

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF )  
DELMARVA POWER & LIGHT COMPANY FOR A ) PSC DOCKET NO. 12-546  
CHANGE IN NATURAL GAS BASE RATES )  
(Filed December 7, 2012) )

DIRECT TESTIMONY OF STAFF WITNESS

DAVID E. PETERSON

June 3, 2013

**I. INTRODUCTION**

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

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

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

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

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

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

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

1 A. Yes. I have presented testimony in 138 other proceedings before the state regulatory  
2 commissions in Alabama, Arkansas, California, Colorado, Connecticut, Delaware,  
3 Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New  
4 York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and before the Federal  
5 Energy Regulatory Commission. Collectively, my testimonies have addressed the  
6 following topics: the appropriate test year, rate base, revenues, expenses, depreciation,  
7 taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle  
8 analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

9  
10 In addition, in 2006 testified twice testified before the Energy Subcommittee of the  
11 Delaware House of Representatives on the issues of consolidated tax savings and tax  
12 normalization. I have also presented utility ratemaking seminars to the Delaware Public  
13 Service Commission (“Commission”), to the Commissioners and Staff of the Washington  
14 Utilities and Transportation Commission and to the Colorado Office of Consumer  
15 Counsel.

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2  
3 **II. SUMMARY**

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

5 A. My appearance in this proceeding is on behalf of the Public Service Commission Staff  
6 (“Commission Staff”).

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

9 A. Yes, I have. I submitted testimony in rate proceedings involving Delaware Electric  
10 Cooperative (Docket No. 04-288), Delmarva Power & Light Company (Docket Nos. 05-  
11 304 and 11-528), and Tidewater Utilities, Inc. (Docket No. 06-145). My appearances in  
12 these proceedings were on behalf of the Commission Staff.

13  
14 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

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

24  
25 **Q. PLEASE IDENTIFY THE WITNESSES WHO WILL BE TESTIFYING FOR THE**  
26 **COMMISSION STAFF IN THIS PROCEEDING.**

27 A. In addition to me, the Commission Staff is sponsoring five other witnesses who address  
28 different aspects of Delmarva’s filing. Mr. David C. Parcell’s testimony presents the

1 Commission Staff's recommendations on the appropriate capital structure, capital cost  
2 rates and rate of return. Mr. Gary Cohen's testimony addresses the future recovery of  
3 AMI deployments costs and related tariff changes. Mr. Brian Kalcic addresses class cost  
4 of service and rate design issues in his testimony. In addition Michael McGarry addresses  
5 the Company's line extension policy and related fees, and Malika Davis, as case manager  
6 for Staff, provides an overview of the Company's Application.

7  
8 **Q. ARE YOU FAMILIAR WITH DELMARVA'S FILING IN THIS PROCEEDING?**

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

13  
14 **Q. PLEASE SUMMARIZE DELMARVA'S RATE REQUEST.**

15 A. Delmarva's existing retail natural gas distribution rates have been in effect on a  
16 permanent basis since February 2, 2011, when the Commission approved a \$5.8 million  
17 annual revenue increase for Delmarva in Docket No. 10-237.

18  
19 On December 7, 2012, Delmarva filed an Application with the Commission requesting a  
20 \$12,174,435 or 7.87 percent annual revenue increase. However, since this proceeding  
21 addresses only Delmarva's retail gas distribution rates, the Company's proposal is more  
22 accurately stated as a 17.1 percent increase in present gas distribution revenues.

23  
24 Delmarva's rate increase request is premised on a test period ended December 31, 2012,  
25 and includes a 10.25 percent return on common equity and a 7.54 percent return on rate  
26 base. Delmarva initially requested that its proposed rates become effective February 5,  
27 2013. The Commission suspended the proposed rates, however, and on February 5

1 Delmarva implemented interim rates designed to increase annual revenues by \$2.5  
2 million, which are subject to refund.

3  
4 Delmarva's December 7, 2012 filing included a revenue requirement study based on six  
5 months of actual and six months of forecasted operating results. On March 11, 2013,  
6 Delmarva supplemented its initial filing to include an updated revenue requirement  
7 analysis. In the updated analysis, the Company replaced the forecasted operating results  
8 with actual operating results. Delmarva's updated analysis purports to prove a  
9 \$13,004,566 annual revenue deficiency (an 18.0 percent increase over test period  
10 distribution revenues).

