DELMARVA POWER & LIGHT COMPANY
REBUTTAL TESTIMONY OF JAY C. ZIMINSKY
BEFORE THE DELAWARE PUBLIC SERVICE COMMISSION
CONCERNING AN INCREASE IN GAS BASE RATES
DOCKET NO. 10-237

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1. Q: <u>Please state your name and position, and business address.</u>

A: My name is Jay C. Ziminsky. I am Manager, Revenue Requirements, in the Regulatory Affairs Department of Pepco Holdings, Inc. (PHI) located at P.O. Box 9239, Newark, DE 19714. I am testifying on behalf of Delmarva Power & Light Company (Delmarva or the Company).

2. Q: <u>Did you previously provide Direct, Supplemental, and AMI-Supplemental Testimony in this proceeding?</u>

A: Yes, I did.

3. Q: <u>What is the purpose of your Rebuttal Testimony?</u>

A: I will address certain contested adjustments and proposals made by Division of Public Advocate (DPA) Witness Andrea C. Crane and Staff Witness Ralph C. Smith in their respective Direct Testimonies. These include:

a) Adjustment No. 11, Pension Expense,

b) Adjustment No. 12, Other Post-Retirement Benefits (OPEB),

c) Adjustment No. 21, Advanced Metering Infrastructure (AMI) Deferred Costs,

d) Adjustment No. 26, Credit Facilities Expense,

e) Adjustment No. 27, Pension Regulatory Asset Amortization,

f) Removal of Prepaid Pension Asset from rate base,

g) Removal of Meals and Entertainment Expense from test period cost of service, and

h) Rejection of Volatility Mitigation Rider (Rider VM).

Contested Adjustments

Adjustment No. 11, Pension Expense

4. Q: Please describe the adjustment for pension expense.

A: On Page 2 of my AMI-Supplemental Testimony, I proposed an adjustment to the Company's booked pension expense to reflect the most current actuarial report. The actual pension expense for 2010 is derived from this actuarial report. This proposal is consistent with the Company's base rate case filings in Docket Nos. 03-217, 05-304 and 09-414. This method of using the most recent actuarial-determined amount as the expense on which rates are set is also the one used in the adjustment to establish the proforma level of OPEB expense.

DPA Witness Crane did not contest the Company's proposed pension expense adjustment.

5. Q: What is Staff Witness Smith's position on this adjustment?

A: On Page 33 of his Direct Testimony, Staff Witness Smith proposes that the pension expense to be included in rates on a going-forward basis be determined based on the average of actual 2008 and 2009 pension expense as allocated to DPL's Gas operating and maintenance expense.

As previously noted, Commission precedent for setting both pension and OPEB expense is based on the latest actuarially determined amount. Similar to the other parties in this case, Staff Witness Smith follows this precedent of using the most recent actuarial report for determining the proforma level of OPEB expense; however, he does not follow that same method for determining the proforma level of pension expense.

6. Q: <u>Do you agree with Staff's position on this matter?</u>

A: No. Staff Witness Smith's proposal to use a two-year average for computing a normalization allowance for pension expense conflicts with the Commission's precedent of using the latest annual expense provided by the Company's independent actuary. The Commission should continue to use the results of the Company's independent actuary to establish pension expenses for the rate effective period. This amount reflects the most recent amount available, the actual amount that will be recorded for 2010 and is the level most likely to be representative of the rate effective period.

7. Q: <u>Is it appropriate to average 2008 and 2009 pension expense as recommended by Staff Witness Smith on page 33 of his Direct Testimony?</u>

A: No. Any averaging of historical expense is inappropriate in this instance since more recent data are available to measure the expected level of the rate effective period costs. Although I do not support Staff Witness Smith's two-year averaging position on pension expense, a more reasonable approach would be to average the actual 2009 and actual 2010 results, if any averaging of pension expense is to be considered. The use of actual 2009 and actual 2010 results would be more reflective of pension expense over the rate effective period than Staff Witness Smith's use of 2008 and 2009 results for his proposed average. It would seem that the use of the 2008 results is merely to provide for a lower amount rather than an amount to be used to properly provide for the amount for the rate effective period.

