BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

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

DIRECT TESTIMONY OF

DAVID E. PETERSON

ON BEHALF OF

COMMISSION STAFF

AUGUST 16, 2013

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is David E. Peterson. I am a Senior Consultant employed by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk, Maryland.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a Master's degree in Business Administration from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate proceedings before federal and state regulatory commissions.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC UTILITY RATE PROCEEDINGS?

A. Yes. I have presented testimony in 140 other proceedings before the state regulatory commissions in Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and before the Federal Energy Regulatory Commission. Collectively, my testimonies have addressed the following topics: the appropriate test year, rate base, revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

In addition, in 2006 testified twice testified before the Energy Subcommittee of the Delaware House of Representatives on the issues of consolidated tax savings and tax normalization. Also in 2006, I presented a one-day seminar to the Delaware Public Service Commission ("Commission") on consolidated tax savings, tax normalization and other utility-related tax issues. In the spring of 2011, I co-presented along with Mr. Scott Hempling, the then-director of NRRI, a three-day seminar on public utility ratemaking principles and issues to the Commissioners and Staff of the Washington Utilities and Transportation Commission. In 2012, I presented a one-day seminar on electric cost allocation and rate design to the Colorado Office of Consumer Counsel. More recently, I presented a three-day seminar on public utility ratemaking, revenue requirements, cost allocation and rate design to the Staff of the Delaware Public Service Commission.

II. SUMMARY

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. My appearance in this proceeding is on behalf of the Public Service Commission Staff ("Commission Staff").

Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS BEFORE THE DELAWARE PUBLIC SERVICE COMMISSION?

A. Yes, I have. I submitted testimony in rate proceedings involving Delaware Electric Cooperative (Docket No. 04-288), Delmarva Power & Light Company (Docket Nos. 05-304, 11-258, and 12-546), and Tidewater Utilities, Inc. (Docket No. 06-145). Each of my appearances in these proceedings was on behalf of the Commission Staff.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I was asked to assist the Commission Staff in analyzing Delmarva Power & Light Company's ("Delmarva" or "the Company") rate increase request and proposed rate changes for its electric distribution services in Delaware. Specifically, I was asked to prepare a detailed analysis of Delmarva's retail electric rate base and *pro forma* operating income under rates that are currently in effect. From these determinations I calculated Delmarva's present revenue deficiency. The purpose of my testimony is to present the results of my analysis to the Commission and to recommend alternative ratemaking treatments for several items included in the Company's claimed revenue requirement.

Q. ARE YOU FAMILIAR WITH DELMARVA'S FILING IN THIS PROCEEDING?

A. Yes, I am. I have carefully reviewed the Direct Testimonies and Exhibits sponsored by the Company's witnesses relating to the issues that I address herein. I also reviewed the Company's responses to data requests of the Commission Staff and the Department of Public Advocate, again relating to the issues that I address in my testimony

Q. PLEASE SUMMARIZE DELMARVA'S RATE REQUEST.

A. Delmarva's existing retail electric distribution rates have been in effect since January 1, 2013 when the Commission approved a $23,152,791 annual revenue increase for Delmarva in Docket No. 11-528.

On March 22, 2013, Delmarva filed an Application with the Commission requesting a $42,044,000 or 7.38 percent annual revenue increase. However, since this proceeding addresses only Delmarva's retail distribution rates, the Company's proposal is more accurately stated as a 23.8 percent increase over existing revenues. Delmarva's present rate request is premised on an actual test period ended December 31, 2012, adjusted for alleged known changes, and includes a 10.25 percent return on common equity and a 7.54 percent return on rate base. Delmarva initially requested that its proposed rates become effective May 21, 2013. The Commission has suspended the effective date, however, allowing Delmarva by statute to put the rates into effect in October 2013, subject to refund. Delmarva also put into effect an interim rate increase of $2.5 million effective June 1, 2013, also subject to refund.

Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING YOUR RECOMMENDATIONS AND ADJUSTMENTS RELATIVE TO THE COMPANY'S CLAIMED REVENUE REQUIREMENT?

A. Yes, I have. Exhibit___(DEP-1) attached to my testimony summarizes the Commission Staff's determination of Delmarva's retail distribution revenue deficiency. Exhibit___(DEP-1), Schedule 1, page 1, summarizes the cumulative effect of my recommendations and adjustments on Delmarva's claimed revenue requirement. From this schedule, I calculated that Delmarva's current retail electric distribution rates produce a 5.93 percent return on rate base. Delaware Division of the Public Advocate witness Mr. David Parcell is testifying in this proceeding that Delmarva requires a 7.09 overall return on rate base. Mr. Parcell was the Staff witness on rate of return and overall capital structure in the prior Delmarva electric base case, PSC Docket 11-528, as well as the Staff witness on rate of return in the more recent Delmarva gas case, PSC Docket 12-546, that is currently pending before the Commission. I have been asked by Staff to rely on Mr. Parcell's return recommendations in determining my over all recommended revenue requirement in this case. Mr. Parcell's overall return includes a 9.35 percent allowance on common equity capital. Therefore, on my Schedule 1, I show that Delmarva's annual revenues will have to be increased by $11,442,413 in order to yield the 7.09 percent overall return that Mr. Parcell recommends, rather than the $42.0 million increase that Delmarva requested.

Exhibit___(DEP-1), Schedule 2, is a multi-page schedule detailing my determination of Delmarva's adjusted average rate base. Schedule 3 shows my calculation of Delmarva's *pro forma* earnings under present rates. The adjustments that bridge Delmarva's updated revenue requirement analysis to my *pro forma* determination are shown in Column C on the first page of Schedules 2 and 3. The bases for my recommended rate base and expense adjustments are set forth in the following sections of my testimony.

III. RATE BASE

A. Test Period

Q. WHAT TEST PERIOD IS REFLECTED IN DELMARVA'S REVENUE REQUIREMENT ANALYSIS?

A. Delmarva's filing is based on an actual test period consisting of the twelve months ended December 31, 2012. An actual test period, such as the one used in Delmarva's revenue requirement cost study, is preferable to a forecasted test period because an actual test period is based on actual, audited operating results. A test year based on financial forecasts, on the other hand is unreliable and unverifiable. Therefore, I used the same actual test period in my calculation of the Company's revenue requirement that Delmarva used.

Q. DOES DELMARVA'S REVENUE REQUIREMENT ANALYSIS INCLUDE ANY ADJUSTMENTS TO ACTUAL TEST PERIOD OPERATING RESULTS?

A. Yes, it does. Delmarva witnesses Jay C. Ziminsky and Marlene C. Santacecilia proposed several adjustments to the actual test period average rate base, revenues and expenses to reflect both known and forecasted changes in test year operating levels.