11  
12 **Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING YOUR**  
13 **RECOMMENDATIONS AND ADJUSTMENTS RELATIVE TO THE**  
14 **COMPANY'S CLAIMED REVENUE REQUIREMENT?**

15 A. Yes, I have. Exhibit\_\_(DEP-1) attached to my testimony summarizes the Commission  
16 Staff's determination of Delmarva's retail gas distribution revenue deficiency.  
17 Exhibit\_\_(DEP-1), Schedule 1 summarizes the cumulative effect of my  
18 recommendations and adjustments, and those of the Commission Staff's other witnesses,  
19 on Delmarva's March 11, 2013 updated revenue requirement analysis. From this  
20 schedule, I calculated that Delmarva's current retail gas distribution rates produce a 6.23  
21 percent return on rate base. Commission Staff witness Mr. Parcell is testifying in this  
22 proceeding that Delmarva requires a 7.15 overall return on rate base. Mr. Parcell's  
23 overall return includes a 9.45 percent allowance on common equity capital. Therefore,  
24 on my Schedule 1, I show that Delmarva's annual revenues will have to be increased by  
25 \$3,583,681 in order to yield the 7.15 percent overall return that Mr. Parcell recommends,  
26 rather than the \$12.1 million increase that Delmarva originally requested.

1 Exhibit\_\_\_\_(DEP-1), Schedule 2, is a multi-page schedule detailing my determination of  
2 Delmarva’s adjusted average rate base. Schedule 3 shows my calculation of Delmarva’s  
3 *pro forma* earnings under present rates. The Commission Staff’s recommended  
4 adjustments that bridge Delmarva’s updated revenue requirement analysis to the  
5 Commission Staff’s *pro forma* determination are shown in Column C on the first page of  
6 Schedules 2 and 3. The bases for the Commission Staff’s recommended rate base and  
7 expense adjustments are set forth in the following sections of my testimony and in the  
8 testimonies of the Commission Staff’s other witnesses.  
9

10 **III. RATE BASE**

11 **A. Test Period**

12 **Q. WHAT TEST PERIOD IS REFLECTED IN DELMARVA’S UPDATED**  
13 **REVENUE REQUIREMENT ANALYSIS?**  
14

15 A. Delmarva’s filing is based on an actual test period consisting of the twelve months ended  
16 December 31, 2012. An actual test period, such as the one used in Delmarva’s revenue  
17 requirement cost study, is preferable to a forecasted test period because an actual test  
18 period is based on actual, audited operating results. A test year based on financial  
19 forecasts, on the other hand is unreliable and unverifiable. Therefore, I used the same  
20 actual test period in my calculation of the Company’s revenue requirement that Delmarva  
21 used.  
22

23 **Q. DOES DELMARVA’S UPDATED REVENUE REQUIREMENT ANALYSIS**  
24 **INCLUDE ANY ADJUSTMENTS TO ACTUAL TEST PERIOD OPERATING**  
25 **RESULTS?**

26 A. Yes, it does. Delmarva’s witnesses Mr. Ziminsky and Ms. Santacecilia proposed several  
27 adjustments to test period rate base, revenues and expenses to reflect both known and  
28 forecasted changes in operating levels.

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

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

**B. Average v. Year-end**

**Q. WHAT DID MR. ZIMINISKY INCLUDE IN RATE BASE?**

A. Mr. Ziminsky’s proposed \$274.7 million rate base includes net plant in service at test year-end, December 31, 2012, plus amounts for forecasted post-test year reliability plant closings, construction work in progress, materials and supplies, cash working capital, certain prepaid assets, less the accumulated deferred income tax reserve, customer deposits and customer advances for construction.

**Q. IS YEAR-END RATE BASE TREATMENT AS PROPOSED BY MR. ZIMINISKY AN ACCEPTED COMMISSION PRACTICE?**

A. No, it is not. Although in specific cases exceptions have been made, the Commission’s general policy is to require jurisdictional utilities to measure rate base using the test period average plant balance, rather than the year-end plant balance.



1  
2 **Q. WHY THEN IS MR. ZIMINISKY PROPOSING TO USE A YEAR-END RATE**  
3 **BASE?**

4 A. The entirety of his testimony that addresses why he believes it is appropriate to use year-  
5 end rate base is his unfounded statement that he used year-end rate base “to better reflect  
6 the assets which will be serving customers during the rate effective period.”<sup>1</sup> Apparently,  
7 the inference that we are supposed to draw from this statement is that an average rate  
8 base will not capture all of the Company’s investment in rates; at least not the same  
9 degree as would a year-end rate base.

10  
11 **Q. WHAT IS YOUR OBJECTION TO USING A YEAR-END RATE BASE?**

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

19  
20 **Q. CAN YOU DEMONSTRATE HOW USING YEAR-END RATE BASE RESULTS**  
21 **IN AN UNDERSTATEMENT OF THE INCOME PRODUCING CAPABILITY OF**  
22 **A UTILITY’S PLANT INVESTMENT?**

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

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<sup>1</sup> Direct Testimony of Jay C. Ziminsky, page 7.