Adjustment No. 12, OPEB Expense

8. Q: Please describe the adjustment for OPEB expense.

A: On Page 2 of my AMI-Supplemental Testimony, I proposed an adjustment to the Company's booked OPEB expense to reflect the most current actuarial report. This proposal is consistent with the Company's base rate case filings in Docket Nos. 03-217, 05-304 and 09-414.

DPA Witness Crane did not contest the Company's proposed OPEB expense adjustment.

9. Q: What is Staff Witness Smith's position on this adjustment?

A: In his response to the Company's Accounting Data Request No. 23, Staff Witness Smith notes that he does not contest my OPEB Adjustment included in my AMI-Supplemental Testimony. In reviewing Staff Witness Smith's revenue requirement, it would appear as if he includes the OPEB adjustment that I proposed in my Supplemental Testimony, 12+0 Update as opposed to the OPEB adjustment included in my AMI-Supplemental Testimony. This difference is also shown as a Contested Adjustment in Schedule WMV R-1 of Company Witness VonSteuben's Rebuttal Testimony. The difference between the two versions of the OPEB adjustments is that the one included in my AMI-Supplemental Testimony removed the effect of AMI labor-related savings. In my Direct Testimony as well as the Supplemental Testimony, 12+0 Update, the OPEB adjustment reflected a reduction in the Company's labor costs as a result of AMI savings related to the planned reduction of meter-reading personnel once AMI is fully deployed. Since the full deployment of AMI is not reflected in this proceeding by any of the parties, the impact of those AMI-related cost savings on OPEB expense should also be removed as I show in Adjustment No. 5 in my AMI-Supplemental Testimony. As previously noted, Staff Witness Smith states that he does not contest the OPEB adjustment included in my AMI-Supplemental Testimony; however, his revenue requirement does not reflect this effect.

Adjustment No. 21, AMI Deferred Expense

10. Q: Please describe the adjustment for AMI Deferred Expense.

A: On page 3 in my AMI-Supplemental Testimony, I proposed an adjustment to amortize the deferred costs related to the infrastructure required to deploy AMI using a 15-year amortization period with the unamortized amount included in rate base. This treatment mirrors the one which was proposed by Staff Witness Mullinax in Docket No. 05-304. Staff Witness Smith did not contest this adjustment.

11. Q: What is DPA Witness Crane's position on this adjustment?

A: DPA Witness Crane agrees with the 15-year amortization of the AMI Deferred Expenses; however, she does not support the unamortized balance to be included in rate base.

12. Q: In comparison to DPA Witness Crane's proposed regulatory treatment of AMI Deferred Expenses in this gas base rate case, did DPA have a different position on the regulatory treatment of similar AMI Deferred Expenses in the Company's current Electric base rate case (Docket No. 09-414)?

A: Yes. In Docket No. 09-414, DPA agreed with both the Company and Staff as to a 15-year amortization of AMI Deferred Expenses with rate base treatment of the unamortized balance. DPA confirmed this ratemaking position during the April 16, 2010 hearing in Docket No. 09-414 during the following cross–examination of DPA Witness Cotton:

> ***Q (Lorenzo).*** *Okay. I also want to ask you a couple of preliminary questions. As you may know, the Staff and the Company agree for amortization of the AMI costs with the unamortized portion balance in rate base over 15 years, and I want to ask you if you have an opinion on that.*
>
> ***A (Cotton).*** *Yes. My opinion is that that is a far better way to go. And I have been authorized by the Division of Public Advocate to tell you that they do not object to that change.*

13. Q: Is there any difference between the types of items included in the deferred Delaware Electric AMI costs and the deferred Delaware Gas AMI costs?

A: No. The same start-up and infrastructure AMI deferred costs are included in both the Delaware Electric AMI deferred costs as well as the Delaware Gas AMI deferred costs. The only difference is that this adjustment reflects the balance assigned to the Gas business as of August 2010. Subsequently, the cost recovery method approved in this proceeding should be consistent.

