BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR APPROVAL OF A CHANGE IN ELECTRIC DISTRIBUTION RATES AND MISCELLANEOUS TARIFF CHANGES (FILED MARCH 22, 2013)

PSC DOCKET NO. 13-115

STAFF'S BRIEF ON EXCEPTIONS TO THE HEARING EXAMINER'S PROPOSED FINDINGS AND RECOMMENDATIONS

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CURRENT STAGE OF THE PROCEEDINGS

On March 22, 2013, Delmarva Power & Light Company ("Delmarva" or the "Company") applied to the Delaware Public Service Commission (the "Commission" or "PSC") for approval to: (1) increase base rates for electric distribution by $42,044,000, a 23.8% increase over existing distribution revenues; and (2) modify certain provisions of its tariff which included adding LED lighting options to its Outdoor Lighting (OL) tariff and proposing a new rider relate to recovering costs associated with DelDOT relocation projects.

The evidentiary hearings on Delmarva's application were held on November 13, 14, and were completed on November 18, 2013. Post-hearing briefing was concluded on February 5, 2014. On March 4, 2014, the Hearing Examiner issued his proposed findings and recommendations. Pursuant to the schedule approved by the Hearing Examiner, exceptions to his proposed findings and recommendations are due on Monday, March 17, 2014. This is Staff's Brief on Exceptions to the Hearing Examiner's proposed findings and recommendations.[1]

OVERVIEW OF THE PARTIES' POSITIONS

The Company's application with the Commission requested $42,043,757 or a 23.8% increase over existing retail distribution rates using a test period ending December 31,

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[1] For a complete summary of the Nature and State of the Proceedings, see Staff's Post-Hearing Brief to the Hearing Examiner (January 21, 2014).

References to the exhibits introduced at the evidentiary hearings will be cited as "Exh. __ (Witness' Name) at __" for direct testimony; Exh. __ (Witness' name-R") at __" for rebuttal testimony; "Exh. __" for non-testimonial exhibits. References to the transcripts of the hearings will be cited as "Tr. at __:" for Delmarva's Post-Hearing Reply Brief "RB at __." References to the Public Advocates Brief ("DPA at __;" Staff's Brief ("SB at __"). References to the Hearing Examiner's decision will be referred to as "HER __ at __."

2012.[2] Delmarva's request was largely premised on $65 million in plant reliability adjustments 12 months beyond the test period, inclusion of Construction Work in Progress ("CWIP"), and a proposed rate of return on common equity of 10.25% resulting in a requested 7.53% return on rate base.[3] The Company subsequently revised its rate request to $39 million, primarily because its forecasted plant closures for 2013 were overstated by over 20%, and accordingly reducing its revenue requirement by over $3 million.[4]

Staff calculated a revenue requirement of $11,442,413, based on a test period rate base of $578,744,304, an overall rate of return of 7.09% on the Company's capital structure and test period pro forma operating income of $34,318,925.[5] The main differences between the Company's and Staff's positions were the use of average test period plant balances, removal of post-test period reliability investments (pending conclusion of the Commission's investigation regarding the issue), removal of CWIP, and a lower return on common equity.

The Division of the Public Advocate ("DPA") calculated a revenue requirement of $7,309,999, based on a test period rate base of $553,669,028, an overall rate of return of 7.09% on the Company's capital structure and test period pro forma operating income of $34,970,408.[6] The primary differences between the Company's and the DPA's positions are removal of post-test period reliability investments, CWIP, and Prepaid Pension, and the return on common equity.

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[2] This is in addition to the $22 million in additional distribution rates that were the product of a settlement in the last DPL rate proceeding based on a December 31, 2011 test period. *See,* PSC Order No. 8265 (December, 18 2012)

[3] Exh. 5 (Ziminsky) at Sch. (JCZ–R)-1 pg. 2.

[4] Exh. 20 (Ziminsky-R) Sch. (JCZ-R)-7; SB at footnote 237.

[5] Exh. 15 (Parcell) at 4); Exh.11 (Peterson) at Ex. DEP-1, Sch. 1, pg.1.
Staff relied on DPA witness Parcell in developing a suggested return on common equity for purposes of calculating its revenue deficiency. Staff has relied on Mr. Parcell's cost of equity recommendations for over 15 years in various utility matters. *See*, Appendix A.

[6] Exh. 13 at (Crane) at 4.

Delaware Energy Users Group ("DEUG") did not proffer an accounting or Cost of capital witness in this proceeding, but did sponsor Mr. Phillips on cost of service and rate design issues.

OVERVIEW OF THE HEARING EXAMINER'S FINDINGS AND RECOMMENDATIONS

The Hearing Examiner's Report, albeit extensive and a good work product, rests on several fundamental flaws that make some of his conclusions unsupportable. With regard to post–test period plant additions, the Hearing Examiner has written the standard of "used and useful" out of the statute, and instead applied a standard applicable to operating expenses.[7] Regarding the appropriate cost of equity, the Hearing Examiner relies -- exclusively -- on the testimony of one witness that no other Commission has ever relied on to the exclusion of other witnesses' opinions. If this Commission adopts the Examiner's recommendation on this one issue, and sets the rate of return on common equity at 10.25 % as he recommended -- it would be the first Commission -- ever -- to adopt this witness' testimony for any of the PHI operating companies; it would also be the highest authorized return as well.

With regard to other rate base issues, the Hearing Examiner adopted Staff's position that the average rate base should be used for the test period rather than year-end, excluded CWIP from rate base, found the Company's proposed cash working capital ("CWC") adjustment was over stated, included the costs associated with the credit facility, and limited Dynamic Pricing ("DP") in rate base to the actual costs ($2,453,025) through the end of the test year, December 31, 2012, but excluded all Direct Load Control ("DLC") from rate base

[7] *See*, 26 *Del. C.* § 102(3)a.

since no actual costs were incurred during the test period.[8] As a result of the Examiner's rate base recommendations the Company's requested rate base was reduced to $629,115,161 from its requested $745,604,175.

Regarding the earnings issues, the Hearing Examiner's report allowed the Company's wage adjustments, eliminated non-executive incentive compensation, allowed the proposed estimates of healthcare cost increases, permitted Delmarva's regulatory expense adjustment, granted the Company's request for SERP (Supplemental Executive Retirement Plan) recovery, and reduced the Company's IRP (Integrated Resource Plan) operating expense to reflect a three (3) year average balance. In addition he denied the Company's request for membership fees and expenses, relocation expenses, corporate governance expenses, meals and entertainment. The result of these findings increased the Company's pro-forma operating income to $33,571,524 from the Company's rebuttal request of $33,298,159. Using Staff's conversion factor, which eliminates the Wilmington Franchise tax in the calculation, this results in a revenue deficiency of $23,627,311.[9]

1. **Applicable Law**

Having correctly established that the Commission has exclusive jurisdiction over this matter, and that the burden of proof rests on the utility throughout the proceeding, the Examiner moves on to the appropriate standard to apply to plant additions, where he concluded:

> [I] find that the "used and useful" standard does not apply to the actual or forecasted plant closings in this proceeding because: 1) these expenses are not "extraordinary" according to the Superior court's decision in the

[8] The Examiner also adopted the DPA's adjustment regarding Medicare costs incurred in 2010, which reduced rate base by $54,650, but denied adjustments requested by the DPA for pre-paid pension, deferral of initial IRP costs and Blue Water RFP costs.

[9] This revenue deficiency includes the Examiner's finding of 10.25% on common equity. If the existing return on equity were maintained, the deficiency would be $20,946,888.

> *Chesapeake* case; and 2) this Commission's precedent correctly holds otherwise. (HER ¶ 35 at 15-16).

Contrary to the Examiner's reasoning, the *Chesapeake* case does not support his conclusion.[10] In addition there is no Commission decision that supports a conclusion that plant does not have to be used and useful before it can be included in customer rates. Rather, the law and prior Commission decisions -- all of them at least since 1974 -- have found that the used and useful standard must be met by a utility before it will be allowed a return of and on such an investment.

In Delmarva's prior electric case (Docket No.11-528), this point was specifically made by one of the co-authors of the 1974 statute -- Mr. Victor Singer. There, in a Wilmington public comment session, Mr. Singer stated:

> Sub-sub-section "a" of the Rate Base definition requires that for an element of capital plant to be included in Rate Base, the element must be "used and useful." It cannot be used and useful until it exists… .
>
> It follows that the PSC can lawfully authorize ratepayer contributions and/or advances against future revenue in aid of construction for the capital plant that Delmarva seeks coverage for, it cannot allow rate base coverage of such plant until it becomes used and useful in the public service without legislative authorization. PSC Commissioners are under oath to uphold these [sic] existing law. They cannot change the law. Only the General Assembly has that power.[11]

Mr. Singer also addressed the issue of regulatory lag in his comments:

> Methodology for accounting for capital plant that takes years to construct is an obvious need. The Delaware PSC and many other utility regulators have properly long recognized that a part of the original cost to be booked as rate base when the capital plant becomes used and useful is the cost of financing during construction. The cost of carrying the investment until it can be booked as rate base is terms [sic] AFUDC, Allowance for Funds Used During Construction. The percentage rate is established every year by the PSC for that year, reflecting current money market realities. The actual capital investment invested in capital plant, plus [s]imple interest

[10] *Chesapeake Utility Corp. v. Delaware Public Service Comm'n,* 705 A.2d 1059 (Del. Super. 1997).
[11] Docket No. 11-528, Tr. at 22-3 (relevant portions attached as Appendix B).

> between the investment date and the date of addition to rate base becomes the booked original cost of the increment of rate base. That is recovered by the utility as depreciation expense charged to the ratepayers over the life of the investment.
>
> That accounting technique has been in use in Delaware for over 40 years that I am aware of and much longer here and elsewhere before my own involvement. It has worked well even in times like the Carter years when the cost of money was much higher than it is today. It follows today's minuscule interest rates. Delmarva Power would be hard-pressed to show that they would be damaged by continuation of the current practice.[12]

Accordingly, as discussed below, the Hearing Examiner's mis-application of the appropriate standard for judging post-test period plant additions invalidates his conclusions and thus cannot form the basis for the Commission's decision in this case.

Under Delaware law, "rate base" begins with a determination of the original costs of all "used and useful utility plant" and intangible assets. 26 *Del. C.* §102(3)a.[13] Thus, if, in fact, the plant closings are part of Delmarva's "utility plant," then the only applicable standard for a review of the expenditures would be the statutorily mandated "used and useful" standard as set forth in the Delaware Code. 26 *Del. C.* §102(3)a.