Q. IS IT APPROPRIATE TO ADJUST ACTUAL TEST PERIOD RESULTS?

A. Yes, under certain conditions. It may be necessary to conform a utility's financial statements to the regulatory commission's ratemaking practices and accounting requirements. It may also be appropriate to eliminate nonrecurring transactions that occurred during the test period, to purge test period results for transactions that occurred outside of the test period and to "normalize" or smooth abnormal test period transactions. Finally, it may be appropriate to annualize changes that occurred during the test period and to recognize post-test year changes provided they have a continuing effect on operations and are known and measurable, and do not distort the test period matching principle. These types of adjustments make an actual test period reasonably representative of the conditions that are likely to exist when the revised rates become effective. Such adjustments provide the utility a reasonable opportunity to earn its authorized rate of return.

B. Average v. Year-end Rate Base

Q. EARLIER IN YOUR TESTIMONY YOU STATED THAT YOU WERE INVOLVED IN DELMARVA'S LAST RATE PROCEEDING IN DOCKET NO. 11-528. IN THIS PROCEEDING, DOES DELMARVA CALCULATE RATE BASE IN THE SAME MANNER AS IT DID IN DOCKET NO. 11-528?

A. No. In Docket No. 11-528, Delmarva's proposed rate base was determined, in part, by using an average of the beginning and each month-end plant balance for the test period. This is commonly referred to as the thirteen-point average method. In this case, however, Delmarva's proposed rate base includes plant in service balances at the end of the test period, rather than an average balance for the entire test period.

Q. IS YEAR-END RATE BASE TREATMENT AS DELMARVA PROPOSES IN THIS PROCEEDING A ROUTINE COMMISSION PRACTICE?

A. No, it is not. Although in specific cases an exception has been made, the Commission's general policy has been to require jurisdictional utilities to calculate rate base using the thirteen-point average method, rather than the test year-end method.

Q. WHAT REASONS DID THE COMPANY GIVE FOR PROPOSING YEAR-END RATE BASE TREATMENT IN THIS CASE?

A. Mr. Ziminsky is sponsoring the Company's proposed year-end rate base treatment in this case. The only reason that Mr. Ziminsky gave for favoring year-end rate base is his unsupported conclusion that year-end rate base "better reflects the assets which will be serving customers during the rate effective period for which rates in this proceeding are being established."[1]

Q. DO YOU AGREE WITH MR. ZIMINSKY'S CONCLUSION IN THIS REGARD?

A. No, I do not. Except for retirements that occurred throughout the 2012 test year, which are recognized in the thirteen-point average method, the assets that were serving customers during the 2012 test year will continue to serve customers in 2013 and beyond.

Q. DID MR. ZIMINSKY DESCRIBE ANY EVENTS OR CHANGES IN CIRCUMSTANCES THAT HAVE OCCURRED FOLLOWING THE COMMISSION'S ORDER IN DOCKET NO. 11-528 THAT JUSTIFIES SWITCHING FROM AN AVERAGE RATE BASE TO YEAR-END RATE BASE?

A. No, he did not. Nor am I aware of any changes that warrant switching from average rate base to year-end.

[1] Direct Testimony of Jay C. Ziminsky, page 33, lines 16-17.

Q. DO YOU SUPPORT CHANGING FROM AN AVERAGE RATE BASE TO YEAR-END IN THIS PROCEEDING?

A. No, I do not.

Q. WHAT IS YOUR OBJECTION TO USING A YEAR-END RATE BASE?

A. As a pure ratemaking matter, year-end rate base is conceptually wrong because it introduces a distortion, or more specifically a mismatch, in the measurement of a utility's earnings and revenue requirement. Revenues are earned and expenses are incurred throughout the entire test period. The matching principle requires that plant investment also be measured throughout the entire test period by using an average, rather than year-end, rate base. A year-end rate base results in an understatement of the income producing capability of the utility's plant investment and excessive rates.

Q. CAN YOU DEMONSTRATE HOW USING YEAR-END RATE BASE RESULTS IN AN UNDERSTATEMENT OF THE INCOME PRODUCING CAPABILITY OF A UTILITY'S PLANT INVESTMENT?

A. Yes. A simplified example using a hypothetical savings account will demonstrate the type of distortion in earnings that results when year-end rate base is used. In this example, assume that an individual has a savings account in a bank with a $100 balance at the beginning of the year. The bank pays simple interest at 1 percent per month. Assume further that an additional $100 deposit was made on December 1. At 1 percent interest per month, by the end of the year the bank would have paid the depositor $13 in interest.

The distortion occurs when one tries to measure the annual earnings rate. The following table compares the indicated annual rate of earning under the year-end approach and under the average rate base approach.

Indicated Annual Rate of Return

	Year-End Approach	Average Approach
Account Balance	$200	$108
Annual Interest	$13	$13
Annual Earnings Rate	6.5%	12%

Clearly, when a bank pays simple interest at a rate of 1 percent per month, the annual earnings rate must be 12 percent, not 6.5 percent as shown in this example under Mr. Ziminsky's year-end rate base approach. To put it another way, why would a banker pay a depositor $13 in interest if nothing was deposited until December 1? Obviously, the banker would not pay $13 in interest in such a case. Nor is it reasonable for ratepayers to pay an annualized return on plant that was only in service a short time during the test year.

When plant balances are growing, as they are for Delmarva, using year-end rate base understates the income producing capability of existing rates and overstates the revenue deficiency. Rates set using year-end rate base will provide Delmarva an unwarranted attrition allowance. This results because year-end rate base understates the income producing capability of the Company's present rates and overstates Delmarva's present revenue deficiency. Delmarva's ratepayers end up paying rates that are higher than necessary to compensate the Company for its cost of service. To avoid the distortion and understatement of Delmarva's actual and *pro forma* earnings, I recommend that the Commission require that Delmarva's revenue requirement and revenue deficiency be determined using the average rate base as it has traditionally done.

Q. HAVE YOU PREPARED AN EXHIBIT TO SHOW THE ADJUSTMENTS THAT ARE NECESSARY TO CONVERT DELMARVA'S YEAR-END RATE BASE TO AN AVERAGE RATE BASE?

A. Yes, I have. My Exhibit DEP-1, Schedule 2, page 2a, summarizes all of the adjustments that are necessary to convert Mr. Ziminsky's year-end rate base to a thirteen-point average (i.e., an average of the test year beginning balance and each of the twelve month-end balances). The detail of these adjustments is provided in my Schedule 2, on pages 3 and 4. The summary schedule on page 2a shows that Mr. Ziminsky's rate base should be reduced by $40,660,264 to properly reflect an average rate base.