14. Q: <u>As part of the Company's Blueprint filing (Docket No. 07-28), did the Commission provided guidance relating to cost recovery of AMI?</u>

A: Yes. The Commission issued Order No. 7420 on September 16, 2008 in Docket No. 07-28. Page 5, paragraph 3 of that Order includes the following language:

> *The Commission approves the diffusion of the advanced metering technology into the electric and natural gas distribution system networks and the Commission permits Delmarva to establish a regulatory asset to cover recovery of and on the appropriate operating costs associated with the deployment of Advanced Metering Infrastructure and demand response equipment.*

By approving the recovery on and of a regulatory asset that includes the appropriate operating costs associated with the deployment of AMI, the Commission has provided guidance as to the appropriate rate base treatment of the unamortized AMI deferral expense balance that is consistent with the Company's proposed cost recovery in this case and opposes DPA Witness Crane's position on this issue.

<u>Adjustment No. 26, Credit Facilities Expense</u>

15. Q: <u>Please describe the adjustment for Credit Facilities Expense.</u>

A: On page 10 of my Direct Testimony, I proposed an adjustment to recover the test period cost of the Company's share of the PHI credit facility, which is a \$1.5 billion credit facility that is vital to the day-to-day working capital needs of the Company. The costs are comprised of an amortization of the start-up costs related to the credit facility as well as annual maintenance fees. Due to the accounting of these costs as interest expense for financial statement purposes, the costs are not recovered anywhere in rates as they are not included in the Company's embedded cost of debt in its cost of capital. Staff Witness Smith did not contest this adjustment.

16. Q: What is DPA Witness Crane's position on this adjustment?

A: DPA Witness Crane contests both the recovery of these credit facility costs in cost of service as well as the rate base treatment of the unamortized balance.

17. Q: Have other jurisdictions in which PHI utilities operate recently addressed the cost recovery of the PHI Credit Facility?

A: Yes. In Formal Case No. 1076, the District of Columbia Commission's Order No. 15710 accepted an adjustment to recognize Potomac Electric Power Company's (Pepco) portion of the costs associated with the PHI Credit facility. That adjustment was the same as is the one requested in this proceeding and it is worth noting that both Commissions exclude short-term debt from utility capital structures for rate of return purposes. The District of Columbia Commission recognized the importance of Pepco's ability to raise capital on reasonable terms during the financial crisis of 2008. The crisis had a severe negative effect on the short-term credit market which closed off access to the commercial paper market for day-to-day funding, necessitating Pepco's borrowing under its bank credit facility, and causing concerns over its ability to maintain liquidity in late 2008 and early 2009. The District of Columbia Commission's language on page 38 in Order No. 15710, issued in March 2010, in Formal Case No. 1076 provides guidance on this issue:

> *The credit facility is beneficial to customers. It has allowed the Company to access the capital and credit markets to meet its daily working requirements on less expensive terms. Balancing the interest of ratepayers and the Company, and recognizing the importance of Pepco's ability to raise capital on reasonable terms, the Commission approves the Company's adjustment and will permit the Company to recover start-up costs and annual maintenance fees.*

In Maryland, a similar credit facilities ratemaking adjustment was uncontested by all parties in the most recent base rate cases for both the Company (Case No. 9192) as well as for Pepco (Case No. 9217).

The Commission should accept the Company's and Staff's position on Credit Facilities expenses as this is a cost that the Company has incurred and will continue to incur. To not include this item in the test period cost of service would not allow the Company the opportunity to earn its authorized rate of return.

Adjustment No. 27, Pension Regulatory Asset Amortization

18. Q: Please describe the adjustment for Pension Regulatory Asset Amortization.

A: The Company's proposal is to defer the difference between 2009 pension expense incurred by the Company's Delaware Gas operations and the pension income benefit that its customers have been receiving in their base rates as set in the settlement in Docket No. 06-284 and following the precedent set in the Company's last Delaware Electric case, Docket No. 05-304.