In contrast to this logical and statutorily-required standard for "utility plant," Delmarva argues that its plant closings must be reviewed under the "waste, inefficiency, or bad faith" standard from *Delmarva Power & Light Co. v. Public Service Comm'n* (the "*Delmarva Power*" case).[14] This standard is inapplicable, however, to "utility plant" and

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[12] *Id.* 23-4

[13] *See also,* 64 Am. Jur. 2d Public Utilities §99: "The property on which a public utility is entitled to earn a fair and reasonable return is that used or useful property that it necessarily devotes to rendering the regulated services. In order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses are all matters for consideration and are to be given such weight as may be just and right in each case." (citations omitted).

[14] 508 A.2d 849 (Del. 1986)

hence inapplicable to Delmarva's reliability plant closings because the *Delmarva Power* case held that the "waste, inefficiency, or bad faith" standard is applicable only for ***operating expenses***.[15] Thus, on the one hand, Delmarva argues that its plant closings are part of rate base as "utility plant," while on the other hand it argues that the "waste, inefficiency, or bad faith" standard that applies to operating expenses is the applicable standard for review for the expenses it incurred for plant closings.[16] Delmarva confuses the two standards, and this confusion carried over into the Hearing Examiner's Report.

Despite this clear distinction between the standard for utility plant and the standard for operating expenses, the Hearing Examiner applied the "waste, inefficiency, or bad faith" standard, which is only applicable to operating expenses. His decision is allegedly supported by two factors: (i) the plant closing expenses are not "extraordinary" expenses according to the decision in *Chesapeake*; and (ii) Commission precedent supports his conclusion and decision. The Hearing Examiner's conclusion that the "used and useful" standard does not apply to the review of the plant closings shows a misinterpretation of the *Chesapeake* case holding and Commission precedent.

The limited issue on appeal in the *Chesapeake* case was whether the Commission erred in denying recovery through expense treatment of the carrying costs or rate base treatment of the unamortized balance of actually incurred remediation costs.[17] The Superior Court discussed the seminal rate case formula, the Commission's authority in

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[15] *Id.* at 859 (Commission required to allow a utility normally accepted operating expenses in the absence of finding waste, inefficiency or bad faith) (citing *Application of Diamond State Telephone Co.*, 103 A.2d 304 (Del. Super. 1954); *Application of Wilmington Suburban Water Corp.*, 203 A.2d 817, 836 (Del. Super. 1964), aff'd, 211 A.2d 602 (Del. 1965)).

[16] RB at 8-9.

[17] *Chesapeake*, 705 A.2d at 1064. The Court there noted that there appeared to be two ways to handle this issue: Either treating the carrying costs as an expense or putting the unamortized balance in the rate base. "It has not always been clear to the Court what Chesapeake is seeking, but it will assume for the purpose of this opinion that both were argued." Id . at 1064, n. 4.

setting rates, the definition of "rate base" as used in 26 *Del. C.* §102(3)a., and the analysis used in setting rates.[18] It also concluded that substantial evidence supported the Commission's decision that Chesapeake's remediation costs were extraordinary expenses (and not entitled to recover carrying costs on such) and that the Commission did not commit legal error in reaching its conclusion. As part of its reasoning, the Court pointed out that operating expenses "simply are not given rate base treatment." Hence, the Court emphasized that it could not call the remediation costs "operating expenses" and at the same time give them rate base treatment because they (i) are recovered completely when incurred and (ii) are not something like plant assets, upon which a utility earns a rate of return.

As shown by the reasoning in the *Chesapeake* decision, if expenditures are part of "utility plant" within the definition of 26 *Del. C.* §102(3)a., such expenditures cannot be ordinary expenses subject to the "waste, inefficiency, or bad faith" standard, nor could they be "extraordinary" expenditures. Only "expenses" are subject to the standard set forth in the *Delmarva Power* case.[19] Operating expenses are generally defined as those expenses inherent in the cost of producing the utility's service and required to keep the utility running.[20] In other words, they are the expenses normally incurred in the course of the utility's ordinary activities.[21] Thus, if an expenditure is an expense, it is not part of a utility's rate based under 26 Del. C. §102(3)a.

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[18] *Chesapeake*, 705 A.2d at 1065-1072.

[19] See *Delmarva Power*, 508 A.2d at 859 ("In reviewing the operating expenses of a public utility, the Commission may not disallow 'normally accepted operating expenses ... unless found to have been made in bad faith or out of an abuse of discretion.'" (citing, *Application of Diamond State Telephone Co.*, 103 A.2d at 304, 319 (Del. Super. 1954)).

[20] *Chesapeake,* 705 A.2d at 1068

[21] *Id. See*, *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 167 (1934); 64 Am. Jur. 2d Public Utilities §§ 173-89; Black's Law Dictionary at 1091 (6th ed.1990).

In addition to the Hearing Examiner's misapplication of the *Chesapeake* holding, the Hearing Examiner has misconstrued the Commission's decision in PSC Docket No. 09-414 as somehow demonstrating that post-test period plant closings are not subject to the "used and useful" standard. But the issue discussed in PSC Order No. 8011 was whether, under the circumstances presented in that case, both the April-July 2009 and August-December 2009 reliability plant should be included in rate base as a known and measurable change.[22]

If the amounts Delmarva incurred for actual and forecasted plant closings are, in fact, part of the costs it incurred for "utility plant" within 26 *Del. C.* §102(3) a., the only proper standard to apply is the three-part test set forth in *Chesapeake* case. There, the Delaware Superior Court determined that three questions must be asked when determining whether an item falls within the definition of "utility plant" as set forth in 26 *Del. C.* §102(3)a.: (i) Is the underlying item for which the expense was incurred a "utility plant" or "intangible asset" (ii) If so, is the utility plant or intangible asset "used and useful;" and (iii) If so, is the expense sought to be recovered the "original cost" or the used and useful utility plant or intangible asset?[23] The Superior Court also noted that the

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[22] Paragraph 60 in PSC Order No. 8011 states in full as follows: "We conclude that under the circumstances presented in this case, both the April-July 2009 and August-December 2009 reliability plant should be included in rate base. As previously discussed, we reject the DPA's strict test period construction. We agree with the Company's position that the August 2009 – December 2009 reliability closings are no different from the April 2009 – July 2009 closings. We agree with Delmarva that these costs are known and measurable, and that they are necessary to make the test period more reflective of the period during which the rates approved in this case will be in effect. *See In re Delmarva Power & Light Company*, PSC Docket No. 91-20, 1992 Del. PSC LEXIS 15, Order No. 3389 (Del. PSC March 31, 1992) at 34. We are also persuaded that these plant additions are necessary to preserve the reliable operation of the distribution system and are not being made to serve future customers. While we note that the test period is there for a reason, we believe it is appropriate to include these costs in rate base based on the evidence presented. (Unanimous)."

[23] *Chesapeake,* 705 A.2d at 1070.

Commission employs a basic four-question analysis in setting rates,[24] which has been recognized by the Delaware Supreme Court.[25] Finally, the Court noted that the formula "plainly indicates that operating expenses ("E") are not part of the rate base ("V"), but, rather, such expenses are included in the overall calculation of the rate."[26]

2. Cost of Capital

The Hearing Examiner's decision on this important issue departs from prior Commission precedent without providing a reasoned analysis or substantial evidentiary support. The Commission should not adopt it.

A. DCF (Discounted Cash Flow) Model

The primacy of the DCF model in determining the cost of equity ("COE") for public utilities in the State of Delaware is clear: "For over 20 years, we have relied primarily on the DCF model in ascertaining the appropriate COE for utilities subject to our jurisdiction, although we consider the results of other COE estimation models in

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[24] "[R]ate determinations involve four basic inquiries, expressed concisely in the formula R=E+(V x r). Defining the four variables, R equals the utility's gross revenues under the rate structure examined. E equals the operating expenses including maintenance, depreciation, and all taxes incurred to produce R. V equals the value of the utility's property which provides the services for which rates are charged, i.e., the rate base." *Chesapeake*, 705 A.2d at 1065.

[25] *Id.* (citing *Public Serv. Comm'n v. Wilmington Suburban Water Corp.*, 467 A.2d 446, 448, n. 2 (Del. 1983)

[26] *Chesapeake*, 705 A.2d at 1065-1066.

reaching our determination."[27] In addition, the Commission does not support under weighting the results of the DCF model.[28]

In contrast to this clear and long-standing precedent, the Hearing Examiner has chosen to adopt the arguments of Delmarva's witness Hevert and "to apply more than one model" to determine Delmarva's ROE (return on equity). (HER, ¶55 at 23). As support for this conclusion, the Hearing Examiner stated that the "current market conditions" (especially interest rates) "require the Commission to apply more than one model." (*Id.*) In addition, he relied on two facts that he found to be conclusive support: Staff did not present a ROE witness, and witness Parcell did not offer a Multi-Stage DCF analysis. (HER, ¶78 at 32-33). The Hearing Examiner therefore decided that 10.25% was the proper COE/ROE because he found that Mr. Hevert's "Constant Growth and Multi-Stage Discounted Cash Flow (DCF) Models" were "the more credible ROE analysis." (HER, ¶ 78 at 32-33).

If the Commission ultimately chooses to deviate from its prior precedent, i.e., relying primarily on the DCF model to determine COE, such decision must be supported by more than simply "current market conditions" and the failure of Mr. Parcell's to perform a similar DCF analysis. In reviewing the Hearing Examiner's decision to use

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[27] *See,* PSC Order No. 8011 ¶ 284 at 113 (August 9, 2011), *citing, e.g.*, Docket No. 91-20, Order No. 3389; Docket No. 05-304, Order No. 6930; see also Order No. 6930 (June 6, 2006) in PSC Docket No. 05-304, ¶ 243 ("The Hearing Examiner observed that this Commission has heard the same arguments that the Company made here, but has consistently stated its preference for the DCF model as its primary equity cost model.") *See also* Re *Artesian Water Company, Inc.*, 225 PUR 4th 81 (Del. PSC 2003) at ¶22; *In the Matter of the Application of Delmarva Power & Light Company for an Increase in Its Electric Base Rates and for Certain Revisions to Its Electric Service Rules and Regulations*, 1992 WL 465021, PSC Docket No. 91-20, Findings, Opinion and Order No. 3389 (Del. PSC March 31, 1992), at *50, ¶228; *In the Matter of the Application of Artesian Water Company, Inc. for an Increase in Water Rates*, 1991 WL 496943, PSC Docket No. 90-10, Findings, Order and Opinion No. 3274 (Del. PSC May 28, 1991) at *27; *Re Wilmington Suburban Water Corp.*, 88 PUR 4th 234, 238 (Del. PSC 1988).

[28] *See,* PSC Order No. 6930 at ¶ 270.

multiple models to find what he considered to be the proper ROE, the Commission must carefully assess whether such conclusions can be supported by the record evidence relied upon by the Hearing Examiner.