C. Reliability Closings

Q. IS MR. ZIMINSKY PROPOSING ANY ADJUSTMENT TO TEST PERIOD YEAR-END PLANT BALANCES?

A. Yes, he is. Mr. Ziminsky is proposing to include in rate base adjustments totaling $66.8 million for forecasted plant closings, net of forecasted retirements, in 2013 for what he calls "reliability" facilities.

Q. ARE MR. ZIMINSKY'S RELIABILITY PLANT ADJUSTMENTS APPROPRIATE?

A. No. His adjustment to include in rate base a forecast of post-test year plant additions constitutes a violation of the test period matching principle in that it creates a mismatch between plant investment and the revenues and expenses that flow from that plant investment. In so doing, calculating earnings under present rates using the post-test year plant additions will result in an understatement of the earnings capability of Delmarva's present rates. This, in turn, results in an overstatement of Delmarva's revenue deficiency and revenue requirement.

The matching principle is a fundamental or "pervasive" principle in accounting and in public utility ratemaking. The matching principle requires that test period revenues and expenses be compared with plant in service throughout the test period – i.e., the thirteen point average. Mr. Ziminsky's reliability plant adjustments distort the test year relationship between plant in service and other elements of the Company's revenue requirement. The distortion can easily be identified in the accumulated reserve for depreciation. While Mr. Ziminsky's adjustments recognize the increasing reserve for depreciation associated with reliability plant additions, his adjustments completely ignore the growth in the depreciation reserve for embedded plant that will be occurring as the reliability plant is placed in service. That is, plant in service during 2012 will continue to accumulate depreciation in 2013 which will reduce Delmarva's net investment in rate base. This known post-test year reduction in rate base is not accounted for in Mr. Ziminsky's rate base calculation. Also, Mr. Ziminsky's post-test year adjustments fail to annualize the effects on the deferred tax reserve arising from bonus tax depreciation on non-reliability plant closings in 2013. In effect, all elements of the test year revenue requirement would have to be restated to December 31, 2013 for the proper matching result to be achieved. Clearly, this is not what Mr. Ziminsky had in mind; nor do I recommend it. Rather, I recommend that rate base reflect only plant in service during the test year calculated using a thirteen-point average. My adjustments to reverse Mr. Ziminsky's proposed reliability-related rate base adjustments are shown on my Exhibit___(DEP-1), Schedule 2, page 2b, Columns B. My adjustment reduces Mr. Ziminsky's proposed rate base by approximately $66.8 million.

D. Construction Work In Progress

Q. IN ADDITION TO THE POST-TEST YEAR RELIABILITY PLANT ADDITIONS, WHICH YOU JUST DISCUSSED, DID THE COMPANY INCLUDE IN RATE BASE ANY OTHER PLANT THAT WAS NOT IN SERVICE DURING THE TEST PERIOD?

A. Yes. In addition to the forecasted reliability additions through December 2013, Delmarva's proposed rate base also includes $70,154,772 of construction work in progress ("CWIP").

Q. IN YOUR OPINION, IS IT APPROPRIATE TO INCLUDE CWIP IN DELMARVA'S RATE BASE?

A. No, it is not. It has been my consistent position that plant that is not used and useful during the test period should not be included in rate base. My position on this applies to the projected post-test year reliability plant closings and to the other CWIP included in Delmarva's claimed rate base. My primary objection to including the post-test year reliability plant closings and CWIP in rate base is that the construction projects in question were not used and useful during the test period. Delmarva's customers received no service benefits from them. More fundamentally, including CWIP in rate base violates the test period matching principle. It does so by stepping outside the test period to measure investment without making similar out of period adjustments for revenues and expenses that flow from the out of period investment. Once it is placed in service, the distribution CWIP that Mr. Ziminsky has included in his rate base presentation will serve new customers or new loads, increase operating efficiency or service reliability, or decrease maintenance requirements on both new and existing facilities. Yet, none of these revenue increasing or expense reducing impacts that flow from CWIP (and the reliability projects) are reflected in Mr. Ziminsky's revenue requirement determination. In other words, Mr. Ziminsky's rate base treatment for CWIP recognizes only the cost increases that flow from the post-test period construction projects, but it does not recognize the service benefits (i.e., increasing revenues and reducing expense) that flow from CWIP. Because of this mismatch, CWIP should not be included in Delmarva's rate base. My position is consistent with the last several Commission decisions regarding Delmarva's rate base and CWIP. (*See*, Commission Order Nos. 8011 and 6930.)

Q. HOW THEN IS DELMARVA TO BE COMPENSATED FOR FINANCING COSTS INCURRED DURING THE CONSTRUCTION PERIOD IF CWIP IS NOT INCLUDED IN RATE BASE?

A. Delmarva is appropriately compensated for construction period financing costs when it capitalizes an allowance for funds used during construction ("AFUDC"). Once capitalized, accumulated AFUDC is added to other construction-related costs in Account 101, Plant in Service, and is depreciated over the useful life of the asset.

Q. MR. ZIMINSKY ADDED AFUDC TO OPERATING INCOME IN THIS PROCEEDING. DOESN'T INCLUDING AFUDC IN CURRENT EARNINGS OFFSET THE REVENUE REQUIREMENT IMPACT OF INCLUDING CWIP IN RATE BASE?

A. In theory, if the AFUDC rate matched Delmarva's authorized rate of return and if Delmarva capitalized AFUDC on all construction projects, then including AFUDC in current earnings would offset the revenue requirement impact of including CWIP in rate base. But this is not the case in this proceeding. Mr. Ziminsky's rate base determination has $70,154,772 of CWIP and his income statement has only $965,309 of AFUDC. This level of AFUDC has an effective earnings rate of only 1.4 percent on the CWIP balance. This earnings rate is far below the 7.53 percent overall rate of return that Delmarva is requesting in this proceeding. Therefore, including AFUDC in current earnings does not come close to offsetting the revenue requirement impact of including CWIP in rate base. (*See,* Commission decisions cited above.)