In opposing the proposal, Staff Witness Smith and DPA Witness Crane make the following claims, all of which I respond to below:

- Management has the ability to control pension expense through its plan design and funding decisions
- Maryland Commission's decision on the Company's similar deferred pension expense proposal in that jurisdiction
- The proposal represents retroactive ratemaking
- The proposal represents single issue ratemaking

19. Q: <u>Please address Staff Witness Smith's claim that pension expense is somewhat under the Company's control via plan design and management's funding decisions.</u>

A: There are some pension expense-related items for which the Company has control, such as plan design and funding decisions; however, pension expense is far more determined by factors, such as asset performance and discount rate, which are outside the control of the Company. In addition, the pension plan benefit is part of the Company's overall compensation plan for its employees. Changes to the pension plan must be taken in context of that overall compensation plan. Company Witness Jenkins describes the Company's overall compensation plan in his Rebuttal Testimony.

The significance of factors outside of companies' control in terms of pension performance was recently discussed in the Pension & Investments 4th

Annual Liability Driven Investing Conference by The Vanguard Group regarding pensions and related performance. As seen on Schedule JCZ-16 of my Direct Testimony, a chart from that conference shows that only 20% of the volatility in pension expense is plan design related (actuarial assumptions that differ from actual results) while 80% of the volatility is related to the discount rate and investment returns (which are out of the control of the company) and impact all plan sponsors and all pension plans. I will cite several examples of these discount rate and investment return impacts. For example, a mere 25 basis point change in the discount rate changes PHI's pension liability by $40 million. In addition, a 10% change in the value of PHI's pension trust will affect its annual pension expense by approximately $12.5 million in terms of expected returns.

In addition, Staff Witness Smith ignores the large role played by legal and regulatory requirements such as Employee Retirement Income Security Act (ERISA) and Financial Accounting Standards Board (FASB) in determining annual pension expense and funding.

20. Q: <u>Please address Staff Witness Smith's comments in regard to the Company's recent rate case decision in Maryland as part of Case No. 9192.</u>

A: On Page 6 of his Direct Testimony, Staff Witness Smith cites the Maryland Commission's rejection of the Company's proposed deferred pension accounting treatment for the difference between 2009 expense and the benefit that customer received in their base rates. If this Commission wishes to consider precedent of other jurisdictions on this issue, it should also take note of the decision of the Public Service Commission of South Carolina in Order No. 2009-

81 in South Carolina Electric & Gas Docket No. 2009-36-E. In that case, the South Carolina Commission authorized the utility to defer the difference between its 2009 pension expense and the amount that it was recovering in its current base rates.

21. Q: <u>Please address Staff Witness Smith's claim that this proposed deferred accounting represents retroactive ratemaking.</u>

A: The Company first raised this proposed pension deferral accounting request on May 1, 2009 in Docket No. 09-182, "In the Matter of the Petition of Delmarva Power & Light Company for Authorization to Defer Certain Charges to the Company's Financial Statements Resulting from the Impact of Recent Economic Developments on Pension Costs". The Company provided timely responses to the discovery requests of the other parties in that proceeding; however, the Commission ultimately decided to consolidate that proceeding into Docket No. 09-414. Thus, the issue was raised in a timely manner and the proposed deferred accounting does not constitute retroactive ratemaking.

22. Q: <u>Please address Staff Witness Smith's claim that this proposed deferred accounting represents single-issue ratemaking.</u>

A: The nature of deferred accounting is to accumulate costs between rate cases so that the ratemaking treatment of those costs can be determined in a future rate case. As such, the deferral of costs does not constitute single-issue ratemaking as ratemaking treatment of those deferred costs can be taken into consideration with all of the other revenue requirement components during the context of a base rate case proceeding. The ratemaking treatment sought by the

Company for this pension issue is warranted in light of the size of the expense and the extraordinary circumstances that gave rise to its incurrence. The difference between the Company's Gas pension expense in 2009 and the amount that it credited its customers during the same year is $4.090 million as shown in Schedule JCZ-14 of my Supplemental Testimony, 12 + 0 Update. By comparison, the Company's per books earnings for the test period were only $14.976 million as shown in Schedule WMV R-1 in Company Witness VonSteuben's Rebuttal Testimony. On Page 8 of his Direct Testimony, Company Witness Wathen details the economic circumstances that were present when this large shift in pension expense was created. These same economic circumstances were also noted by the Public Service Commission of South Carolina in its Order No. 2009-81 in Docket No. 2009-36-E. In that order, the Commission stated:

> *Clearly, the recent downturn in the economy is unprecedented. In general, the Company has seen an annual pension income rather than an expense. This income has reduced rates.*

23. Q: <u>Can you summarize your rebuttal position on the proposed pension expense regulatory asset?</u>

A: Pension expense is an item which is largely out of the control of the Company. Customers have benefited from the Company's strong pension plan performance in the past. The current ratemaking penalizes the Company's shareholders in a scenario such as the recent economic downturn when pension expense has a dramatic increase. This expense has a significant impact on the

Company's Gas cost of service expense level and hindered the Company from its ability to earn its authorized rate of return when the Company did not have an ability to recover these costs. The Commission should allow the Company to defer the difference between 2009 pension expense and the pension credit that customers are currently receiving in their base rates and provide recovery of that difference over a five-year amortization period with the unamortized balance receiving rate base treatment.

<u>Meals and Entertainment Expense</u>

24. Q: <u>Please describe the Company's position in regard to the inclusion of Meals and Entertainment expense in test period cost of service.</u>

A: The Company included the actual test period level of Meals and Entertainment expense in its cost of service expense which is factored into the revenue requirement development for this proceeding.

25. Q: <u>Please describe the adjustments made by Staff Witness Smith and DPA Witness Crane in regard to Meals and Entertainment expense.</u>

A: In comparison to the Company's proposed treatment, Staff Witness Smith and DPA Witness Crane propose different alternatives related to the rate-making treatment of Meals and Entertainment expense.

In his Adjustment No. NOI-17, Staff Witness Smith proposes a three-year normalization of these expenses to account for the test period increase related to Winter 2010 snowstorms and June 2010 International Brotherhood of Electrical Workers (IBEW) 1238 strike, as noted in the Company's response to PSC-LA-

248. Staff Witness Smith's adjustment reduces test period cost of service earnings by $8,000.

In Schedule ACC-32, DPA Witness Crane reduces test period cost of service earnings by $10,000 with her proposed adjustment to Meals and Entertainment expense. Her adjustment is based on the 50% disallowance of Meals and Entertainment expenses by the Internal Revenue Service (IRS) for federal tax purposes. On Page 84 of her Direct Testimony, DPA Witness Crane states "If these costs are not deemed to be reasonable business expenses by the IRS, it seems appropriate to conclude that they are not reasonable business expenses to include in a regulated utility's cost of service". DPA Witness Crane ignores Commission precedent and relies on the IRS regulations for her adjustment. Given the different purposes of the IRS and the Commission, it is not appropriate to solely justify ratemaking policy based on IRS regulations.

Upon review of the various rate-making proposals in regard to Meals and Entertainment expenses, I agree with Staff Witness Smith as to his proposed three-year normalization of these expenses due to their volatility in the test period associated with the winter ice storms and IBEW 1238 strike in comparison to prior years. I adopt his rate-making adjustment and it is reflected in the Company's overall rebuttal revenue requirement position as seen in Schedule WMV R-1 of Company Witness VonSteuben's Rebuttal Testimony in this proceeding.

Prepaid Pension Asset

26. Q: **What is the Company's position in regard to the inclusion of the Prepaid Pension Asset in rate base?**

A: The prepaid pension asset arises when annual increases in pension plan assets exceed annual costs associated with pension obligations. The prepaid pension asset included in rate base represents the accumulated amount of negative pension expense that the Company has booked pursuant to Financial Accounting Statement 87 (SFAS 87). The inclusion of the prepaid pension asset in rate base follows the Commission's decision on page 27 of Order No. 6930 of the Company's Electric Docket No. 05-304, which states:

> ***Discussion and Decision:*** *We are sympathetic to the DPA's concern that the Company has long been collecting more than it needs for pension payments. However, we believe that the prepaid pension asset is appropriately included in rate base because it is caused by a negative pension expense, which both 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. We also recognize that the Company has no access to this asset to use for other operating expenses; it is precluded by federal law from using any of the money it has collected for pensions for any other purpose. Thus, for these reasons and the reasons set forth in the Hearing Examiner's findings and recommendations, we adopt the Hearing Examiner's findings and recommendations. (Unanimous.).*

Staff Witness Smith did not contest the Company's position in regard to the inclusion of prepaid pension asset in rate base.