In adopting his approach in determining the proper COE, the Hearing Examiner noted that Mr. Hevert's Multi-Stage DCF analysis was "as persuasive as his Constant Growth DCF analysis in this docket because Multi-Stage DCF analysis does not assume that earnings and dividends will grow indefinitely at the same rate" and that such model "relies upon multiple earnings growth projections and longer-term financial market metrics." (HER, ¶ 84 at 35-36). The Hearing Examiner found these two factors were important because of "significant increases in Treasury bond yields, utility bond yields and the relative under-performance of utility stocks." (*Id.* at 36). Although these factors can affect a utility investor's expected return, these factors alone do not determine the returns on other comparable-risk investments (which is a primary consideration for the Commission in determining COE).[29]

The other additional shortcomings of the Hearing Examiner's analysis regarding the appropriate cost of equity for Delmarva sprout from this introductory paragraph of his decision:

> Based upon the evidentiary record, I find that Company Witness Hevert's Constant Growth and Multi-Stage Discounted Cash Flow (DCF) Models to be the more credible ROE analysis. First, Staff did not present a ROE witness, although it relied upon Public Advocate Parcell's testimony. Although Public Advocate Witness Parcell presented his Constant Growth DCF analysis, he did not offer a Multi-Stage DCF analysis. (HER ¶78 at 32-3).

From this point forward, the Hearing Examiner's analysis on this important issue spreads forth into the other portions of his decision.

First, the fact that Staff did not present a Cost of capital expert has no relevance to any issue before the Hearing Examiner or this Commission, and Staff was surprised that the Examiner would mention it.[30] At the hearing and in its brief, Staff stated that it was relying on the DPA's expert, Mr. David Parcell who -- as Staff also pointed out -- has testified on numerous occasions on behalf of Staff.[31] Thus, given that he was being sponsored by the DPA, it made perfect sense to Staff not to incur the additional expense in hiring a Cost of capital expert when Staff had such an extensive experience with Mr. Parcell in previous cases before this Commission. Thus, Staff chose to rely on his testimony and opinion on the appropriate Cost of capital issues to recommend to the Hearing Examiner and the Commission.

Second, the Examiner appears to criticize Mr. Parcell for his failure to present a Multi-Stage DCF analysis as Mr. Hevert did -- which, Staff notes, was presented for the first time in Mr. Hevert's rebuttal testimony. Staff finds the Hearing Examiner's reliance on Mr. Hevert's Multi-Stage DCF analysis troubling for several reasons, but chooses to point out only three in these Exceptions. Technically, Mr. Hevert's filing is in violation of Minimum Filing Rules since it contained a new study introduced at the rebuttal stage of the proceedings, not in his direct testimony.[32] Because Mr. Hevert waited until his rebuttal testimony to present his Mulit-Stage DCF analysis, Mr. Parcell, whose direct

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[29] *See*, e.g., PSC Order No. 8111, ¶ 282.

[30] Actually he made note of it three times *See*, HER ¶¶51, 78 and 120 at 20, 33 and 47.

[31] Appendix A to Staff's Post-hearing brief included a list of cases in which Mr. Parcell has testified on behalf of Staff. It is reproduced here as Appendix A to these exceptions.

[32] 26 *Del. Admin. C.* Part A - § 1002-1.3.1 provides, in pertinent part, that "[m]odifications in test period data occasioned by reasonably known and measurable changes in current or future rate base items, expenses (i.e., labor costs, tax expenses, insurance, etc.) or revenues may be offered in evidence by the utility at any time prior to its filing of rebuttal evidence.... Notwithstanding anything to the contrary in 1.3, the Commission, Presiding Officer or Hearing Examiner may permit the utility to offer in evidence the modifications contemplated hereunder simultaneously with the filing of rebuttal evidence, where extraordinary circumstances and the interests of justice so warrant."

testimony had been filed weeks before, had no opportunity to address this new study in his direct testimony. Moreover, as the Examiner was forced to admit, only in Mr. Hevert's "entire high growth scenario" did he find support for his recommended 10.25% return on equity. Notably, Mr. Hevert's other two (2) Multi-Stage scenarios do not support his recommendation. (HER ¶ 85 at 36). Finally, the Hearing Examiner's criticism of Mr. Parcell's failure to offer a Multi-Stage DCF model (or even two or more additional models, which the Hearing Examiner seemed to emphasize as rather important)[33] is irrelevant.

Moving past the Hearing Examiner's fixation with a study that could not be rebutted by any other witness in the proceeding, Staff has several additional concerns with the Hearing Examiner's recommendation on the cost of common equity.

B. Interest Rates

The Hearing Examiner pointed out that both cost of capital witnesses (Mr. Hevert and Mr. Parcell) acknowledged, as they must, that interest rates have moved up from November 2012, the approximate date of the Commission's decision in Docket No. 11-528 which approved an agreed-upon cost of equity for Delmarva of 9.75% (HER ¶ 81 at 34). The Hearing Examiner seems to assume -- from this fact alone -- that higher interest rates must somehow translate into higher equity costs for the utility.[34] But if that is true, why did the Hearing Examiner not ask himself the question why then did the same witness for the same Company reduce his recommended equity return from 10.75% in Docket No. 11-528 to 10.25% in this docket? Why then, as the Hearing Examiner noted,

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[33] The Hearing Examiner notably pointed out that Delmarva presented four models, while the DPA and Staff presented only two. HER ¶ 122 at 48.

did only the high earnings growth scenario in Mr. Hevert's Constant Growth DCF analysis (in his rebuttal testimony filed in September 2013) come close to supporting his recommended return on equity, while both his medium and high growth scenarios in his direct testimony, (filed in March 2013), exceeded 10.25%? Stated another way, why in 2012 in the face of Mr. Hevert's recommended 10.75% on common equity, did the Company accept in settlement a ROE of 9.75%? Why now (in 2013) would Mr. Hevert recommend a 50 basis point drop in this utility's equity return to 10.25% if the admitted rise in interest rates was so impactful?

C. Hevert's DCF Analysis

Unlike Mr. Parcell who has filed testimony in numerous proceedings before this Commission, this was the first time that Mr. Hevert has had his testimony examined in this jurisdiction.[35] As Staff and the DPA pointed out, Mr. Hevert has provided cost of equity testimony in other jurisdictions such as Maryland, where that Commission found his conclusions "wanting" regarding the cost of equity for Pepco, so much so that it characterized them as "excessive and totally unjustified."[36] In a more recent Pepco case, the Maryland Commission muted its criticism of Mr. Hevert's testimony, but only somewhat, by characterizing it as "anomalously high in relation to the other recommendations."[37]

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[34] *See*, HER ¶ 82 at 35, referencing Mr. Hevert's opinion that a utility's ROE should generally increase as interest rates rise.

[35] Mr. Hevert filed testimony on behalf of Delmarva in both Docket Nos. 11-528 and 12-546, but since both matters were resolved before hearings, he did not appear as a witness in either case.

[36] "[P]epco's request that we increase its ROE to 10.75% is not supported and we will not consider that specific recommendation further." See, Maryland Commission Decision Order No. 85028 – *In the Matter of the Application of Potomac Electric Power Company for Authority to Increase its Rates and Charges for Electric Distribution Service,* Case No. 9286 (July 20, 2012) at 107.

[37] See Maryland Commission Decision Order No. 85724 – *In the Matter of the Application of Potomac Electric Power Company for an Increase in its Retail Rates for the Distribution of Electric* Energy, Case No. 9311 (July 12, 2013) at 106.

Notwithstanding the criticism in two successive cases of Mr. Hevert's work in Maryland, the Hearing Examiner in this proceeding -- in a footnote to his decision -- found Staff's criticism deficient of the necessary "nexus" to be relevant and stated "that the Maryland Commission virtually agreed with Mr. Hevert's proposed ROE in a recent case involving Delmarva Power Maryland." (HER footnote 18 at 32). Unfortunately, the Hearing Examiner's first point misses the issue Staff and the DPA were trying to highlight; the second is just factually wrong.

Beginning sometime in 2011, Mr. Hevert was hired by PHI to provide cost of capital testimony for all of its operating companies. In 2012, he recommended the same cost of equity values for all PHI operating companies; that assignment included Pepco, Delmarva Delaware and Delmarva Maryland. In the first round of cases, litigated in 2012, Mr. Hevert recommended 10.75% for each company, including Delmarva Delaware. The Maryland Commission's criticism of his recommendation as totally unjustified (referenced above) was the same testimony he filed in PSC Docket No. 11-528 (where Delmarva requested 10.75% return on equity). The Delaware case was settled for 9.75%; the Maryland case was decided by the Commission at an equivalent basis of 9.75%.[38] Thus, contrary to the Hearing Examiner's opinion, a clear evidentiary nexus exists between the two cases because in both, Mr. Hevert's recommendation of 10.75% was not adopted. Moreover, the Maryland Commission's criticism about Mr. Hevert's testimony goes to the weight this Commission should place on Mr. Hevert's testimony in determining the ROE issue in this case.

[38] The Maryland Commission granted 9.25% plus .6 for flotation costs, which this Commission does not traditionally allow. By adding the decoupling adjustment of 50 basis points and removing the floatation allowance, the Maryland decision effective results in 9.75% ROE.

The reasons for the Maryland Commission's observations regarding Mr. Hevert's conclusions are quite clear and applicable here since Mr. Hevert used the same inflating measures to increase his recommended equity return for the Company: (1) his proxy group carries significant risk in the form of generation facilities which Delmarva no longer possesses; (2) some of his comparable companies have growth rates hundreds of points higher than Delmarva; and (3) he relies only on the highest growth estimates (and only one estimate – i.e., Value Line, First Call or Zacks) to determine the projected high growth rate in his DCF calculations. Thus, Mr. Hevert's analyses focuses only on the methods and data that produce the highest possible results.

For example, as Mr. Parcell explained in looking at Mr. Hevert's schedules, he implicitly assumes that investors only look at the most optimistic growth rates for each individual company in making their individual investment decisions. Furthermore, it may not even be the same analyst for each individual company that Mr. Hevert is relying on since he picks only the highest estimate for his individual company analysis. In looking at Mr. Hevert's Schedule (RBH-1), which shows his Constant Growth DCF analysis, his "High ROE" only considers one of the earnings growth rate (reflected in columns [5], [6], and [7]), not three. Stated another way, the "High ROE" calculation only relies on one data point for earnings per share growth rate, and it may not be the same analyst making the projection for each member of the proxy group.[39] Thus, Mr. Hevert is using only one data point -- always the highest -- among the various EPS growth rate indicators to influence (and drive upwards) his growth rate calculation in his DCF.

[39] Exh. 15 (Parcell) at 37-8.