Q. WHAT REASONS ARE THERE FOR THE LOW AFUDC EARNINGS RATE ON DELMARVA'S CWIP BALANCE?

A. There are at least two reasons for this. First, short-term debt is not included in the Company's capital structure for rate setting purposes. Rather, short-term debt is assigned to CWIP in the calculation of the AFUDC rate. Short-term debt rates presently are very low. This results in an AFUDC rate that is lower than the authorized overall rate of return. Second, Mr. Ziminsky testified that Delmarva does not capitalize AFUDC on construction projects of short duration and on those projects that have low per unit costs.[2]

Q. CAN ANYTHING BE DONE TO MAKE AFUDC MORE COMPENSATORY TO THE COMPANY?

A. Yes. Mr. Ziminsky proposed two solutions. His first recommendation is to include CWIP in rate base. I have already stated my objection to, and the Commission's recent rejection of, this approach. His alternative recommendation is to accrue a carrying charge on all CWIP. Under Mr. Ziminsky's alternative recommendation, the difference between the accrued carrying charge and the actual amount of AFUDC that is recorded on the Company's books would be treated as a regulatory asset and amortized over the service lives of the related construction projects once they are completed and placed into service. Although better than his first alternative, a more straightforward approach would be for Delmarva to change its AFUDC capitalization policies so that it actually

[2] Testimony of Jay C. Ziminsky, page 32.

capitalizes AFUDC on all projects. In that way, there would be no need for Delmarva to create and track the regulatory assets that are created under Mr. Ziminsky's alternative recommendation.

E. Cash Working Capital

Q. FOR WHAT PURPOSE SHOULD A CASH WORKING CAPITAL ALLOWANCE BE INCLUDED IN RATE BASE?

A. A cash working capital allowance should be included in rate base to compensate investors for investor-supplied funds, if any, used to provide the day-to-day cash needs of the utility. These cash needs are measured in a lead-lag study. Specifically, a lead-lag study measures the time between (1) the provision of service to utility customers and the receipt of revenue for that service by the utility, and (2) the provision of service by the utility and its disbursements to employees and vendors in payment for the associated cost of those services. The difference between the revenue "lag" and the expense "lead" is expressed in days. The difference, which can be either a net lag or a net lead, multiplied by the average daily cash operating expenses, quantifies the cash working capital required for, or available from utility operations.

Q. DID DELMARVA PRESENT A LEAD-LAG STUDY IN THIS PROCEEDING?

A. Yes. Based on the result of the Company's lead-lag analysis, Mr. Ziminsky included a $10,911,603 allowance for cash working capital in his proposed rate base.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO MR. ZIMINSKY'S PROPOSED CASH WORKING CAPITAL ALLOWANCE?

A. Yes, I am. I am recommending two types of adjustments to the Company's claimed allowance for cash working capital. First, I disagree with the expense lead days that Mr. Ziminsky assigned to O&M expenses; specifically the expense lead days that were assigned to Service Company billings. Second, I have adjusted the Company's cash working capital amount to reflect the consequences of my recommended expense adjustments on the cash working capital allowance.

Q. REFERRING TO THE FIRST CASH WORKING CAPITAL ADJUSTMENT THAT YOU JUST MENTIONED, WHAT EXPENSE LEAD DAYS DID DELMARVA ASSIGN TO PAYMENTS TO ITS AFFILIATE SERVICE COMPANY?

A. Mr. Ziminsky assigned a 14.43-day expense lead to Delmarva's payments to the affiliate Service Company. This amount was calculated assuming that Delmarva paid the Service Company on the 15th of each month and at the end of the month, each month.

Q. IS A 14.43-DAY EXPENSE LEAD REASONABLE FOR DELMARVA'S PAYMENTS TO THE SERVICE COMPANY?

A. No, it is not. The Service Company Agreement under which Delmarva receives centralized corporate governance and other services from the Service Company specifies that the Service Company render a bill only once a month. Moreover, in response to a Staff discovery request, Delmarva stated that transactions between Delmarva and the Service Company are settled each month through the PHI Money Pool and that the settlements take place "around the 15th business day…for the preceding month."[3] Thus, contrary to how payments to the Service Company are reflected in the Company's lead-lag analysis (i.e., paid twice each

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[3] See Delmarva's response to PSC-RR-94b.

month for current month billings), Delmarva's payments to the Service Company are made around the 15th business day in the month following the billing month. For example, for corporate treasury services provided to Delmarva in January by the Service Company, the associated charges will be settled through the PHI Money Pool around the 15th business day in February. Thus, by assigning a 14.43-day expense lead to Service Company billings, Mr. Ziminsky has significantly over-stated the Company's cash working capital requirement to carry those expenses until they are paid.

Q. WHAT EXPENSE LEAD DAYS IS APPROPRIATE TO ASSIGN TO SERVICE COMPANY BILLINGS?

A. There are two parts to this equation. The first part is calculating the average service period. This is the same calculation that is made in determining Delmarva's revenue lag. An average month has 30.42 days (365/12). Thus, the average service period is one-half of the length of the average month; or 15.2 days. For the second part of the equation, according to Delmarva's discovery response, affiliate transactions are generally settled by the 15th business day of the following month. Depending on the day of the week that the first business day falls during the month, the 15th billing day will range between 19 and 21 calendar days. If we use the mid-point of this range, there are 20 days from the first of the month following the provision of service and the date on which the bill is settled. Adding these two pieces together we can determine that the correct expense lead to assign to Service Company charges is 35.2 days (15.2 + 20).

Q. DOES CHANGING THE EXPENSE LEAD FOR SERVICE COMPANY BILLINGS FROM 14.43 DAYS TO 35.2 DAYS HAVE A SIGNIFICANT IMPACT ON DELMARVA'S CASH WORKING CAPITAL REQUIREMENT?

A. Yes, it does. Nearly 70 percent of Delmarva's distribution O&M expenses are Service Company charges. Thus, the assignment of expense lead days to Service Company billings has a significant effect on the working cash requirement. In this instance, a 35.2-day expense lead for Service Company billings increases the overall weighted average lead days for all O&M expenses from 17.33 days to 31.70 days. As shown on my Exhibit___(DEP-1), Schedule 2, page 5, the increase in expense lead days assigned to O&M expenses decreases Delmarva's claimed working capital requirement by $4,200,129.

Q. WHAT OTHER ADJUSTMENTS TO CASH WORKING CAPITAL ARE YOU RECOMMENDING?

A. Later in my testimony I describe the adjustments to Delmarva's claimed O&M, tax and interest expenses that I am recommending. Each of these expense adjustments has an impact on the Company's cash working capital requirement. The bottom portion of my Exhibit___(DEP-1), Schedule 2, page 5 illustrates the impact of my recommended expense adjustments on the Company's claimed cash working capital requirement. Together, these changes result in a $266,162 increase in Delmarva's claimed cash working capital allowance. Therefore, my net adjustment is a $3,933,968 decrease to Mr. Ziminsky's proposed cash working capital allowance.