1 interest per month, by the end of the year the bank would have paid the depositor \$13 in  
2 interest.

3  
4 The distortion occurs when one tries to measure the annual earnings rate. The following  
5 table compares the indicated annual rate of earning under the year-end approach and  
6 under the average rate base approach.

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8

<b>Indicated Annual Rate of Return</b>		
	<b>Year-End Approach</b>	<b>Average Approach</b>
Account Balance	\$200	\$108
Annual Interest	\$13	\$13
Annual Earnings Rate	6.5%	12%

9

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

17  
18 When plant balances are growing, as they are for Delmarva, using year-end rate base  
19 understates the income producing capability of existing rates and overstates the revenue  
20 deficiency. Rates set using year-end rate base will provide Delmarva an unwarranted  
21 attrition allowance. This results because year-end rate base understates the income  
22 producing capability of the Company's present rates and overstates Delmarva's present  
23 revenue deficiency. Delmarva's ratepayers end up paying rates that are higher than

1 necessary to compensate the Company for its cost of service. To avoid the distortion and  
2 understatement of Delmarva's actual and *pro forma* earnings, I recommend that the  
3 Commission require that Delmarva's revenue requirement and revenue deficiency be  
4 determined using the average rate base as it has traditionally done.  
5

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

9 A. Yes, I have. My Exhibit DEP-1, Schedule 2, page 2a, summarizes all of the adjustments  
10 that are necessary to convert Mr. Ziminsky's year-end rate base to a thirteen-point  
11 average (i.e., an average of the test year beginning balance and each of the twelve month-  
12 end balances). The detail of these adjustments is provided in my Schedule 2, on pages 3  
13 through 6. The summary schedule on page 2 shows that Mr. Ziminsky's rate base should  
14 be reduced by \$9,999,500 to properly reflect an average rate base.  
15

16 **C. Reliability Closings**

17 **Q. IS MR. ZIMINSKY PROPOSING ANY ADJUSTMENT TO THE TEST PERIOD**  
18 **PLANT BALANCES?**

19 A. Yes, he is. Mr. Ziminsky is proposing to include in rate base adjustments totaling \$16.7  
20 million for forecasted plant closings, net of forecasted retirements, in 2013 for what he  
21 calls "reliability" facilities.  
22

23 **Q. IS MR. ZIMINSKY'S RELIABILITY PLANT ADJUSTMENTS APPROPRIATE?**

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

1 present rates. The matching principle requires that test period revenues and expenses be  
2 compared with plant in service throughout the test period – i.e., the thirteen point  
3 average. Mr. Ziminsky’s reliability plant adjustments distort the test year relationship  
4 between plant in service and other elements of the revenue requirement. The distortion  
5 can easily be identified in the accumulated reserves for depreciation and deferred taxes.  
6 While Mr. Ziminsky’s adjustments recognize the increasing reserves for depreciation and  
7 deferred income taxes associated with reliability plant additions, his adjustments  
8 completely ignore the growth in the depreciation reserve for embedded plant that will be  
9 occurring as the reliability plant is placed in service. Also, his adjustments fail to  
10 annualize the effects on the deferred tax reserve arising from bonus tax depreciation on  
11 non-reliability plant closings in 2013. In effect, all elements of the test year revenue  
12 requirement would have to be restated to December 31, 2013 for the proper matching  
13 result to be achieved. Clearly, this is not what Mr. Ziminsky had in mind; nor do I  
14 recommend it. Rather, I recommend that rate base reflect only plant in service during the  
15 test year calculated using a thirteen-point average. My adjustments to reverse Mr.  
16 Ziminsky’s proposed reliability-related rate base adjustments are shown on my  
17 Exhibit\_\_(DEP-1), Schedule 2, page 2b, Columns B. My adjustment reduces Mr.  
18 Ziminsky’s proposed rate base by \$16.7 million.

19  
20 **D. AMI Additions**

21 **Q. WHAT RATE TREATMENT IS DELMARVA REQUESTING FOR IT**  
22 **ADVANCED METERING INFRASTRUCTURE (“AMI”) PROJECT?**

23 A. Mr. Collacchi testifies that approximately 32 percent of the gas Interface Management  
24 Units (“IMUs”) were installed as of October 31, 2012, and that the remainder is projected  
25 to be installed by the third quarter of 2013. Therefore, Mr. Ziminsky proposed two  
26 separate ratemaking treatments for the Company’s AMI project. First, Mr. Ziminsky  
27 included in his proposed rate base forecasted AMI plant additions during 2013. He also  
28 added forecasted AMI-related depreciation to operating expenses. Second, once AMI is

1 producing customer benefits and the Company is reading at least 95 percent of its gas  
2 meters remotely through the IMUs, Delmarva will file a separate petition to begin  
3 recovering the accumulated AMI regulatory asset, which the Commission authorized in  
4 Docket No. 07-28.