"Cherry picking" financial information to drive a DCF analysis in a particular direction is not the type of analysis that this Commission has historically relied on -- nor should it (or the Hearing Examiner) rely on such distorted information in this case. Mr. Hevert further increases his DCF values by using only analysts' EPS forecasts of growth, ignoring alternative measurements of growth rates found in more traditional Constant Growth DCF models. This again tends to drive his DCF values up. Mr. Parcell's Exhibit DCP-14 updated Mr. Hevert's DCF analyses using the same three sources of EPS projections for Hevert's proxy companies. Exhibit DCP-14 shows much lower values for DCF cost rates when using three sources for EPS projections rather than one -- the highest -- as shown below:

	DCF Results	
Growth Rate	Average	Median
Zacks	9.20%	9.19%
First Call	8.98%	9.29%
Value Line	9.59%	9.08%[40]

Other commissions before which Mr. Hevert has testified have noted the upward bias of his results due to his exclusive use of the forecasted EPS growth rates of Wall Street analysts in estimating the growth component in the DCF model, holding that,

[40] *Id.* at 39.

"[p]rojected EPS growth rates are overstated and should not be exclusively relied upon."[41]

Also, as noted by the Maryland Commission, the inclusion of companies with substantially disparate growth rates that are markedly higher than Delmarva's is not appropriate either.[42] As Mr. Parcell suggested, Mr. Hevert's analysis is again influenced -- upwardly -- by inclusion of two companies in his composite group: Otter Tail Company and PNM Resources, both of which have growth rates that far exceed that of the remainder of the Hevert proxy group (12% and 21.5%, respectively).[43] By just removing those two companies from Mr. Hevert's analysis, the resulting DCF values fall within the range suggested by Mr. Parcell (i.e., 9.35%).

The upward bias in Mr. Hevert's analysis was pointed out not only in the two Maryland cases mentioned above, but also in the decision that the Hearing Examiner mentioned in his footnote. (*Supra*, footnote 18 at 32). Contrary to the Hearing Examiner's statement, the Maryland Commission did not "virtually agree" with Mr. Hevert in a recent Maryland case, nor has it ever agreed with Mr. Hevert's recommendation on cost of common equity for any PHI operating company. In the case mentioned by the Hearing Examiner, Mr. Hevert recommended 10.75% as he did in the other 2012 cases filed on behalf of PHI. In dismissing Mr. Hevert's recommendation, the Maryland Commission found that the presence of generation-owned companies in Mr.

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[41] *In the Matter of the Application of Potomac Electric Power Company for Authority to Increase Existing Retail Rates for Electric Distribution Service*, FC 1087, Order No. 16930 (DC PSC Sept. 27, 2012) at 60.
[42] *See,* Maryland Commission Decision in Case No. 9286, Order No. 85028 (July 20, 2012) at 107.
[43] Exh. 15 (Parcell) at 40-41. Otter Tail and PNM Resources also have negative growth rates based on the last five years, so it is unlikely the levels reflected in the Hevert proxy group are sustainable over time. *Id.* at 41. Mr. Hevert removed Otter Tail from his Constant Growth DCF analysis, but included it in his Multi-Stage analysis filed as part of his rebuttal testimony, which underlies his recommended COE. *See,* Chart *infra* at 20.

Hevert's proxy groups "skewed" his results to the high side and that "Delmarva (Maryland) is not subject to sufficient risk to justify Mr. Hevert's recommended 10.75% ROE."[44] Thus, far from supporting the Hearing Examiner's conclusions, the Maryland case supports a substantial reduction from Mr. Hevert's recommendation.

Finally, even the charts below that the Examiner includes in his report as representative of Mr. Hevert's Constant Growth and Multi-Stage DCF analysis do not support his findings. (HER ¶ ¶ 60,65 at 24,27).

Constant Growth Discounted Cash Flow Model
30-Day Average Stock Price

	Low ROE	Mean ROE	High ROE
Proxy Group Mean	8.25%	9.18%	10.15%
Proxy Group Median	8.28%	9.05%	10.15%

Constant Growth Discounted Cash Flow Model
90-Day Average Stock Price

	Low ROE	Mean ROE	High ROE
Proxy Group Mean	8.21%	9.15%	10.11%

Constant Growth Discounted Cash Flow Model
180-Day Average Stock Price

	Low ROE	Mean ROE	High ROE
Proxy Group Mean	8.37%	9.30%	10.27%

[44] *In the Matter of the Application of Delmarva Power & Light Company for Authority to Increase its Rates and Charges for Electric Distribution Service,* Case No 9285, Order No. 85028 (July 20, 2012) at 78. The Hearing Examiner conflated the 2012 Delmarva (Maryland) case with Mr. Hevert's current reduced recommendation of 10.25% in this case in reaching his conclusion that the Maryland Commission "virtually agreed" with Mr. Hevert's proposed ROE. Staff counsel admits that he may be partially at fault for this confusion in failing to clarify the record on this point. *See,* Tr. at 462-464.

Multi-Stage Growth Discounted Cash Flow Model
Mr. Hevert's Proxy Group

	Min ROE	Mean ROE	Max ROE
30-Day Average Stock Price	9.49%	10.00%	10.55%
90-Day Average Stock Price	9.48%	9.97%	10.51%
180-Day Average Stock Price	9.70%	10.15%	10.68%
Average of DFC Results	8.83%	9.54%	10.34%
Average of all Hevert DCF Results		9.57%	

D. CAPM

The Hearing Examiner found Mr. Hevert's CAPM model more persuasive because, although Staff preformed a similar analysis, Mr. Parcell did not specifically rely on this model in forming his opinion about the appropriate ROE in this proceeding. (HER ¶107 at 43).[45] Staff is unclear concerning the logic of the Hearing Examiner's opinion on this point.

As the Hearing Examiner knows, this Commission for more than 20 years has relied on the DCF model as the principal method to establish cost of equity for the utilities it regulates, in part because of the fluctuations and instability in calculating risk premiums required in the other models. Accordingly, other models are used to test the premise or results of the DCF analysis.

[45] It should be noted that Mr. Parcell did, in fact, consider CAPM a factor in determining the cost of equity for Delmarva. He stated at the very least, the CAPM results indicate capital cost remain historically low and that Delmarva's equity costs are less than in prior years. Exh. 15 (Parcell) at 34. See also, HER, footnote 26 at 48 which makes a similar misstatement.

Here, Mr. Parcell performed a CAPM analysis similar to the ones he has previously performed in numerous cases for this Commission and found the results too low upon which to base his opinion. Unlike Mr. Hevert, he did not adjust his results to reflect a particular outcome, but instead decided not to rely on them. The reason for this is quite obvious given the current status of the capital markets. As Mr. Parcell explained, risk premiums are lower now than they were in previous years. This shows a decline in investor expectations of equity returns and hence the premium required for an investment in stocks versus U.S. Treasury bond rates. In addition, interest rate levels on the U.S. Treasury bonds (i.e., the risk-free rate) have been lower in recent years because the Federal Reserve System's policy has been to stimulate the economy by reducing interest rates. Although many believed this decline in U.S. Treasury yields was temporary, interest rates have remained low and continue to be historically low. Thus, low interest rates (and low CAPM results) are not temporary, but rather reflect investors' current expectations. Accordingly, Mr. Parcell used a risk premium of less than 6% based on historical information going back to 1926.[46]

The Hearing Examiner's conclusion that Mr. Hevert's CAPM analysis was more persuasive fails to take into account that the rate effective period in this case -- based on the Company's statements -- is likely to be only 12 to 18 months. In addition, as with the DCF model, Mr. Hevert's analysis is based primarily on projections of future returns and thus contains no explanation as to why investors in the future would expect such a dramatic increase in risk premiums over historic levels. And even Mr. Hevert jettisoned

[46] *Id.* at 41-42.

one of his three (3) risk premium values -- the Sharpe Ratio MRP -- because the results were too low and "should be given little to no weight in the context of developing a recommended ROE."[47] The Hearing Examiner's finding that somehow Mr. Hevert's CAPM analysis is more persuasive, and somehow more relevant, is curious and unsupported by the record evidence.

E. Risk Premium/Comparable Earnings

Mr. Hevert performed a Risk Premium analysis (RP) while Mr. Parcell performed a Comparative Earnings analysis. Both methods attempt to capture the premium that investors expect in their returns over bonds since the equity investors bear the additional risk of ownership. The Hearing Examiner discussed the two studies, but appears to draw no conclusion from them in reaching his recommendation.

Both Staff and the DPA criticize Mr. Hevert's RP analysis for relying on data points (i.e., authorized electric utility returns), some of which were more than 30 years old. As the Delmarva witness was forced to admit, authorized returns in the 1980s and 1990s were quite high and are unlikely to occur during the rate effective period in this case.[48] The study also included returns for vertically integrated companies that generally bear more risk than transmission-and–distribution only utilities.[49] These observations by Mr. Hevert are consistent with this Commission's own experience during the same period. For example, in Docket No. 91-20, this utility was vertically integrated, owning its own generation, and was requesting returns above 13%.[50] Including such high returns that clearly are not available today to any electric utility in an era of low interest rates and

[47] Exh. 18 (Hevert) at 41.
[48] Tr. at 435-38.
[49] *Id.* at 440
[50] PSC Order No. 3389 ¶ 179 at 110 (March 31, 1992).

with no generation assets is anomalous. As Mr. Parcell pointed out, the average authorized return for electric utilities has not been as high as 10.23% since 2010.[51] Thus, Mr. Hevert's risk premium results, which in part are based on three-decade-old results, are excessive in today's economy. Accordingly, no weight should be given by the Commission to this analysis.

F. Hearing Examiner's Conclusions

The Hearing Examiner made two rather troubling closing observations in this section of his report: (1) that he was presented with only two options for a recommended rate of return on equity -- 10.25% or 9.35%; and (2) that the Company presented four models, while Staff and the DPA presented only two. Staff disagrees with the first observation and believes the second one to be irrelevant.

First, the Hearing Examiner was not limited to only an A or B option as he indicated. Rather, the case law is well settled that the establishment of a rate of return on common equity within a range of reasonableness is within a regulatory Commission's authority to set as a just and reasonable rate.[52] Here, the Hearing Examiner was given a zone of more than 90 basis points in which to decide the rate of return issue. Contrary to his delegated authority from this Commission, he chose to ignore any option other than the two goal posts that set the zone of reasonableness -- 9.35% and 10.25%.[53]

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[51] Exh. 15 (Parcell) at 42.

[52] *See, Federal Power Comm'n v. Hope*, 320 U.S. 591(1944); *Federal Power Comm'n v. Natural Gas Pipeline*, 315 U.S. 585, 586 (1942); see also *Permian Basin Area Rate Cas*es, 390 U.S. 747, 767, 806-13 (1967).

