to employees when not needed for "business purposes." I find it difficult to conceive of a business purpose that would support ratepayers paying for tickets to entertainment or sporting events. Clearly, these are costs that should be borne by the Company's shareholders, and not its ratepayers. While there may be costs for certain meals included in this category that should be borne by ratepayers, there are also clearly costs which should be entirely excluded from the Company's revenue requirement. Therefore, my recommendation to use the 50% IRS criteria provides a reasonable balance between shareholders and ratepayers and should be adopted by the Commission.

P. Membership Dues Expense

Q. Are you recommending any adjustment to the Company's claim for membership dues?

A. Yes, I am. The Company identified a total of $315,474 of Dues and Membership expenses in Exhibit 3-G to the MFRs. The most significant cost relates to dues to the Edison Electric Institute. Most of the other dues are for memberships in various Chambers of Commerce. The Company's claim also includes dues to such organizations as the Art League of Ocean City, Inc., the Girl Scouts, and the Committee of 100.

Many of these organizations, including the Chambers of Commerce, participate in lobbying activities. In addition to explicit lobbying costs, most of these organizations also engage in other activities that should not be charged to ratepayers, such as public affairs, media relations, and other advocacy initiatives. Other organizations, such as the Girl Scouts, do not have a direct link to the provision of safe and reliable utility service and should not be paid for by Delaware ratepayers.

Q. Are lobbying costs an appropriate expense to include in a regulated utility's cost of service?

A. No, they are not. Lobbying expenses are not necessary for the provision of safe and adequate utility service. Ratepayers have the ability to lobby on their own through the legislative process. Moreover, lobbying activities have no functional relationship to the provision of safe and adequate regulated utility service. If the Company were to immediately cease contributing to these types of efforts, utility service would in no way be disrupted. For all these reasons, I recommend that costs associated with lobbying activities, and other activities that are not directly related to the provision of service, be disallowed.

Q. How did you quantify your adjustment?

A. I am recommending that 20% of the Company's membership dues identified in MFR Exhibit G-3 to the Company's filing be disallowed on the basis that such costs constitute lobbying activities or should not otherwise be charged to cost of service. I recognize that the specific level of lobbying/public affairs/media activity varies from organization to organization. However, based on my review of these organizations and on recommendations in other utility rate proceedings, I believe that a 20% disallowance is a reasonable overall recommendation. My adjustment is shown in Schedule ACC-33.

Q. Did the Company make any adjustment to eliminate lobbying costs from its revenue requirement claim?

A. While the Company claims that no lobbying costs are included in its claim, it has failed to quantify how much, if any, of these costs were eliminated on the basis of lobbying. In AG-RR-53 we asked the Company to quantify any portion of dues or membership fees that are directed toward lobbying activities by the respective entities. Instead of identifying dues used for lobbying activities, the Company responded that "[p]ortions of dues or membership fees identified as lobbying activities by the organization are not included in this filing." In AG-RR-54, we asked the Company to identify all lobbying costs incurred in the Test Year and to identify the amount of any such costs included in the Company's claim. Again, it failed to quantify the costs incurred and instead stated only that "[l]obbying costs identified by an organization and incurred by the Company are not included in this filing." We tried again with a follow-up question, AG-RR-158. In response, the Company stated that lobbying costs are booked to a below-the-line account, but again failed to identify either the organizations that engaged in lobbying or the amount of dues recorded below-the-line.

It is very important to know how much, if any, of these costs have been identified as lobbying by the Company. These organizations frequently take a very narrow view of what constitutes lobbying and therefore identify only a very small portion of their costs as "lobbying" costs. At this point, I am unable to ascertain whether my recommended adjustment double-counts any amounts removed by DPL from its claim, so I am assuming that my entire adjustment is incremental to any amounts that may have been booked below-the-line by DPL. If this is not correct, then DPL can provide to me the information that I repeatedly requested in discovery and I will revise my recommendation, if necessary.

Q. Depreciation Expense

Q. Have you made any adjustment to the Company's claim for pro forma depreciation expense?

A. Yes, I have made one adjustment. Since I am recommending that post-test year plant additions be excluded from rate base, it is necessary to make a corresponding adjustment to eliminate the associated depreciation expense. At Schedule ACC-34, I have made an adjustment to eliminate depreciation expense associated with the post-test year utility plant additions that I recommend excluding from rate base.

R. Allowance for Funds Used During Construction ("AFUDC")

Q. How did the Company reflect AFUDC in its filing?

A. The Company included AFUDC earnings of $965,309 in its revenue requirement. The AFUDC was included as earnings because DPL proposes to include CWIP in rate base. As discussed in the Rate Base section of my testimony, I am recommending that the PSC eliminate CWIP from the Company's pro forma rate base. Therefore, it is necessary to make a corresponding adjustment to remove the AFUDC from earnings. The impact of this adjustment is to reduce the Company's pro forma earnings at present rates by $965,309. My adjustment is shown in Schedule ACC-35.

S. Interest Synchronization

Q. Have you adjusted the pro forma interest expense for income tax purposes?

A. Yes, I have made this adjustment at Schedule ACC-36. It is consistent (synchronized) with my recommended rate base and with the capital structure and cost of capital recommendations of Mr. Parcell. I am recommending a lower rate base than the rate base included in the Company's filing, which results in a lower pro forma interest expense for the Company. This lower interest expense, which is an income tax deduction for state and federal tax purposes, will result in an increase to the Company's income tax liability under the DPA's recommendations. Therefore, I have included an interest synchronization adjustment that reflects a higher pro forma income tax expense for the Company and a decrease to pro forma income at present rates.

T. Income Taxes and Revenue Multiplier

Q. What income tax factors have you used to quantify your adjustments?

A. As shown on Schedule ACC-37, I have used a composite income tax factor of 40.65%, which includes a state income tax rate of 8.7% and a federal income tax rate of 35%. These are the state and federal income tax rates contained in the Company's filing.

My revenue multiplier, which is shown in Schedule ACC-38, incorporates these tax rates. In addition, the revenue multiplier also reflects a regulatory tax of 0.3%, a City of Wilmington tax of 0.106%, and a bad debt expense ratio of 0.825%, resulting in a revenue multiplier of 1.70606. This is the same revenue multiplier used by DPL in its filing.

VII. REVENUE REQUIREMENT SUMMARY

Q. What is the result of the recommendations contained in your testimony?

A. My adjustments indicate a revenue deficiency at present rates of $7,309,999, as summarized on Schedule ACC-1. This recommendation reflects revenue requirement adjustments of $34,733,758 to the Company's requested revenue increase of $42,043,757.

Q. Have you quantified the revenue requirement impact of each of your recommendations?

A. Yes, at Schedule ACC-39, I have quantified the revenue requirement impact of the rate of return, rate base and expense recommendations contained in this testimony.

Q. Does this conclude your testimony?

A. Yes, it does.