F. Prepaid Insurance

Q. PLEASE EXPLAIN THE PREPAID INSURANCE ADJUSTMENT THAT YOU SHOW ON YOUR EXHIBIT___(DEP-1), SCHEDULE 2, PAGE 2B, COLUMN E.

A. Mr. Ziminsky's proposed rate base includes a $17,826 allowance for prepaid insurance. In response to a Staff data request, however, the Company acknowledged that the expense lead days associated with payment of insurance premiums is already measured in the lead-lag study.[4] Therefore, to include a separate rate base allowance for prepaid insurance double-counts the working capital requirement for prepaid insurance. My adjustment on this schedule eliminates the double-counting of working capital required for prepaid insurance that is reflected in the Company's filed case.

G. Credit Facilities

Q. PLEASE EXPLAIN YOUR RATE BASE ADJUSTMENT FOR CREDIT FACILITIES SHOWN ON YOUR EXHIBIT___(DEP-1), SCHEDULE 2, PAGE 2B, COLUMN F.

A. Mr. Ziminsky proposed an adjustment to Delmarva's test year operating expenses to reflect the Company's annual cost of maintaining a credit facility as well as an amortization of the start-up costs associated with acquiring the credit facility. In addition, Mr. Ziminsky proposed a $520,000 adjustment to include in rate base the unamortized start-up costs associated with the credit facility. Later in my testimony I explain why it is inappropriate to include in rates Delmarva's credit facility costs in the manner that Mr. Ziminsky proposes. Because I am recommending that Delmarva's credit facility costs be reflected in its AFUDC rate and be capitalized as a construction-related cost, it is necessary to remove the proposed credit facility allowance that Mr. Ziminsky included in his rate base calculation. My adjustment removes the $520,111 credit facility allowance from Delmarva's rate base.

[4] See Delmarva's response to PSC-RR-12.

H. Dynamic Pricing and Direct Load Control Regulatory Assets

Q. WHAT DOES MR. ZIMINSKY'S PROPOSED RATE BASE REFLECT CONCERNING DELMARVA'S DYNAMIC PRICING AND DIRECT LOAD CONTROL PROGRAMS?

A. The Commission previously authorized the Company to defer incremental costs incurred in connection with the Dynamic Pricing and Direct Load Control programs into a regulatory asset account. Mr. Ziminsky is proposing adjustments in this proceeding to begin amortizing in rates those deferred regulatory assets. In addition, he has included the unamortized deferred assets in his proposed rate base. Later in my testimony I explain why it is inappropriate at this time to begin the regulatory asset amortization. Given my opposition to beginning the amortization at this time, it is also inappropriate to include the unamortized regulatory asset balances in rate base. Therefore, on my Exhibit___(DEP-1), Schedule 2, page 2b, Column G, I reduced Delmarva's proposed rate base by $3,843,284 to exclude the unamortized regulatory asset for the Dynamic Pricing program. Similarly, in Column H on the same schedule I eliminated from rate base the $5,706,782 unamortized regulatory asset balance associated with the Direct Load Control program. As explained later in my testimony, the Company should continue deferring all incremental costs associated with these two programs.

I. Rate Base Summary

Q. PLEASE SUMMARIZE YOUR RECOMMENDED RATE BASE.

A. Mr. Ziminsky proposed a $754,706,877 rate base for Delmarva's electric distribution operations in Delaware. My rate base adjustments, which are summarized on Exhibit___(DEP-1), Schedule 2, page 2, reduce Delmarva's claimed rate base by $175,962,574. I recommend that the Commission set

Delmarva's rate base at $578,744,302, as detailed on my Exhibit___(DEP-1), Schedule 2, page 1.

IV. EARNINGS UNDER CURRENT RATES

Q. WHERE IN EXHIBIT___(DEP-1) DO YOU SHOW THE COMMISSION STAFF'S ADJUSTMENTS TO DELMARVA'S CALCULATION OF *PRO FORMA* INCOME UNDER PRESENT RATES?

A. All of the Commission Staff's income adjustments are summarized on Exhibit ___(DEP-1), Schedule 3, pages 2, 2a, and 2b. These schedules show the revenue, expense, tax and net income effects of the Commission Staff's adjustments to Delmarva's updated test year presentation in this proceeding. The remaining pages in Schedule 3 detail the development of my adjustments.

A. Average v. Year-end Rate Base

Q. WHAT ADJUSTMENTS TO MR. ZIMINSKY'S INCOME STATEMENT ARE YOU RECOMMENDING TO CONVERT FROM YEAR-END RATE BASE TO AN AVERAGE RATE BASE FOR THE TEST YEAR?

A. Ms. Santacecilia annualized revenues associated with the number of customers at test period year-end. In addition, Mr. Ziminsky annualized the book depreciation expense on plant at test year-end. Because I am recommending that the Commission measure Delmarva's revenue requirement using the test period average rate base rather than year-end, it was necessary for me to reverse both of these adjustments. My reversal of the year-end customer and depreciation adjustments is detailed on my Schedule 3, page 3.

B. Reliability Plant Closings

Q. PLEASE EXPLAIN THE ADJUSTMENTS THAT YOU MADE FOR RELIABILITY PLANT CLOSINGS ON YOUR SCHEDULE 3, PAGE 2A, COLUMN C.

A. Earlier in my testimony I explained my opposition to including post-test year plant additions in rate base. In that section of my testimony I described my adjustments to reverse Mr. Ziminsky's proposed rate base additions. The adjustments shown in this column detail my reversal Mr. Ziminsky's proposed operating income adjustments associated with the forecasted post-test period plant closings.

C. Labor and Payroll Taxes

Q. WHAT ADJUSTMENTS TO TEST YEAR PAYROLL EXPENSE DID DELMARVA PROPOSE IN THIS CASE?

A. Mr. Ziminsky's schedules include a series of adjustments to increase test year payroll expenses to reflect union contract wage increases and non-union salary increases that became effective during the 2012 test year, that will become effective during 2013, and that are forecasted to become effective in 2014. Together, Mr. Ziminsky's proposed payroll increase adjustments increase test year labor expense by $1,782,036.