[53] In Docket No. 09-414, the Commission stated: "The DCF-derived estimates ranged from a low of 9.55% to a high of 11.4%; the CAPM estimates range from a low of 8.53% to a high of 9.7%;... Thus, the record supports a COE anywhere from 8.53% to 11.4%." (PSC Order No. 8011¶ 235 at 113 (August 9, 2011)).

Accordingly, this Commission may and should consider whether the evidence here supports a lower rate of return for the Company. If the Commission adopts the Hearing Examiner's recommendation -- specifically the testimony of Mr. Hevert -- it will: (1) be the first Commission to agree with Mr. Hevert's testimony; (2) grant Delmarva the highest ROE of any of the other PHI operating companies; and (3) cause Delmarva ratepayers to subsidize Maryland and DC ratepayers with higher rates.

Second, the observation that Staff and the DPA only presented two models -- while the Company presented four -- suggests that the Hearing Examiner relied, in part, on the sheer number of models presented by the parties and that this was relevant to his decision on the appropriate recommendation for Delmarva's cost of equity. As this Commission well knows, in its prior decisions it has primarily relied upon the DCF method to determine a utility's cost of common equity, in part because it has found that the DCF method produces more reasonable results than other methods. The Commission's preference for the DCF model does not preclude the consideration of other methods for calculating the cost of equity in some instances, but it is the filter that the Commission uses to weigh the results of those other models and to determine if they are reasonable through the lens of the DCF analysis.

In this case it is clear, for the reasons stated above, that both Mr. Hevert and Mr. Parcell's DCF analyses do not support a 10.25% cost of equity for the Company. The number of companion studies performed is also irrelevant to any meaningful analysis of the record on what the appropriate equity cost is. The Commission should consider the entire record as is required by case law. Its consideration should not be anchored on the number of studies performed, but the credibility of each witness and how each study

supports the witness' conclusions using the DCF methodology as a lens through which to evaluate each witness' opinion. As shown by the Hearing Examiner's first concluding statement in this section, he found this task more restricted than what is actually required. The Commission should disregard the Hearing Examiner's conclusions on this issue, look at the record afresh, and make its own independent determination of the appropriate cost of equity for this utility in this proceeding.

3. Post –Test Period Capital Additions

The Hearing Examiner's reasoning for his decision on this major issue is found in paragraph 176 of his report:

> I agree with Delmarva that its post-test period Adjustment 26A, involving actual plant closings eight (8) months after the test year, warrants Commission approval, based upon the nine (9) month plant closings adjustment approved by the Commission in Docket No. 09–414 over Staff's and the Public Advocate's objections in that docket. Also, the Commission allowed recovery for four (4) months of such plant closings in Docket No. 05–304. The Company persuasively argues that, although outside the test period, the plant closings for which the Company seeks recovery in this case are in service, directly benefiting customers, and are known and measurable. Thus, I recommend that the Commission approve Adjustment 26A. [*Citations omitted*] (See HER ¶ 176 at 71-2).

Later on, when discussing his reasoning for not allowing recovery of forecasted post-test period plant additions (i.e., Adjustment 26B), the Hearing Examiner again emphasized these plant additions were "not in service." (HER ¶ 178 at 72). This conclusion conflicts with his earlier pronouncement that the standard of used (in service) and useful (of actual benefit to customers) is inapplicable to some post-test period capital additions (i.e., Adjustment 26A).[54]

[54] See footnote 28, where the Hearing Examiner found that "the expenses related to Adjustment 26A, and all other expenses described in this Report for which I have found that the Company has met its Burden of Proof, were not incurred in bad faith, waste, inefficiency, or out of an abuse of discretion." (HER at 72).

Besides applying the incorrect standard, the Examiner's decision does not appear to address the differences between the earlier Commission decisions cited as support for his conclusion in paragraph 176 and the facts in this case. As both Staff and the DPA pointed out, in the earlier cases -- primarily the most-recently litigated electric case Docket No. 09-414 -- the Commission specifically limited its decision by the facts of the case before it. The Commission stated: "We conclude that under the circumstances presented in this case... ." (PSC Order No. 8011, ¶ 60 at 21 (dated August 9, 2011)).

Staff and the DPA presented to the Examiner the reasons why the facts in this case materially differ from those on which the Commission based its prior decisions on post-test period capital additions. Although the Hearing Examiner mentioned some of the factual differences, he presented no analysis of them -- other than what is quoted above -- as to why he believed the factual distinctions highlighted by both Staff and the DPA were not relevant to his decision.

Staff's major reasons for opposing any post-test period additions in this case are four: (1) these additions should be addressed by the Commission in Docket No. 13-152; (2) these capital additions differ from the ones in Docket No. 05-304 (which were agreed to by the parties) and the ones in Docket No. 09-414 (which were not agreed to, but were also not the subject of an on-going Commission investigation into their usefulness in providing service); (3) the Company agreed to work with Staff to develop metrics for the future recovery of reliability investments; and (4) the rate effective period will be much shorter than in prior cases based on Delmarva's own statements.[55]

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[55] An additional reason is one that has been raised in the prior contested case Docket No. 09-414 -- namely the distortion of the test period relationship between plant in service and other elements of the Company's revenue requirement. As Staff pointed out, although Delmarva recognizes the increasing reserve for depreciation associated with post-test period reliability plant additions, it completely ignores the growth in

First, Staff opposes any post-test period additions here because all of the 2013 post-test period reliability investments are logically the subject of the ongoing investigation (i.e., in Docket No. 13-152) into whether those investments are necessary to provide adequate service to Delaware ratepayers. That does not mean, as the Hearing Examiner suggested or the Company argued, that Staff is attempting to deny the Company's recovery of those investments. Rather, Staff's argument focuses on when and in which docket the Commission should review the level of those investments.

There is no question that the predicate for the investigation opened as Docket No. 13-152 is fundamentally based on the chart contained in Mr. Maxwell's direct testimony which indicates that the Company plans to spend $397 million on infra-structure improvements through 2017. That chart includes 2013 -- all of it -- and is the subject of that investigation.

Delmarva Delaware
2012 Expenditure
And
Five-Year Plan 2013-2017
Dollars in Millions[56]

Table 1

Distribution	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Total 2013 Through 2017**
Customer Driven	$12.6	$12.1	$11.9	$12.1	$12.6	$13.0	**$61.7**
Reliability	$64.1	$71.4	$58.9	$59.2	$60.3	$59.2	**$309.1**

the depreciation reserve for embedded plant that will be occurring as reliability plant is placed in service in 2013. This will reduce Delmarva's net investment in rate base, but is not accounted for. In other words the rate base is over stated because this reduction is not being made for the existing plant for the period when the post-test period plant is being placed in service. The result is that ratepayers are paying more than they should because the rate base is inflated. (*See*, Exh 11 (Peterson) at 12; Tr. at 610-11). This is in direct violation of 26 Del. C. § 102 (3)b. that requires a reduction in rate base for all accumulated depreciation -- which includes 2012 embedded plant.

[56] Exh. 4 (Maxwell) at 5.

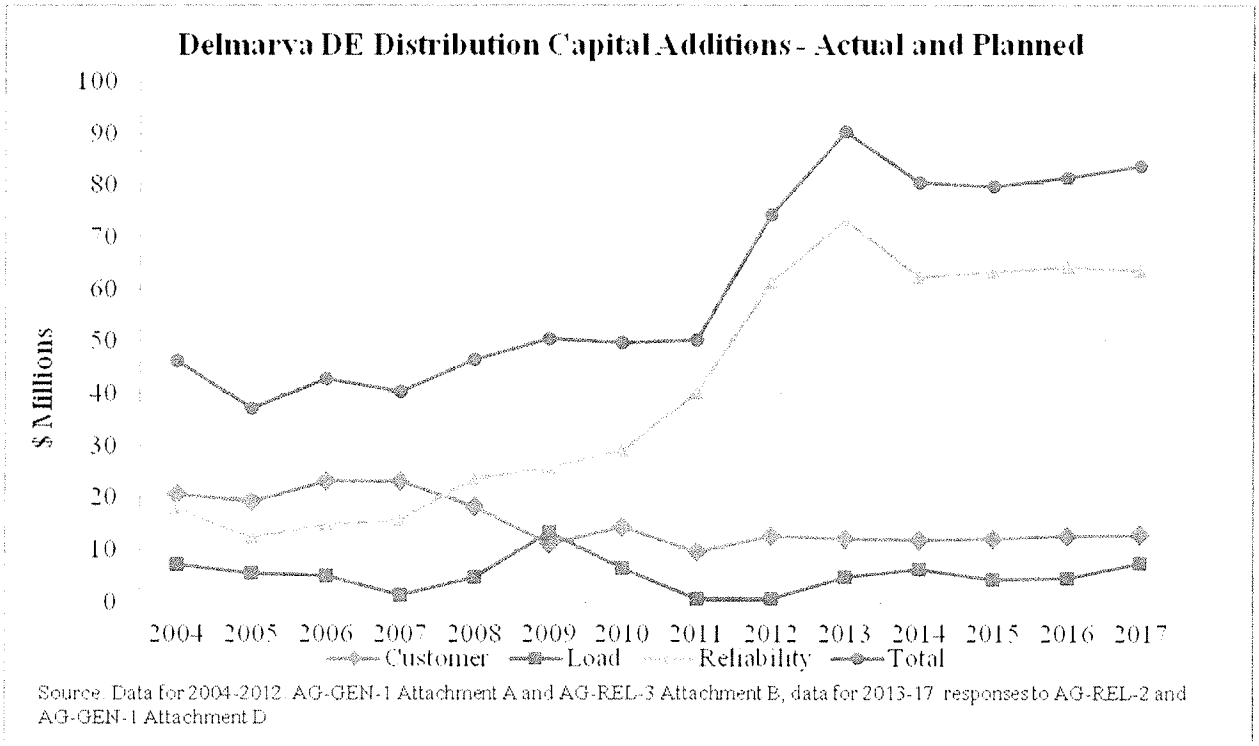
Load	$2.8	$4.3	$6.1	$4.2	$4.5	$7.4	**$26.6**
Total	**$79.5**	**$87.8**	**$76.9**	**$75.7**	**$77.4**	**$79.6**	**$397.4**

Nowhere does the Company, nor the Hearing Examiner (since he applied the incorrect standard), address the issue raised by Staff that if the Commission grants recovery of the 2013 post-test period investments in this docket and subsequently finds in Docket No. 13-152 that: (i) some or all of the post-test period investments for 2013 were not used and useful at this time; or (ii) their inclusion in rate base should be delayed, how could the Commission implement such a decision regarding plant already approved for inclusion in rate base? Thus, Staff only requests that those investments outside the test–period await the Commission's decision in Docket No. 13-152 and a determination that all of those investments are actually now required to provide adequate, reliable service to ratepayers at levels established by the Commission.[57] Based on its review, Staff's consultant and witness Silverpoint concluded that there was no engineering basis for the reliability enhanced capital investments ***now***, that the Company was putting the cart before the horse given that the Company had no new performance standards to meet, and there exists no framework or context within which to consider these new investments. Silverpoint concluded that the dramatic increase in reliability spending must be part of a broader corporate strategy, one that is unrelated to existing reliability standards found in Regulation Docket 50.[58]

[57] The Commission will recall that the Company was opposed to the opening of Docket No. 13-152 on the basis that the appropriate forum to review the costs of Delmarva's reliability investments was in a rate case. However, the Commission rejected the Company's position and reserved the right to review the level of these investments in a separate docket, which includes the period 2013-2017. *See*, PSC Order No. 8363 (May 7, 2013).