5  
6 **Q. DO YOU AGREE WITH MR. ZIMINSKY’S PROPOSED TREATMENTS FOR**  
7 **AMI-RELATED COSTS?**

8 A. No, not entirely. I agree with Mr. Ziminsky that it is premature to decide in this case the  
9 precise value of the regulatory asset and how the regulatory asset should be recovered  
10 from ratepayers. However, I disagree with Mr. Ziminsky’s adjustment to include 2013  
11 forecasted AMI investment in rate base. Essentially, the forecasted AMI investment is  
12 construction work in progress (“CWIP”). As such, that equipment was not in service  
13 during the 2012 test period and did not provide service benefits to Delaware ratepayers.  
14 Mr. Ziminsky’s proposed adjustment violates the test year matching principle because it  
15 recognizes costs without also recognizing offsetting benefits to customers. The basis for  
16 my disagreement with Mr. Ziminsky is discussed more fully in the next subsection of my  
17 testimony where I state my objection to including CWIP in rate base. My criticisms of  
18 including Delmarva’s general CWIP in rate base apply equally to the Company’s AMI-  
19 related CWIP. On Exhibit\_\_\_(DEP-1), Schedule 2, page 2a, Column C, I show the  
20 reversal of Mr. Ziminsky’s proposed AMI-related rate base adjustments. On Schedule 3,  
21 page 2b, Column B, I show the reversal of Mr. Ziminsky’s proposed depreciation  
22 expense adjustment relating to the 2013 forecasted AMI plant additions.

23  
24 **E. Construction Work In Progress**

25 **Q. DID MR. ZIMINSKY INCLUDE IN RATE BASE ANY OTHER PLANT THAT**  
26 **WAS NOT IN SERVICE DURING THE TEST PERIOD?**

1 A. Yes, he did. In addition to the forecasted reliability and AMI-related additions through  
2 December 2013, Mr. Ziminsky's proposed rate base also includes \$9,095,071 of other  
3 CWIP.

4  
5 **Q. IN YOUR OPINION, IS IT APPROPRIATE TO INCLUDE CWIP IN**  
6 **DELMARVA'S RATE BASE?**

7 A. No, it is not. It has been my consistent position that plant that is not used and useful  
8 during the test period should not be included in rate base. My position on this applies to  
9 the projected post-test year reliability plant closings and AMI-related equipment, which I  
10 discussed earlier in my testimony, and to the other CWIP included in Delmarva's  
11 proposed rate base. My primary objection to including the post-test year reliability plant  
12 closings and CWIP in rate base is that the construction projects in question were not used  
13 and useful during the test period. Delmarva's customers received no service benefits  
14 from them. More fundamentally, including CWIP in rate base violates the test period  
15 matching principle. It does so by stepping outside the test period to measure investment  
16 without making similar out of period adjustments for revenues and expenses that flow  
17 from the out of period investment. Once it is placed in service, the CWIP that Mr.  
18 Ziminsky has included in his rate base will serve new customers or new loads, increase  
19 operating efficiency or service reliability, or decrease maintenance requirements on both  
20 new and existing facilities. Yet, none of these revenue increasing or expense reducing  
21 impacts that flow from CWIP (and the reliability projects) are reflected in Mr.  
22 Ziminsky's revenue requirement determination. In other words, Mr. Ziminsky's rate base  
23 treatment for CWIP recognizes only the cost increases that flow from the post-test period  
24 construction projects, but it does not recognize the service benefits (i.e., increasing  
25 revenues and reducing expense) that flow from CWIP. Because of this mismatch, CWIP  
26 should not be included in Delmarva's rate base. My position is consistent with the last  
27 several Commission decisions regarding Delmarva's rate base and CWIP. (*See,*  
28 *Commission Order Nos. 8011 and 6039.*)

1  
2 **Q. HOW THEN IS DELMARVA TO BE COMPENSATED FOR FINANCING**  
3 **COSTS INCURRED DURING THE CONSTRUCTION PERIOD IF CWIP IS NOT**  
4 **INCLUDED IN RATE BASE?**

5 A. Delmarva is appropriately compensated for construction period financing costs when it  
6 capitalizes an allowance for funds used during construction (“AFUDC”). Once  
7 capitalized, accumulated AFUDC is added to other construction-related costs in Account  
8 101, Plant in Service, and is depreciated over the useful life of the asset.