Q. ARE ALL OF MR. ZIMINSKY'S PROPOSED LABOR EXPENSE ADJUSTMENTS APPROPRIATE?

A. No. Delmarva originally forecasted a 2 percent increase for IBEW Local 1238 members to be effective in February 2013. The actual contract that was ratified included a 2.25 percent increase effective February 2013. Similarly, Mr. Ziminsky's payroll adjustment includes a 2.00 percent increase for IBEW Local 1238 members to become effective in February 2014. The ratified contract includes a 2.50 percent increase in February 2014 for these workers. At the time of the Staff's filing in this case, the Company has not reached a wage agreement with IBEW Local 1307 members for an increase in 2013, even though Mr. Ziminsky included a 2.00 percent increase for these employees in his payroll adjustment. The projected 3.00 percent increase effective in March 2014 for non-union employees included in Mr. Ziminsky's *pro forma* labor cost also is not a known change. Presently, there is no commitment for Delmarva to increase non-union salaries by 3 percent in 2014; thus, Mr. Ziminsky's adjustment to include this forecasted increase is speculative. Therefore, on Schedule 3, page 4, of my revenue requirement exhibit I made an adjustment to substitute the known payroll rate changes for Mr. Ziminsky's earlier estimates. I also eliminated all speculative payroll rate changes that were included in Mr. Ziminsky's payroll adjustment. Together, my payroll expense adjustments reduce Mr. Ziminsky's claimed *pro forma* payroll costs by $513,480. My adjustment on this schedule also reduces FICA taxes by $27,591 corresponding to my *pro forma* payroll adjustment.

D. Incentive Compensation

Q. DOES DELMARVA'S CLAIMED REVENUE REQUIREMENT INCLUDE ANY AMOUNTS FOR INCENTIVE COMPENSATION PAID DURING THE TEST PERIOD?

A. Yes, it does. Mr. Ziminsky adjusted test year expenses to eliminate amounts paid during the test period under the Executive Incentive Compensation program. However, there still remains in Mr. Ziminsky's proposed revenue requirement $1,993,802 for incentive payments made during the test period under the 2012 Annual Incentive Plan applicable to Delmarva and PHI Service Company's non-executive managers.

Q. IS IT APPROPRIATE FOR THE COMPANY TO HAVE INCENTIVE COMPENSATION PLANS?

A. Incentive pay has become prevalent in many industries, including public utilities. Generally, I do not have a problem with utilities motivating key employees through incentive compensation plans. I have not objected to recognizing in rates incentive compensation costs incurred under plans that were designed to promote employee safety and ratepayer interests. On the other hand, I have consistently objected to recognizing in utility rates incentive payments made under plans that were primarily designed to promote shareholder interests rather than ratepayer interests. It is especially objectionable that some incentive compensation plans, including PHI's Annual Incentive Plan, provide perverse incentives for the utility to overstate its revenue requirement and to maintain excessive rates.

Q. IS IT REASONABLE TO CONCLUDE THAT THE PURPOSE OF PHI'S ANNUAL INCENTIVE PLAN IS TO PROMOTE EMPLOYEE SAFETY AND RATEPAYER INTERESTS RATHER THAN SHAREHOLDER INTERESTS?

A. No, there is no support for that conclusion. The Company's plan is a prime example of where the interests of stockholders are placed far above those of Delaware ratepayers. Therefore, it is not appropriate to recognize in rates any costs incurred under the plans because of the way that PHI has structured the Annual Incentive Plan.

Under the Annual Incentive Plan in effect during 2012, total performance payouts were first determined by how well the Company and/or PHI met pre-established financial earnings goals. That is, the plan placed a threshold hurdle on the Company's ability to make performance-related payouts regardless of whether other financial, safety or operational individual or team goals were met. For utility employees, utility earnings had to have reached a 90 percent threshold to qualify for any potential payout. Corporate Service employees were eligible to receive incentive payments only if utility earnings or non-regulated earnings met or exceeded threshold levels. These thresholds had to be met before any performance payouts are made. If the financial threshold goals were met, employees were then eligible to earn additional performance payments for meeting or exceeding other pre-established individual or group safety and operational goals. But, even if all other individual or team goals had been met or exceeded, no incentive payments would have been made unless the minimum financial threshold targets were also met.

Q. ON WHAT BASIS DO YOU CONCLUDE THAT THE COMPANY'S 2012 ANNUAL INCENTIVE PLAN WAS PRIMARILY DESIGNED TO PROMOTE STOCKHOLDER INTERESTS RATHER THAN RATEPAYER INTERESTS?

A. There is no reasonable conclusion other than that this plan was primarily designed to promote shareholder interests given that it requires the Company and or PHI to achieve threshold levels of earnings before any incentive payments are made. That is, Delmarva must first satisfy shareholders by producing sufficient earnings before eligible employees are rewarded for achieving other financial and operational goals. If Delmarva and PHI were more concerned about providing incentives for achieving employee and public safety or ratepayer services and satisfaction goals, for example, there would be no earnings threshold as a necessary pre-condition. Thus, it is clear that the paramount goal of the Annual Incentive Plan was to increase shareholder wealth. This goal is inconsistent with ratepayers' goal of receiving service at the lowest reasonable price. In fact, there is a perverse incentive in the Annual Incentive Plan for the Company to artificially inflate requests for rate relief, to maintain excessive rate levels and to suppress operating expenses and capital investment. Since stockholders are the primary beneficiaries when the Company achieves the financial threshold, stockholders rather than Delaware ratepayers should pay for the incentive awards. Therefore, I recommend that incentive payments made under the Annual Incentive Plan during the test period be excluded from Delmarva's recoverable costs in this proceeding. My position is consistent with the Commission's decision in Docket No. 09-414 on this issue. My adjustment to exclude these payments is shown on Schedule 3, page 2a, Column E in my revenue requirement exhibit.

E. Healthcare Costs

Q. WHAT INCREASES IN EMPLOYEE BENEFIT COSTS ARE REFLECTED IN THE COMPANY'S REVENUE REQUIREMENT ANALYSIS?

A. Mr. Ziminsky proposed adjustments that increase test year medical benefits expense by 8 percent, increases dental benefits expense by 5 percent, and increases vision benefits expense by 5.0 percent. Mr. Ziminsky explained in his testimony that these increases reflect the Company's projections of future cost trends based on a survey prepared by its benefit consultant, Lake Consulting, Inc. Together, these adjustments, if approved, increase test year expenses by $536,185.

Q. ARE YOU IN AGREEMENT WITH MR. ZIMINSKY'S PROPOSED EMPLOYEE BENEFITS ADJUSTMENTS?

A. No, I am not. Mr. Ziminsky's adjustments are not based on known cost changes. Delmarva's employee benefits are provided through self-insurance by the Company and its parent corporation, PHI. Because it is self-insured, Delmarva's annual medical benefits expense depends on not only changes in healthcare cost trends but also on the number of claims and the types of claims that are made. Therefore, knowing only the general trend in healthcare costs, such as that surveyed by Lake Consulting, does not provide us with enough information to qualify Mr. Ziminsky's adjustments as known changes in Delmarva's healthcare costs. Nor does it tell us what Delmarva's healthcare costs will be in the post-test period. Mr. Ziminsky's healthcare adjustments are speculative and, therefore, should not be recognized for rate setting purposes. My adjustment to reverse the Company's claimed employee benefit cost adjustment is shown on Schedule 3, page 2a, Column F of my revenue requirement exhibit.