[58] Exh. 12 (Vavro) at 12-14.

The lack of any context for the review of reliability standards was the primary impetus behind the creation of Docket No. 13-152. The Commission opened the docket to investigate Delmarva's proposed distribution infrastructure and reliability investments on a going-forward basis, including those incurred in 2013 (i.e., Adjustment 26A and 26B).[59] Staff merely seeks to provide the Commission with the opportunity to consider whether some of these post-test period reliability investments are necessary to include in rates at this time.[60] The Company failed to establish that it could not provide safe, adequate and reliable service to its customers in the absence of these dramatically escalating expenditures.



[59] Staff concerns equally apply to 2012, which is also part of the Company's $397 million infrastructure plan, but Staff has not challenged the reliability investments made in the test period.

Next, Staff opposes the inclusion of Adjustment 26A and 26B in rates at this time because the Company has failed to work with Staff to develop metrics for future recovery of these reliability investments. At the conclusion of the prior Delmarva electric case, Docket No. 11-528, and as part of the settlement of that matter, the Company agreed to develop metrics for the recovery of future reliability investments. That understanding was part of the settlement agreement that the Commission approved to conclude the prior docket and to finalize the issue before the current docket began. Claims by the Company that Staff's objection to the recovery of post–test period reliability investments without metrics or some context by which to judge their appropriateness as untimely must thus be rejected. The Company has failed to even attempt to meet this agreed-upon condition from the prior case. Mr. Boyle, the chief policy witness, and Mr. Maxwell, the witness supporting the Company's reliability investments, had no knowledge of any attempt by the Company to create such metrics and no knowledge of any meeting with Staff in which the subject was even discussed.[61] The meetings the Company referenced in its brief, to the extent it involved members of the Commission Staff, did not involve any attempt to address the Company's commitment to "establish" metrics for approval of reliability projects. Rather, these meetings involved the development of the Company's multi-year plan.[62] Staff is still waiting for the opportunity to address and develop the establishment of "reliability metrics" by which customers can individually determine and quantify the benefits of such dramatic increases in capital spending. Staff therefore

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[60] The above chart shows these investments are much higher in 2013 than test period levels ($87.8 million vs. $79.5 million) and higher than projected levels ($87.8 million vs. $76.9 million for 2014).
[61] Tr. at 270-1; Tr. at 310.
[62] Although the Company mentions "over a dozen meetings, " only one involved the Commission's Executive Director, Mr. O'Brien and new reliability metrics were not discussed. Its footnote is inaccurate and gives the false impression that members of Staff were involved in discussions other than those related to the development of the FLRP Application. *See,* OB footnote 105 at 25.

requests at this time that the Commission order the Company to meet with Staff and other interested parties to develop such metrics.

Finally, Staff opposes any post-test period additions here because the Hearing Examiner's decision failed to address the factual distinction that the Company has made on the record regarding its announcement that it will file rate cases on an annual basis going forward. In the last two electric base rate filings, the Company used 2011 and 2012 as the effective test periods, respectively. It is anticipated that if the Company files another rate case at the conclusion of this one, as promised by the Company, the test period would be 2013 and would include these same post-test period adjustments.[63] Thus, rather than using in this proceeding a test period that has been manipulated to include only post-test period reliability investments, Staff argues that recovery of those investments should await the earlier conclusion of either a future rate case or the conclusion of the Commission's investigation in Docket. No. 13-152.

4. <u>Cash Working Capital</u>

The Hearing Examiner agreed that the Company had not carried its burden of proof on this issue and recommended the Commission reject the Company's claimed $10,887,807 of Cash Working Capital ("CWC"). (HER ¶ 209 at 83). However, as between the Staff's recommended adjustment of $4,200,129 and the DPA's of

[63] The Pepco has already filed a new rate case in Maryland -- several months after the Commission's July decision (Maryland Order No. 85724, Case No. 9311 (July 12, 2013)). Pepco is currently appealing the Maryland Commission's July order.

$1,889,057, he could not decide which calculation was correct and suggested the record was unclear on this point. (*Id.* ¶ 210 at 84).[64]

Staff believes its adjustment of the CWC is correct, and that the difference between Staff's recommended number and the DPA's number is simple -- business days versus calendar days. Staff's calculation used business days (excluding weekends) because as Delmarva admitted in its discovery, affiliated transactions are generally settled by the 15th business day of the following month.[65] As Mr. Peterson explained, depending on the day of the week on which the first business day falls during the month, the 15th billing day will range between 19 and 21 calendar days (or an average 20).[66] Because an average month has 30.42 days, the average service period is one-half of the length of the average month, or 15.2 days. Combining these two pieces of information together results in an expense lead of 35.2 days as compared to the Company's assigned 14.43 days.[67] Because 70% of Delmarva's distribution O&M expenses are Service Company charges, this significantly impacts the CWC requirement. The inclusion of a 35.2–day expense lead increases the overall weighted lead days for O&M expenses from 17.33 days to 31.70 days.[68]

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[64] Because the Hearing Examiner concluded that this issue was not addressed to his satisfaction in the evidentiary record, the hearing transcript, or the parties' briefs, he concluded that three options were available: (i) the issue could be presented differently to the Commission based on the existing evidentiary record; (ii) the record could be supplemented by agreement of the parties; or (iii) a supplemental evidentiary hearing could be held. HER ¶210 at 83-84. Staff believes the existing record is sufficient and complete on this issue and that its explanation of the differences between Staff's adjustment and the DPA's adjustment clarifies any confusion on this point. Hence, supplemental evidence is unnecessary.
[65] *See*, Delmarva response to PSC-RR-94.
[66] Exh. 11 (Peterson) at 18.
[67] *Id.* and (DEP-1) Sch. 2 at page 5 of 5.
[68] *Id.*

Reviewing the DPA's witness testimony on this point, it appears that Ms. Crane calculated her adjustment using 15 calendar days -- not 15 business days.[69] This explains the resulting difference in the two adjustments. Staff respectfully suggests that its adjustment is the correct one and that the record in this case supports Staff's position on this issue.

5. Pre-Paid Pension Asset

As the Hearing Examiner correctly noted, this was originally not a Staff issue; however, nothing bars Staff from joining in the DPA's arguments in its brief as to why a proposed adjustment should not be made.[70] And Staff's reasoning is simple -- if shareholders did not supply the funds, then it is illegal under Delaware law to give them a return on those monies by including such funds in rate base.

The Hearing Examiner's decision on this issue is incorrect for three primary reasons: (1) he ignored the burden of proof that Delmarva must meet under Delaware law; (2) he suggested that all case law -- nationwide -- must be provided to him before he could decide in favor of the DPA on its proposed adjustment to the Company's rate base; and (3) he inferred that the DPA had not established to his satisfaction that 90% of the current account balance is attributable to market (i.e., non-shareholder supplied) earnings.

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[69] "This lag is based on a service period of 15.21 days (365/12/2) and on a combined billing and payment lag of 15 days." Exh. 13 (Crane) at 13.

[70] The Hearing Examiner stated that Staff filed "an untimely brief joinder" that cited to no new case law. HER, ¶ 211, 84. Staff believes that a party may "join in" or accept an issue in fact tendered by an opposing party and that a joinder does not require a party to add any new case law. See Blacks Law Dictionary (9th ed. 2009) re "joinder of issue": 1. The submission of an issue jointly for decision. 2. The acceptance or adoption of a disputed point as the basis of argument in a controversy.

Under 26 *Del. C.* §307(b),[71] a utility bears the burden of proof on any issue questioned by the Commission. The Hearing Examiner recognized this proper legal standard earlier in his report and also recognized that Delmarva failed to address the holding in the *Hawaiian Electric Company* case[72] cited by the DPA. He nevertheless did not conclude that Delmarva had failed to meet its legal obligation to provide satisfactory and sufficient proof that all of the pension funds included in the adjustment were, in fact, supplied by shareholders. Instead, he noted that even if he agreed with the DPA's argument, another evidentiary hearing would have to be conducted to determine the exact nature of the funds contained in the Company's pension funds. (HER ¶ 213 at 85). He also concluded that although the DPA's claim may eventually prove to be valid, the pre-paid asset should remain in rate base because the case law and evidence presented to him did not warrant changing Commission precedent. (HER ¶ 216 at 86). Contrary to this conclusion, ratepayers should not be forced to pay higher rates based on an inflated rate base unless or until the Company meets its burden of proof. The Hawaii case is correct and consistent with Delaware law -- absent sufficient proof that utility investors, rather than ratepayers, have contributed 100% of these funds, pre-paid expenses should not be in rate base.

The Examiner's decision seems to suggest that if the funds are excluded from rate base, other adjustments have to be made. That may be so, but that is not relevant to the central issue: Did Delmarva, in this record, submit sufficient proof that all the funds

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[71] "The public utility shall have the burden of proof in justifying every accounting entry of record questioned by the Commission which may suspend and charge or credit pending submission of satisfactory and sufficient proof in support thereof by the public utility." 26 *Del. C.* §307(b).
[72] *In the Matter of Hawaiian Electric Company, Inc.*, 2007 WL 4477336, (Hawaii PUC, Oct. 25, 2007).

were contributed by shareholders? The answer must be no. Accordingly, until the Company does establish that fact, the inclusion of these funds in rate base should not be allowed.

One other point that appears to be missing from the Hearing Examiner's analysis is the change in circumstances from Docket No. 05-304. In that docket, the Company first included a negative pension expense in its revenue requirement. This, in turn, reduced operating expenses and formed the pretext to supplement its rate base with an offsetting regulatory asset in order to provide a return to investors who were providing the working capital associated with the negative expense. There the Commission stated:

> [W]e 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.[73]

But those facts do not exist here. The Company no longer has a negative pension expense included in its revenue requirement. Without a negative pension expense, operating expenses are not reduced and do not create a working capital need. Thus, the basis for the Commission's prior decision is inapplicable here. In the absence of substantial proof that all the funds are investor-generated, the regulatory asset associated with pre-paid pension costs should be excluded from rate base in this proceeding.