9  
10 **Q. MR. ZIMINSKY ADDED AFUDC TO OPERATING INCOME IN THIS**  
11 **PROCEEDING. DOESN’T INCLUDING AFUDC IN CURRENT EARNINGS**  
12 **OFFSET THE REVENUE REQUIREMENT IMPACT OF INCLUDING CWIP IN**  
13 **RATE BASE?**

14 A. In theory, if the AFUDC rate matched Delmarva’s authorized rate of return and if  
15 Delmarva capitalized AFUDC on all construction projects, then including AFUDC in  
16 current earnings would offset the revenue requirement impact of including CWIP in rate  
17 base. But this is not the case in this proceeding. After considering the effects of Mr.  
18 Ziminsky’s reliability plant closing adjustments, his rate base determination has  
19 \$27,654,001 of CWIP and his income statement has only \$276,786 of AFUDC. This  
20 level of AFUDC has an effective earnings rate of only 1.0 percent on the CWIP balance.  
21 This earnings rate is far below the 7.54 percent overall rate of return that Delmarva is  
22 requesting in this proceeding. Therefore, including AFUDC in current earnings does not  
23 come close to offsetting the revenue requirement impact of including CWIP in rate base.  
24 (See, Commission decisions cited above.)

25  
26 **Q. WHAT REASONS ARE THERE FOR THE LOW AFUDC EARNINGS RATE ON**  
27 **DELMARVA’S CWIP BALANCE?**

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

7  
8 **Q. CAN ANYTHING BE DONE TO MAKE AFUDC MORE COMPENSATORY TO**  
9 **THE COMPANY?**

10 A. Yes. Delmarva could begin accruing AFUDC on all CWIP.

11  
12 **F. Credit Facility**

13 **Q. WHAT IS THE BASIS FOR YOUR RATE BASE ADJUSTMENT RELATING TO**  
14 **THE COST OF DELMARVA'S CREDIT FACILITIES?**

15 A. Mr. Ziminsky proposed an expense adjustment to reflect an amortization of the  
16 Company's credit facilities costs. In addition, Mr. Ziminsky included the amortized  
17 credit facility costs in his rate base.

18  
19 In the next section of my testimony I explain why it is inappropriate to include the credit  
20 facilities amortization in rates. Since it is wrong to recognize the expense amortization in  
21 rates, it is also wrong to include the unamortized expense in rate base as Mr. Ziminsky  
22 proposed. Therefore, I have excluded the unamortized expense in my rate base  
23 determination. My adjustment reduces Delmarva's proposed rate base by \$182,203.

24  
25 **G. Cash Working Capital**

26 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO DELMARVA'S**  
27 **PROPOSED CASH WORKING CAPITAL ALLOWANCE?**



1 A. Yes, I am. I have accepted the revenue and expense lead and lag days reflected in the  
2 Company's working capital analysis. My adjustments merely reflect the consequences of  
3 my expense adjustments on the cash working capital allowance sponsored by Delmarva.  
4 In addition, the Company acknowledged that certain amounts that were included in its  
5 proposed rate base as prepayments were already included in the cash working capital  
6 lead-lag analysis.<sup>2</sup> This resulted in double-counting the prepayments in rate base. My  
7 adjustments to synchronize the lead-lag analysis with my recommended expense  
8 adjustments and to eliminate the double-counting of certain prepaid expenses are  
9 summarize on Exhibit\_\_\_(DEP-1), Schedule 2, page 2b, Column F and on Schedule 2,  
10 page 7. My cash working capital adjustments increases Mr. Ziminsky's proposed rate  
11 base by \$374,730.

12  
13 **H. Rate Case Expense**

14 **Q. HOW DOES MR. ZIMINSKY PROPOSE TO RECOVER THE COSTS**  
15 **EXPECTED TO BE INCURRED ASSOCIATED WITH THIS RATE CASE?**

16 A. Mr. Ziminsky proposed to amortize his estimate of rate case expense over the next three  
17 years. In addition, Mr. Ziminsky included his unamortized rate case expense estimate,  
18 net of deferred taxes, in rate base.