F. Regulatory Commission Expense

Q. WHAT ALLOWANCE FOR REGULATORY COMMISSION EXPENSE IS INCLUDED IN DELMARVA'S PROPOSED REVENUE REQUIREMENT?

A. Mr. Ziminsky proposed a set of adjustments that result in a $264,183 annual allowance for regulatory commission expense. The allowance that he proposed for non-rate case regulatory commission expense is $53,316 and was calculated using a three-year average of actual expenses. The proposed expense allowance also includes the Company's estimate of its costs for this rate proceeding ($632,600) amortized over three years, or $210,867 per year.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO DELMARVA'S PROPOSED REGULATORY COMMISSION EXPENSE ALLOWANCE?

A. Yes, I am. Mr. Ziminsky's $632,600 estimate of the costs associated with this rate proceeding does not represent a known cost at this time. The following table lists Delmarva actual rate case expenses for the three immediately preceding electric rate proceedings.

Delmarva Electric Rate Case Expense

Docket No. 11-528 (settled)	$634,054
Docket No. 09-414 (litigated)	$245,241
Docket No. 05-304 (litigated)	$400,000
Average	$426,432

Regardless of whether rate cases are settled or litigated, the chart above illustrates how variable and unpredictable rate case expenses can be. Until we have a better understanding of what Delmarva's actual rate case expenses associated with this case may be, a better approach is to normalize the Company's rate case costs just as the Company did for its non-rate case legal expenses. Therefore, I have adjusted Mr. Ziminsky's forecasted rate case expense to reflect Delmarva's average rate case expense incurred over the last three rate proceedings. This adjustment reduces Mr. Ziminsky's requested annual rate case expense allowance by $68,723, as detailed on Exhibit___(DEP-1), Schedule 3, page 5.

G. Automated Metering Infrastructure ("AMI")

Q. WHAT IS THE CURRENT STATUS OF DELMARVA'S AMI PROGRAM IN DELAWARE?

A. Mr. Ziminsky stated in his testimony in this proceeding that AMI "has been fully deployed to customers."[5] Therefore, Mr. Ziminsky proposed a series of adjustments to reflect in rates ongoing AMI O&M expenses, associated savings, depreciation and amortization expenses.

Q. DO MR. ZIMINSKY'S PROPOSED ADJUSTMENTS REFLECT ALL OF THE ANTICIPATED SAVINGS FROM THE AMI PROGRAM?

[5] Testimony of Jay C. Ziminsky, page 17.

A. No, they do not. Mr. Ziminsky explained in his testimony that the Company anticipates additional savings can be achieved by remotely turning on or off service related to involuntary service terminations. The ability to achieve these savings, however, is dependent upon Delmarva receiving a favorable ruling from the Commission on the Company's request to amend the Commission's termination rules. I agree with Mr. Ziminsky in that if a favorable ruling from the Commission is received, Delmarva should defer the associated savings as a credit to the Company's AMI regulatory asset account until the Company's next base rate proceeding when the saving can be factored into base rates.

H. Integrated Resource Plan ("IRP") Recurring Costs

Q. WHAT IS THE COMPANY PROPOSING CONCERNING IRP-RELATED COSTS?

A. Delmarva is required to prepare an IRP every two years. Therefore, Mr. Ziminsky proposed an expense adjustment based on estimated costs associated with preparing an IRP ($1,745,000) annualized over two years ($872,500).

Q. DO YOU AGREE WITH MR. ZIMINSKY'S ADJUSTMENT?

A. No, not entirely. I agree that some allowance in rates is necessary to reflect the recurring costs incurred to prepare bi-annual IRPs. But, Mr. Ziminsky's estimates of what it will cost to prepare the IRP's are speculative. Moreover, even the tasks to be undertaken in each IRP are somewhat speculative at this time. Therefore, I do not agree with Mr. Ziminsky's proposed expense normalization adjustment.

Delmarva has been preparing IRPs in one form or another since 2006. While the specific tasks, studies, and costs associated with each previous study have varied, we now have a seven-year history of the Company's IRP-related annual costs. Rather than rely on Mr. Ziminsky's speculative cost estimates, I think a far better approach is to normalize Delmarva's actual IRP expenses over the last seven years using the Company's actual average annual expense. Doing so results in a $700,587 annual allowance for IRP preparation rather than $872,500 as Mr. Ziminsky proposed. My $171,913 adjustment to Mr. Ziminsky's proposed IRP annual allowance is detailed on Exhibit___(DEP-1), Schedule 3, page 6.

I. Dynamic Pricing Program

Q. WHAT IS THE CURRENT STATUS OF THE COMPANY'S DYNAMIC PRICING PROGRAM IN DELAWARE?

A. Mr. Ziminsky's testimony in this proceeding is that the program is not yet fully deployed.[6] The initial roll-out began in the summer of 2012. The full roll-out to all Residential Standard Offer Service customers is planned for some time this summer.

Q. WHAT RATE TREATMENT IS THE COMPANY REQUESTING IN CONNECTION WITH THE DYNAMIC PRICING PROGRAM?

A. Mr. Ziminsky proposed a series of adjustments to: 1) begin a 15-year amortization of previously deferred costs associated program costs; 2) include in the Company's revenue requirement O&M costs related to the program that are not already included in rates; and 3) include in the Company's revenue requirement an amortization expense for related equipment costs.

Q. ARE MR. ZIMINSKY'S ADJUSTMENTS APPRORIATE AT THIS TIME?

A. No, they are not. Because full deployment of the Company's Dynamic Pricing program did not occur before or during the test period in this case, the related benefits and savings to be achieved through the program are not reflected in the

[6] Testimony of Jay C. Ziminsky, page 17.

Company's test period results. Moreover, full deployment of the program will not be completed until well after the end of the test period in this case. The difference in timing between recognition of program related costs and expected benefits to be achieved through the program creates a test period mismatch, which should be avoided. Rather, I recommend that Delmarva continue to defer all incremental costs associated with the Dynamic Pricing program until the Company's next base rate proceeding following full deployment of the program. Deferral of these costs, as previously provided for by the Commission, provides a strong measure of assurance of eventual recovery of such costs provided they are deemed necessary, and reasonably incurred.