6. Deferred IRP and RFP Costs

As the Hearing Examiner points out, Staff joined the DPA in requesting that Delmarva be denied recovery of these costs for a very simple reason: There is no Commission order specially allowing the continued deferral and ultimate collection of

[73] PSC Order No. 6930 ¶ 58 at 28 (June 6, 2006).

these expenses. The Hearing Examiner does not address Staff's over-arching concern that in the absence of a specific Commission order, no utility should be allowed to defer costs for future collection from ratepayers. Such a deferral constitutes retroactive rate making. Furthermore, the Delaware statue cited by the Hearing Examiner (26 *Del. C.* §1007(c)(1)d. does not eliminate subsequent necessary actions and non-actions taken by the utility in connection with the collection of such costs. Moreover, that same statute also certainly does not make these costs 100% recoverable if the utility (by its actions, or rather by its inactions in this case) has agreed to a procedure that does not collect 100% of the costs.

In its post-hearing brief, the DPA described in some detail the reasons why he feels that Delmarva should be preempted from now recovering these costs. Instead of addressing those arguments, the Hearing Examiner merely cited to the enabling statute, but failed to address the actions and non-actions taken by the Company that compromised its position on this issue.

Staff firmly believes that in the absence of a specific Commission order, no utility should be able to defer for future recovery any expense not within the test period or test year, and certainly should not be able to argue that subsequent agreements made (and orders entered into) that addressed such expenses have no validity in cutting off continued deferrals of costs over long periods of time that are de minimus in nature.[74]

[74] Apparently the DPA and Staff's argument on the Medicare Subsidy deferral that the Hearing Examiner agreed with were not persuasive with regard to these deferrals. (HER ¶ 266 at 104). Staff believes the same reasoning applies to the IRP and RFP deferrals, and recovery should be denied on a similar basis.

7. Credit Facility

As with other issues discussed above, the Hearing Examiner wrapped the basis of his conclusion in the cloth of a prior Commission decision -- in Docket No. 09-414 -- and did not address the distinctions that Staff and the DPA raised in this proceeding.[75] Neither Staff nor the DPA is refuting the Company's claims regarding the benefits of the credit facility. But Staff and the DPA are suggesting that the ratepayers should get all of the benefits of the facility, including recognition that over-all capital costs are lower for the Company than they otherwise would be without this facility. The Hearing Examiner's decision failed to address this important point.

As pointed out by both Staff and the DPA, the credit facility is serving the day-to-day cash needs of the Company and is recorded as an interest expense for financial reporting. But it is not reflected in the cost of capital for ratemaking purposes because neither commercial paper nor short term debt -- supported by the credit facility -- are included in the capital structure upon which rates are being set in this proceeding. Accordingly, ratepayers are not receiving the benefits in rates of this lower cost of capital but should be.[76]

In addition, the Hearing Examiner's decision ignores the fact that the ratepayers are already paying for the working capital needs that Delmarva claims are being funded by the credit facility. As discussed above, the Company's working capital requirements are in rate base, which the Company recovers through rates. Thus, Delmarva is asking ratepayers to fund its working capital needs as well as asking them to fund the credit

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[75] The Hearing Examiner did not address Staff's issue that a portion of this expense attempts to capture start up costs that occurred outside the test period without a specific Commission order allowing such a deferral. (HER ¶ 246 at 97).
[76] Exh. 13 (Crane) at 29-30.

facility. Despite these benefits to the Company, ratepayers are not getting the benefit from the lower-cost financing associated with the credit facility. Rather, the ratepayers are instead paying the carrying costs for the working capital included in the Company's rate base at its overall weighted average cost of capital approved by this Commission. This is antithetical given that the Company admits its working capital is being financed through the credit facility at rates that are significantly lower than the overall weighted cost of capital.

As the DPA witness pointed out, if Delmarva wants to exclude short-term debt from its 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.[77] What Delmarva should not be allowed to do is recover both the costs associated with its credit facility, while at the same time (i) excluding this low-cost financing facility from its capital structure; and (ii) charging ratepayers for all of its working capital requirements.

Staff's alternative proposal, which the Hearing Examiner also did not address, is to include these costs in the calculations of the AFUDC rate thereby allowing the Company to recover these costs. As staff witness Peterson pointed out, Delmarva first assigns short-term debt to CWIP under the Uniform System of Accounts. Since CWIP is capitalized to the Company's construction accounts, Delmarva would be compensated for its credit facility costs at its AFUDC rate. This method would better match the costs to ratepayers with the benefits resulting from the use of short-term debt, which Delmarva does not recognize as a source of capital in its proposed capital structure.[78]

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[77] *Id* at 30.
[78] Exh. 11 (Peterson) at 20 and 33-4.

The Commission should approve one of these options so ratepayers receive at least some of the value derived from the use of the credit facility to finance the short-term needs of the Company. To adopt the Hearing Examiner's proposal is unfair to the ratepayers.

8. Wage and FICA Adjustment

Again, in accepting the Company's proposed wage adjustments outside the test period and into 2014, the Hearing Examiner failed to analyze the distinctions that Staff and the DPA raised in opposing this adjustment. Relying on prior Commission decisions on this issue, the Hearing Examiner did not address the new normal -- that Delmarva will be filing rate cases more frequently. Both Staff and the DAP argued that annual rate cases should act as a governor, to some extent, which limits the ability of this utility is adjust its test period operating expenses for anticipated, as well as unknown, wage inflation. In this case Delmarva seeks adjustments almost two years past the test period, even though it is on record as stating that it plans to file annual rate cases. As Staff pointed out, some of these wage increases have not even been approved by the Board of Directors and, therefore, cannot be either known or measurable. But that did not deter the Hearing Examiner in allowing all of them.

In light of Delmarva's new policy of filing rate cases more frequently, Staff believes that some limit on adjustments to the test period, which the Company chose, should be required. As the DPA pointed out, Delmarva could have used a partially projected test period consisting of as many as nine months of projections, which would have included most of the 2013 wage increases. However, it did not. Instead, it chose to use actual results for the 12 months ending December 31, 2012, and then included

projected increases extending almost two years past that period for wage increases. Including these projected increases without any corresponding adjustment to recognize increased revenues or other changes in the regulatory triad violates traditional rate setting principles. Staff has no issue with normalizing wage and salary changes that occur during the test period, nor would it have a problem with accepting known and measurable wage and salary changes nine months passed the test period had the Company chosen to file its case in such a manner. Given the choice in how it filed this case, and its stated corporate policy on filing rate cases more frequently, Staff believes this adjustment should not be made to the test period operating expenses.

9. <u>Regulatory Expenses</u>

The Hearing Examiner's decision to simply accept the Company's estimate of rate case expenses for this proceeding ignores three relevant facts: (1) these expenses were merely an estimate -- they are not known or measurable as of yet; (2) the volatility in rate case expenses over several cases; and (3) the unaddressed issue that the DPA raised concerning the level of expenses being incurred by the Company in this proceeding.

Because the rate case expenses have varied significantly over the last several cases ($245,241 in Docket No. 09-414, $400,000 in Docket No. 05-304, $634,054 in Docket No. 11-528), both Staff and the DPA believe that normalizing the average of the historical costs, which are actually known, is a more appropriate way to allow the Company to recover these costs rather than to base them on an estimate. Normalizing also will address the DPA's concern that some of these estimated costs (i.e., the $92,600 cost associated with the Cost of capital witness) are excessive. Staff believes that until it

has a better understanding of what Delmarva's actual rate case expenses are, a better approach is to normalize the Company's rate case expenses based on the average of the last three rate cases, just as the Company has proposed for its non-rate case legal expenses.[79]

10. Supplemental Executive Retirement Plan (SERP)

Although Staff did not address this issue in its direct testimony in this case, it did oppose ratepayer's obligation to underwrite these benefits in the prior Delmarva litigated case (Docket No. 09-414) and made an adjustment to remove it. The Hearing Examiner's decision did not specifically address the factual distinctions that the DPA made between this case and the prior Commission decision. (HER ¶¶ 298-301 at 116-7).

In rebuttal, the Company contends that offering these benefits is a way to circumvent the IRS salary caps found in qualified defined benefit pension plans. Stated another way, if Mr. Rigby's, or Mr. Boyle's salary who testified on behalf of the incentive plans, were to be included in the calculation, the required benefits to the typical employee would dramatically increase. Instead, the SERP allows the Company to discriminate in favor of the highly compensated, which the Company suggests is because "[e]xecutives do not receive equitable pension contributions, relatively speaking, when compared to the typical company employee."[80]

This argument is no more persuasive in this context than it is in the context of incentive compensation benefits, which the Hearing Examiner in this case excluded from the Company's operating expenses. Staff has not challenged the inclusion of

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[79] The Examiner did not address the Company's other proposal to include the unamortized amount of rate case expenses in rate base, which both Staff and the DPA opposed.
[80] *See*, Exh 20 (Ziminsky-R) at 75.

many of the executive retirement benefits in the Company's cost of service. But this is *additional* executive compensation *over and above* what these executives will receive as part of those retirement benefits. It is called supplemental because the benefits exceed various limits imposed on retirement programs by the IRS and therefore are captioned "Non-qualified" since the payout ratios are much higher than exist under normal "qualified" pension plans.[81]

Rate recovery for SERP expenses should only be permitted if it has been established that the payment of the expenses provide benefits to ratepayers. While executive incentive plan expenses are not at issue in this case, SERP expenses are, and Delmarva provided no evidence whatsoever that established any benefit, direct or indirect, to ratepayers related to this program. Arguments that such benefits are necessary to attract and keep highly skilled and talented executives, who are all making hundreds of thousands of dollars -- if not millions of dollars in compensation -- should fail of their own weight. In an era in which ratepayers are being confronted with repeated requests for rate increases, elite benefits for the select few should not be included in the cost of service and paid for by ratepayers unless and until there is some benefit that can be measured or quantified from which the ratepayers profit.

As the DPA pointed out, other commissions have rejected identical arguments regarding the need to have such programs to attract qualified employees.[82] This Commission should do the same. Removing this executive benefit will increase net operating income by $653,963.[83]

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[81] *See*, Internal Revenue Code, 26 U.S.C. §415.
[82] *See*, cases cited, DPA Brief at 85-6.
[83] Ex. 13 (Crane) Sch. ACC-21.

11. Medical Benefit Expense

Once again the Hearing Examiner wrapped this decision in the cloak of a prior Commission order and dismissed Staff's arguments by stating they were the same arguments that the Commission previously rejected in Docket No. 09-414. Staff asks the Commission to reconsider its earlier decision in the context of the arguments that both Staff and the DPA made in this case and in the context of anticipated annual rate cases, which the Company plans to file.