19  
20 **Q. DO YOU AGREE WITH MR. ZIMINSKY'S PROPOSED RATE TREATMENTS**  
21 **FOR RATE CASE EXPENSE?**

22 A. No. In the next section of my testimony I discuss my recommended adjustment to Mr.  
23 Ziminsky's proposed annual rate case expense amortization. In addition, I also object to  
24 Mr. Ziminsky including the unamortized rate case expense balance in rate base. I am  
25 unaware of any recent Delmarva case wherein the Commission authorized rate base  
26 treatment for unamortized expenses as Mr. Ziminsky proposes. Assigning carrying  
27 charges on unamortized rate case expenses to the Company and its stockholders is

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<sup>2</sup> See Delmarva's response to PSC-RR-10.

1 appropriate in that it provides an incentive for the Company to minimize rate case costs.  
2 It also properly aligns costs with benefits by recognizing the fact that stockholders, rather  
3 than ratepayers, are a significant beneficiary of the Company's success in receiving a rate  
4 increase. For this same reason, the New Jersey Board of Public Utilities routinely  
5 requires that utilities under its jurisdiction, and their stockholders, absorb 50 percent of  
6 rate case expenses with no rate base treatment for the unamortized expense. While the  
7 New Jersey approach is reasonable, I am not seeking that treatment in this case because  
8 of Commission precedent. That same precedent, however, supports my recommendation  
9 to exclude unamortized rate case expenses from rate base.

10  
11 **I. Capitalized Payroll**

12 **Q. PLEASE EXPLAIN YOUR CAPITALIZED PAYROLL RATE BASE**  
13 **ADJUSTMENT THAT YOU SHOW ON YOUR EXHIBIT\_\_(DEP-1),**  
14 **SCHEDULE 2, PAGE 2B.**

15 **A.** In the next section of my testimony I describe my adjustment to normalize Delmarva's  
16 test year payroll expense by shifting a portion of that expense to capital accounts. Had  
17 Delmarva's test year labor expense been more normal, the Company would have  
18 capitalized a greater percentage of total labor dollars. The additional capitalized labor  
19 costs would have increased the Company's rate base. The \$228,667 adjustment  
20 recognizes the impact of the additional capitalized labor costs on Delmarva's test year  
21 average rate base.

22  
23 **J. Rate Base Summary**

24 **Q. PLEASE SUMMARIZE YOUR RECOMMENDED RATE BASE.**

25 **A.** Delmarva's updated test period revenue requirement analysis includes a \$274,670,334  
26 rate base. My rate base adjustments, which are summarized on Exhibit\_\_(DEP-1),  
27 Schedule 2, page 2, reduce Delmarva's claimed rate base by \$44,916,099. Therefore, I

1 recommend that the Commission set Delmarva’s rate base at \$229,754,235, as detailed  
2 on my Exhibit\_\_\_(DEP-1), Schedule 2, page 1.

3  
4 **IV. EARNINGS UNDER CURRENT RATES**

5  
6 **Q. WHERE IN EXHIBIT\_\_\_(DEP-1) DO YOU SHOW THE COMMISSION**  
7 **STAFF’S ADJUSTMENTS TO DELMARVA’S CALCULATION OF *PRO***  
8 ***FORMA* INCOME UNDER PRESENT RATES?**

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

14  
15 **A. Reliability Plant Closings**

16 **Q. PLEASE EXPLAIN THE ADJUSTMENT THAT YOU MADE FOR**  
17 **RELIABILITY PLANT CLOSINGS ON YOUR SCHEDULE 3, PAGE 2A,**  
18 **COLUMNS B.**

19 A. Earlier in my testimony I explained my opposition to Mr. Ziminsky’s inclusion of post-  
20 test year plant closings in rate base. In that section of my testimony I described my  
21 adjustments to reverse Mr. Ziminsky’s proposed rate base additions. In Schedule 3 of my  
22 revenue requirement exhibit I reverse Mr. Ziminsky’s proposed operating income  
23 adjustments associated with projected post-test period plant closings.

24  
25 **B. Average v. Year-end Rate Base**

26 **Q. WHAT ADJUSTMENTS TO MR. ZIMINSKY’S INCOME STATEMENT ARE**  
27 **YOU RECOMMENDING TO CONVERT FROM YEAR-END RATE BASE TO A**  
28 **TEST PERIOD AVERAGE RATE BASE TREATMENT?**

1 A. In addition to adjusting the average test period rate base to reflect a year-end treatment,  
2 Mr. Ziminsky annualized revenues associated with the number of customers at test period  
3 year-end and he annualized the book depreciation expense on plant at test year-end.  
4 Because I am recommending that the Commission measure Delmarva's revenue  
5 requirement using the test period average rate base rather than year-end, it was necessary  
6 for me to reverse Mr. Ziminsky's year-end revenue and depreciation adjustments. The  
7 adjustments detailed on my Schedule 3, page 3, accomplish this reversal.