27. Q: <u>Do you agree with DPA Witness Crane's position to remove the Company's prepaid pension asset from rate base?</u>

A: No. DPA Witness Crane proposes the removal of the prepaid pension from rate base since the Company did not have negative pension expense during the test period for Docket No. 10-237 while it did have negative pension expense for the test period in Docket No. 05-304. The prepaid pension asset balance represents the accumulation of negative pension expense, cash contributions and associated growth over a period of time, not just a single year, and thus it should be included in rate base. The Company's pension expense is less than it would have been without the return from the Company-funded prepaid pension asset. As previously noted, the Commission noted in Order No. 6930 that the Company has no access to the assets in the pension asset in terms of using them for other operating expenses. The Commission should continue to follow its precedent and include the prepaid pension asset in rate base.

28. Q: <u>In terms of the rate-making treatment of prepaid pension assets, what are the precedents set by some of the commissions in other jurisdictions in which PHI utilities operate?</u>

A: The inclusion of Prepaid Pension Asset/OPEB Liability in rate base is the precedent in the District of Columbia. In Order No, 14712, which was issued in January 2008, in Pepco's Formal Case No. 1053, the District of Columbia Commission rendered the following decisions:

112. The Company's inclusion of Prepaid Pension Asset/OPEB Liability in the rate base is consistent with Commission precedent. In an earlier case concerning BA-DC, the Commission found that BA-DC was required to continue its policy of placing an amount equal to the SFAS accrual into an external funding mechanism to the extent that tax advantaged vehicles exist, with any accruals in excess of that amount applied as a reduction to rate base. In a subsequent case involving Pepco, the Commission similarly found that "as in the BA-DC case, it is appropriate that Pepco account for any amounts not externally funded ... as a reduction to rate base."

113. The Commission finds that investor-supplied cash contributions have resulted in an asset from which Pepco's customers receive a tangible benefit in the form of reduced pension expenses. Therefore, investors are entitled to earn a return on the capital they provided. ... Accordingly, the Commission retains the Prepaid Pension Asset/OPEB Liability included in rate base, as proposed by the Company, and rejects OPC's requested adjustment.

In Maryland, Delmarva and Pepco include prepaid pension assets/OPEB Liabilities in rate base.

Rider VM

29. Q: <u>Please explain the Company's alternative rate mitigation plan – Rider VM.</u>

A: As explained in Company Witness Wathen's Direct Testimony on page 16 and further explained in my Direct Testimony on page 16, the Company proposed a ratemaking alternative to recover the costs of three expenses that are extremely volatile and are largely outside of the Company's control – pension, OPEB and uncollectible expenses. This mitigation proposal would reduce the amount of the rate increase being requested in this proceeding by $156,000. Under this proposal, Delmarva would recover a rolling three-year average of costs for pension, OPEB and uncollectible expenses in the form of a rider – Rider VM. My Direct Testimony explains how the Rider VM would operate.

30. Q: <u>What are the positions of Staff and DPA regarding Rider VM.</u>

A: Both the Staff and DPA recommend that the Company's mitigation proposal be rejected. Staff Witness Smith argues that while pension and OPEB expenses are influenced by market returns and interest rates, these expenses are not wholly beyond the Company, and that the Company's management does exercise influence over the levels of pension, OPEB and uncollectible expenses. He also claims that this type of rider removes risk from shareholders and places it on customers; that this would be a departure from long-standing ratemaking precedent; and that it would reduce the Company's cost containment incentives. DPA Witness Crane raises similar arguments related to risk and cost containment incentives in addition to claiming Rider VM is both single-issue ratemaking and reimbursement ratemaking.

31. Q: <u>What is the Company's response to these criticisms?</u>

A: There can be no dispute that these expenses show great variability and are largely out of the Company's control. The Rider VM mechanism provides a better match of the costs and related recovery in a symmetrical manner for both the

Company and its customers. Based on these facts, I recommend that the Commission adopt this alternative ratemaking proposal.

32. Q: <u>Does this conclude your Rebuttal Testimony?</u>

A: Yes.