In this proceeding, the Company increased test period expenses by 8% for medical expenses and 5% for vision and dental expenses based on "work" performed by the Company's benefits consultant, Lake Consulting, Inc. ("Lake").[84] Staff rejected this additional attempt to increase test period expenses because: (1) Delmarva is self-insured; and (2) the adjustment is based on general trends in healthcare costs and not on Delmarva's actual results.[85]

Because it is self-insured, Delmarva's actual costs may very based on the number of claims that it actually experiences and the fact that its profit motive is also different from a typical healthcare provider like Blue Cross, Aetna, etc. Based on the testimony of Mr. Ziminsky, Delmarva's actual average increases in medical, dental and vision over the last five (5) years has varied significantly, and certain does not match the exact trends shown in the Lake Study.[86]

The Lake study has no data that is specific to Delmarva. Instead, the study is based on trends in medical premiums experienced by several major insurance

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[84] Ex. 5 (Ziminsky) at 15.
[85] Ex. 11 (Peterson) at 27-28.
[86] Exh. 20 (Ziminsky) at 31.

companies. In order for the Commission to accept this increase in test period operating results, it must find: (1) that the general trends for major insurance companies are similar to Delmarva's actual experience, of which there is no evidence; and (2) that use of a post-test period trends, not related specifically to Delmarva, is a known and measurable change. In absence of such findings, it appears that Delmarva's request is nothing more than an inflation adjustment which the, in the past, this Commission has found unpersuasive for determining rates.[87]

Although Lake showed an average increase of 6.1% in dental expenses, the Company only increased the test period medical expense level by 5%. Similarly, although the estimated average medical expense increase was expected to be 9.5%, the Company only increased the test period expense level by 8%.[88] As shown above the Company's values used to inflate test period operating results are simply that: estimates that the Company used based solely on the opinion of Delmarva employees who made the adjustments.

Also, it does not appear that the Company considered the impact of any modifications to its benefit plans may have regarding such expenses. There is no evidence that any of the companies that Lake surveyed provide coverage to Delaware employees, or that the expense trend in the geographic area it surveyed is representative of the expense trend in Delaware. Indeed, Staff suggests that it is not: the Virginia-Maryland-District of Columbia area is well known to be more expensive than Delaware, and Delmarva's own experience demonstrates that. Rather than basing its

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[87] PSC Order No. 3369 ¶ ¶ 139, 142 at 81-83.
[88] Exh. 5 (Ziminsky) at 31.

future medical projections on actual results in Delaware, which were lower, the Company chose to use general trends.[89]

This adjustment is not "reasonably known and measurable;" it is based on estimates derived from a survey of companies in a different geographical area. It should be rejected.

17. Cost of Service ("COS")

The Hearing Examiner implicitly adopted Delmarva's argument that its COS model allocates the costs of Delmarva's distribution system to the customer classes on the basis of the principles of cost causation. (HER ¶ 314 at 122). However, Delmarva failed to present sufficient record evidence to show that the COS, and the Company's method of allocating the costs of its distribution system, followed the principles of cost causation.[90] Accordingly its COS model should not be adopted in this proceeding.

First, Delmarva failed to carry its burden of proof to support its use of the same demand allocator for the costs of the underground and overhead distribution facilities.[91] Delmarva does not dispute that underground facilities cost more than overhead facilities.[92] However, Delmarva apparently disputes Staff witness Pavlovic's argument that -- in general -- residential customers use overhead facilities more than commercial customers and commercial customers use underground facilities more than residential customers.[93] In addition, the only evidence Delmarva produced to support using the

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[89] *See*, Exh. 20 (Ziminsky-R) at 31.
[90] *See,* SB at 86-96.
[91] The Hearing Examiner has mistakenly referred to this issue as a 50/50 weighting of class diversified demands and customer non-coincident demands ***for the underground and above ground facilities***. (HER ¶ 320 at 124.)
[92] Q. "And isn't it true that underground facilities in general are significantly more costly than overhead facilities?" A: "Yes." Tr. 927 (cross examination of Mr. Tanos).
[93] Exh. 10 (Pavlovic) at 12-13; Ex. 22 (Tanos-R) at 5.

same demand allocator was testimony from Mr. Tanos regarding Delmarva's "recent experience with underground installations."[94] The Hearing Examiner erroneously stated that Mr. Tanos provided evidence on Delaware law regarding installations of underground facilities for new residential subdivisions of more than five lots and for multi-family buildings. (HER ¶ 321 at 125). These statements came directly from Delmarva's arguments in its Reply Brief and are not record evidence. No witness provided any such evidence.[95] Hence, the Hearing Examiner relied on non-record evidence to support his conclusion on this issue.

Second, Delmarva has failed to prove that half of its transformers serve single customers and half serve multiple customers. On cross examination, Mr. Tanos confirmed that Delmarva had performed no empirical studies to confirm that there is a 50/50 demand split for Delmarva's line transformers.[96] Yet when allocating the costs of its transformers, Delmarva used a simple average, 50/50 split of its single customer demand cost metric and class demand metric. This 50/50 split fails to accurately reflect which class is actually responsible for the costs of Delmarva's transformers.

Third, the Hearing Examiner erroneously agreed that Delmarva's cost allocation approach used in its COS for the twelve-month period ending 2012[97] was "approved by the Commission in Docket Nos. 05-403, 09-414, and 11-528." (HER ¶¶ 338, 340 at 130-

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[94] Ex. 22, (Tanos-R) at 5-6.

[95] "***According to Company Witness Tanos***, '…[f]or the past forty-three years, Delaware law has required….' DPL at 41-42." (emphasis added).

[96] Q: "...do you have specific studies to show that you know for certain that there is a 50/50 demand split on Delmarva's line transformers?" A: "No. Based on my experience and the analysis over the years, we feel the 50/50 split is a reasonable method to allocate those costs." Tr. at 945-946 (cross examination of Mr. Tanos).

[97] Ex. 8 (Tanos), at 2-3.

131). The Orders in those dockets show that the Commission never adopted or approved the cost allocation approach being used by Delmarva in this particular proceeding.[98]

More specifically regarding any "approval" of the cost allocation method used in a COS, the Commission in Docket No. 09-414 approved settlement agreement provisions regarding COS and rate design as being in the public interest and stated as follows: "We further find that it is in the public interest to convene a workshop to address issues raised by the COSS. The COSS has been a source of much disagreement in previous rate cases, and we believe that a consensus on the approach to be used in future cases can save significant time and effort, not to mention expense."[99] Nowhere in the final order for PSC Docket No. 09-414 does the Commission state that it approved the cost allocation approach used by Delmarva in that case, nor has the Commission in any other case specifically approved the cost allocation approach used by Delmarva in this proceeding.

The Hearing Examiner neglected to note Staff's argument that the initiatives discussed in PSC Docket No. 09-414, and incorporated by Delmarva into the COS as adjustments, were not agreed upon by all of the parties. (HER ¶ 338 at 130). The evidence showed all of the parties did not, in fact, reach an agreement to incorporate the four initiatives that Delmarva unilaterally used to adjust its COS results.[100]

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[98] See Order No. 6930 (June 6, 2006) in PSC Docket No. 05-304, p. 136 to 152 (no discussion of COS used by Delmarva); see also Order No. 8011 (August 9, 2011) in PSC Docket No. 09-414, ¶ 316, p. 127-128 (Commission approved a settlement agreement in which the participants agreed to convene a workshop with a "focused agenda" on COS and revenue allocation issues for the purpose of developing an agreement on a COS approach to be used in future rate cases, but no approval of Delmarva's cost allocation method used via the COS in that proceeding); see also Order No. 8265 (December 18, 2012) (no specific approval of any cost allocation method via the COS; the order simply approved a settlement agreement that also did not specify any cost allocation method to be used via the COS in that proceeding).
[99] PSC Order No. 8011, ¶ 318, p. 128-129 (August 9, 2011).
[100] Tr. at 919.

Finally, the Hearing Examiner mischaracterized Staff's arguments (and its witness' statements) in its Post-Hearing Brief regarding the COS and rate design issues. The Hearing Examiner incorrectly stated that Staff argued for the use of AMI data *in this proceeding*. (HER ¶¶ 328 and 329 at 127).[101] Staff did not, nor does it now, advocate for using the AMI data for this proceeding.[102] In addition, the Hearing Examiner incorrectly stated that Staff argued Delmarva's "use of a ***single allocator***" for underground and overhead distribution facilities "has caused inaccurate costs to the residential and commercial classes...." (HER ¶332 at 128-9). The Hearing Examiner has misconstrued Staff's argument on this issue because the single allocator was a reference to *one allocator* that failed to reflect the differences in the customer classes' use of the overhead and underground facilities.[103] In summary, Staff believes that the Company's COS cannot be used as a basis to set rates in this proceeding. Rather, the Commission should use the existing COS for the purpose of setting rates in this docket.

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[101] "Both argue that Delmarva's 50/50 allocation is less accurate than AMI data ***which Staff argues should be used now.***" (emphasis added). (HER ¶ 328 at 127.)

[102] The exact wording of Staff's argument was stated by Staff witness Mr. Pavlovic as follows: "I recommend that the Commission direct Delmarva to develop accurate demand allocators to be used in the class cost of service study submitted ***in Delmarva's next rate case***." Ex. 10, (Pavlovic) at 16 (emphasis added). Delmarva also understood that Staff's witness was recommending the use of AMI data to develop the COSS demand measures ***in the next base rate case***. Ex. 22 (Tanos –R) at L. 5-7 and 19-21. Staff does note, however, that the Hearing Examiner did correctly state its argument for the use of AMI data in Delmarva's next rate case in one paragraph of the report. (*See,* HER ¶ 333 at 129.)

[103] Staff's full argument was as follows: "Because commercial customers generally make greater use of underground facilities, and because underground facilities are generally more expensive, Delmarva's use of ***a single allocator that does not reflect the differences*** in customer classes' use of overhead and underground facilities represents a source of inaccuracy in the COSS and likely results in over-allocation to underground costs to the residential class." (emphasis added). SB at 88.

Respectfully submitted,

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Dated: March 17, 2014

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

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

CERTIFICATE OF SERVICE

I hereby certify that on March 17, 2014, I caused the attached **STAFF'S BRIEF ON EXCEPTIONS TO THE HEARING EXAMINER'S PROPOSED FINDINGS AND RECOMMENDATIONS** to be served upon the Commission's Secretary and all parties on the attached service list in the manner indicated thereon.

Dated: March 17, 2014 */s/ James McC. Geddes*

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Attachments: Staff's Brief on Exceptions to the Hearing Examiner's Proposed Findings and Recommendations and exhibits
Service List – 1-17-14

SERVICE LIST
DP&L ELECTRIC BASE RATE CASE
PSC DOCKET No. 13-115
As of January 17, 2014

Mark Lawrence
Hearing Examiner
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