8

9 **C. Payroll and Payroll Taxes**

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

12 A. Mr. Ziminsky's adjustments increase test year payroll expenses to reflect union contract  
13 wage increases and non-union salary increases that became effective during the test year,  
14 that will become effective during 2013, and that are forecasted to become effective in  
15 2014. Together, Mr. Ziminsky's proposed payroll increase adjustments increase test year  
16 labor expense by \$607,550.

17

18 **Q. ARE ALL OF THE LABOR EXPENSE ADJUSTMENTS THAT MR. ZIMINSKY**  
19 **PROPOSED APPROPRIATE?**

20 A. No. The 2 percent increase forecasted to become effective in June 2013 for Local 1307  
21 union employees and the 2 percent increase forecasted to become effective in February  
22 2014 for Local 1238 union employees are not known changes in Delmarva's costs at this  
23 time because there is no signed collective bargaining agreement providing for such  
24 increases. Similarly, the 3 percent increase effective in March 2014 for non-union  
25 employees included in Mr. Ziminsky's *pro forma* labor cost is not a known change.  
26 Presently, there is no commitment for Delmarva to increase non-union salaries by 3  
27 percent in 2014; thus, Mr. Ziminsky's adjustment to include this forecasted increase is  
28 speculative. Therefore, on Schedule 3, page 4, of my revenue requirement exhibit I made

1 an adjustment to reduce Mr. Ziminsky’s payroll expense claim by \$300,475 to reflect  
2 elimination of speculative wage and salary increases in 2013 and 2014. My adjustment on  
3 this schedule also reduces FICA taxes by \$16,390 corresponding to my *pro forma* payroll  
4 adjustment.

5  
6 **D. Capitalized Payroll**

7 **Q. DO ALL OF DELMARVA’S LABOR COSTS GET CHARGED TO CURRENT**  
8 **OPERATING COSTS?**

9 A. No, they do not. Each year, Delmarva charges approximately 30 percent of its total labor  
10 costs to capital (construction) accounts and to non-utility operations. The following table  
11 shows the percentage of total labor costs, excluding service company labor, that were  
12 charged to Delmarva’s current operations each year during the five-year period 2008  
13 through 2012.

14  
15 **Percentage of Labor Costs Charged To Current Operations**

16	2008	69.75%
17	2009	65.03%
18	2010	67.38%
19	2011	66.85%
20	2012	70.68%
21		
22	Five-Year Avg.	67.94%
23		

24 **Q. IS THERE ANYTHING UNUSUAL OR ABNORMAL ABOUT THE AMOUNT**  
25 **OF LABOR COSTS THAT WERE CHARGED TO CURRENT OPERATIONS**  
26 **DURING THE 2011 TEST YEAR.**

27 A. Yes. The table above clearly shows that Delmarva’s labor expense to total labor cost  
28 ratio (70.68 percent) was abnormally high during the 2012 test year. That is, a greater  
29 percentage of labor costs was charged to current operations during the test year than has  
30 been charged to current operations in any other year over the last five years. In fact, the  
31 expense ratio has been as low as 65.03 percent as recently as 2009. Because the 2012

1 expense ratio is significantly higher than average, I recommend that the test year labor  
2 expense amount be adjusted to reflect a more normal expense ratio. The adjustment that I  
3 detail in my Schedule 3, page 5, normalizes the test year labor expense ratio to reflect the  
4 five-year average (67.94 percent). Delmarva's actual labor expense ratio was 2.74  
5 percent higher than the five-year average. Therefore, I recommend that test year labor  
6 expenses be reduced by 2.74 percent or \$433,679, as shown on my Schedule 3, page 5.  
7 Similarly, payroll taxes would have been reduced by \$23,655 had a more normal  
8 capitalization ratio been used during the test year. If a more normal level of labor costs  
9 been capitalized rather than expensed, the additional capitalized labor costs and payroll  
10 taxes would have been reflected in test year plant additions. Thus, I am also  
11 recommending a corresponding adjustment to include additional capitalized labor costs  
12 and payroll taxes in rate base. My capitalized labor adjustment increases rate base by  
13 \$228,667 (i.e., one-half of the expense and payroll tax adjustments to reflect an average  
14 rate base treatment).

15  
16 **E. Incentive Compensation**

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

20 **A.** Yes, it does. Mr. Ziminsky adjusted test year expenses to eliminate amounts paid during  
21 the test period under the Executive Incentive Compensation program. However, there  
22 still remains in Mr. Ziminsky's proposed revenue requirement \$808,072 for incentive  
23 payments made during the test period under the 2012 Annual Incentive Plan applicable to  
24 Delmarva's and PHI Service Company's non-executive managers.