J. Direct Load Control Program

Q. WHAT IS THE CURRENT STATUS OF THE COMPANY'S DIRECT LOAD CONTROL PROGRAM?

A. Mr. Ziminsky states in his testimony that the roll-out to customers of this program is to start this summer and continue through 2016.[7] Delmarva's costs incurred under this program are being deferred into a regulatory asset account pursuant to a prior Commission order.

Q. WHAT RATE TREATMENT IS THE COMPANY SEEKING IN THIS PROCEEDING CONCERNING ITS DIRECT LOAD CONTROL PROGRAM?

A. Mr. Ziminsky proposes to begin a 15-year amortization through rates of the accumulated regulatory asset established for this program. His proposed revenue requirement in this case includes a $663,192 amortization expense allowance for actual and projected costs associated with this program.

[7] Testimony of Jay C. Ziminsky, page 17.

Q. DO YOU AGREE WITH MR. ZIMINSKY'S PROPOSED RATE TREATMENT?

A. Similar to my objection to including in rates at this time costs associated with Delmarva's Dynamic Pricing program, the Direct Load Control program is too far beyond the end of the test year and the benefits expected to accrue from the program are not factored into test period operating results. Therefore, I recommend that Delmarva continue to defer costs associated with its Direct Load Control program into the regulatory asset account previously established for this program. On Exhibit___(DEP-1), Schedule 3, page 2b, Column E, I reverse Mr. Ziminsky's proposed $663,192 amortization expense adjustment.

K. Credit Facility

Q. WHAT IS DELMARVA REQUESTING IN THIS PROCEEDING RELATIVE TO THE PHI CREDIT FACILITY?

A. Mr. Ziminisky explained in his testimony that on August 1, 2011, PHI renewed its credit facility, from which it receives short-term financing, for a five-year term.[8] Mr. Ziminsky proposed an adjustment to amortize Delmarva's allocated share of the start-up costs and the annual cost of maintaining the credit facility in rates.

Q. DO YOU AGREE WITH MR. ZIMINSKY'S PROPOSED ADJUSTMENTS RELATING TO THE PHI CREDIT FACILITY?

A. No, I do not. Mr. Ziminsky states that the credit facility costs are recorded on Delmarva's books as an interest expense. It is important to recognize that the credit facility costs are a cost associated with securing short-term debt financing. Short-term debt, however, is not included in the Company's capital structure.

[8] Testimony of Jay C. Ziminsky, page 30.

Rather, under the Uniform System of Accounts, Delmarva first assigns short-term debt to construction work in progress. This assignment is recognized in the AFUDC rate, which Delmarva capitalizes to its construction accounts. Therefore, rather than including the PHI credit facility costs in current rates as Mr. Ziminsky proposes, the proper treatment of these costs is to recognize them as an increase in the effective cost of short-term debt in the calculation of Delmarva's AFUDC rate. In that way, Delmarva will be appropriately compensated for its credit facility costs in the Company's AFUDC rate, which is the manner intended under the Uniform System of Accounts. I recommend that both the test year level of credit facilities costs as well as Mr. Ziminsky's PHI credit facility cost adjustments be reversed. My adjustments that accomplish this reversal are shown on my Schedule 3, page 2b, Column F.

L. Interest Synchronization

Q. PLEASE EXPLAIN THE INTEREST SYNCHRONIZATION ADJUSTMENT THAT YOU SHOW ON SCHEDULE 3, PAGE 7.

A. This schedule shows the required adjustment to state and federal income taxes to synchronize the interest expense tax deduction with the debt portion of the overall return requirement that Staff is recommending. The pro forma tax deduction for interest expense is the product of the weighted cost of debt and my rate base determination and results in a $1,781,279 increase in income taxes currently payable.

M. AFUDC

Q. WHAT IS THE BASIS FOR THE AFUDC ADJUSTMENT THAT YOU SHOW ON EXHIBIT___(DEP-1), SCHEDULE 3, PAGE 2B, COLUMN H?

A. I explained earlier in my testimony that Delmarva's claimed revenue requirement includes CWIP in rate base. It also includes the test year AFUDC balance as a credit to operating income. Thus, in the Company's revenue requirement analysis, AFUDC is a partial, albeit non-compensatory, offset to the revenue requirements associated with including CWIP in rate base. Since it is my recommendation that CWIP be excluded from rate base, it is also appropriate to remove the AFUDC income credit. My adjustment to remove the AFUDC income credit decreases test year operating income by $965,309.

N. Wilmington Franchise Tax

Q. HOW IS THE FRANCHISE TAX IMPOSED BY THE CITY OF WILMINGTON REFLECTED IN DELMARVA'S PROPOSED REVENUE REQUIREMENT?

A. The Company includes a 0.106 percent allowance for the Wilmington Franchise Tax in its revenue conversion factor. Thus, the Company proposes to collect the tax from all Delaware distribution customers, as it has in the past, including those located outside Wilmington's city limits.

Q. IS THE COMPANY'S RATE TREATMENT OF THIS TAX APPROPRIATE?

A. No, it is not. Municipal services funded by revenues raised through the Wilmington Franchise Tax are not available to customers located outside the City of Wilmington. Therefore, only electric distribution customers located within Wilmington, who actually receive the municipal services funded by the franchise tax, should be assessed the tax. For this reason, I have removed the Wilmington Franchise Tax from my determination on the revenue conversion factor on Exhibit___(DEP-1), Schedule 1, page 2. Delmarva's distribution tariff and the Company's monthly customer statements should be modified to include an assessment of the Franchise Tax to only customers located within the City of Wilmington.

O. Summary of Revenue Requirement

Q. WHAT IS THE COMBINED EFFECT OF THE YOUR RECOMMENDED ADJUSTMENTS TO DELMARVA'S UPDATED CALCULATION ITS REVENUE REQUIREMENT FOR THE TEST PERIOD ENDED DECEMBER 31, 2012?

A. As shown on my Schedule 3, page 1, Delmarva calculated *pro forma* earnings under present rates of $32,185,654 for the adjusted test period ended December 31, 2012. My recommended income adjustments add $2,133,271 to Delmarva's claimed *pro forma* earnings. Thus, I calculate that Delmarva's present revenues generate $34,318,925 of earnings under *pro forma* conditions for the test period and a 5.93 percent return on the test year average rate base.

Division of the Public Advocate witness Mr. Parcell determined that Delmarva requires a 9.35 percent return on common equity capital and a 7.09 percent overall return on rate base. Rate levels will have to be increased by $11,442,413 to produce a 7.09 percent overall rate of return for Delmarva. Therefore, I recommend that Delmarva's proposed rate schedules be rejected and that the Company be ordered to file new rate schedules reflecting the lower revenue requirement that the Commission Staff has determined is necessary at this time.

Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does.