25  
26 **Q. IS IT APPROPRIATE FOR THE COMPANY TO HAVE INCENTIVE**  
27 **COMPENSATION PLANS?**

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

11  
12 **Q. IS IT REASONABLE TO CONCLUDE THAT THE PURPOSE OF PHI'S**  
13 **ANNUAL INCENTIVE PLAN IS TO PROMOTE EMPLOYEE SAFETY AND**  
14 **RATEPAYER INTERESTS RATHER THAN SHAREHOLDER INTERESTS?**

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

19  
20 Under the Annual Incentive Plan in effect during 2012, total performance payouts were  
21 first determined by how well the Company and/or PHI met pre-established financial  
22 earnings goals. That is, the plan placed a threshold hurdle on the Company's ability to  
23 make performance-related payouts regardless of whether other financial, safety or  
24 operational individual or team goals were met. For utility employees, utility earnings had  
25 to have reached a 90 percent threshold to qualify for any potential payout. Corporate  
26 Service employees were eligible to receive incentive payments only if utility earnings or  
27 non-regulated earnings met or exceeded threshold levels. These thresholds had to be met  
28 before any performance payouts are made. If the financial threshold goals were met,

1 employees were then eligible to earn additional performance payments for meeting or  
2 exceeding other pre-established individual or group safety and operational goals. But,  
3 even if all other individual or team goals had been met or exceeded, no incentive  
4 payments would have been made unless the minimum financial threshold targets were  
5 also met.

6  
7 **Q. ON WHAT BASIS DO YOU CONCLUDE THAT THE COMPANY’S 2012**  
8 **ANNUAL INCENTIVE PLAN WAS PRIMARILY DESIGNED TO PROMOTE**  
9 **STOCKHOLDER INTERESTS RATHER THAN RATEPAYER INTERESTS?**

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



1 adjustment to exclude these payments is shown on Schedule 3, page 2a, Column F in my  
2 revenue requirement exhibit.

3  
4 **F. Healthcare Costs**

5 **Q. WHAT INCREASES IN EMPLOYEE BENEFIT COSTS ARE REFLECTED IN**  
6 **THE COMPANY’S UPDATED REVENUE REQUIREMENT ANALYSIS?**

7 A. Mr. Ziminsky proposed an adjustment that increases the test year medical benefits  
8 expense by 8.0 percent and increases the dental and vision care benefits expense by 5.0  
9 percent. Mr. Ziminsky explained in his testimony that the increases are based on the  
10 Company’s projections of future cost trends from a survey prepared by its benefit  
11 consultant, Lake Consulting, Inc. Together, these adjustments, if approved, increase test  
12 year expenses by \$310,059.

13  
14 **Q. ARE YOU IN AGREEMENT WITH MR. ZIMINSKY’S PROPOSED EMPLOYEE**  
15 **BENEFITS ADJUSTMENTS?**

16 A. No, I am not. Mr. Ziminsky’s adjustments are not based on signed contracts that specify  
17 the post-test period costs of employee benefits. Rather, his adjustments are based on  
18 forecasts of future costs, not known changes in costs. Therefore, his employee expense  
19 adjustments are not known and measurable and should not be recognized for rate setting  
20 purposes. My adjustment to reverse the Company’s claimed employee benefit cost  
21 adjustment is shown on Schedule 3, page 2a, Column G of my revenue requirement  
22 exhibit.

23  
24 **G. Regulatory Commission Expense**

25 **Q. WHAT ALLOWANCE FOR REGULATORY COMMISSION EXPENSE IS**  
26 **INCLUDED IN DELMARVA’S UPDATED REVENUE REQUIREMENT**  
27 **ANALYSIS?**

1 A. Mr. Ziminsky proposed a set of adjustments that result in a \$267,514 annual allowance  
2 for regulatory commission expense. The allowance for non-rate case regulatory  
3 commission expense is \$56,647 and was calculated using a three-year average of actual  
4 expenses. Delmarva’s proposed expense allowance also includes the Company’s  
5 estimate of its costs for this rate proceeding (\$632,600) amortized over three years, or  
6 \$210,867 per year.

7  
8 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO DELMARVA’S**  
9 **PROPOSED REGULATORY COMMISSION EXPENSE ALLOWANCE?**

10 A. Yes, I am. Mr. Ziminsky’s \$632,600 estimate of the costs associated with this rate  
11 proceeding does not represent a known cost at this time. Moreover, Mr. Ziminsky’s cost  
12 estimate is considerably higher than costs incurred by Delmarva in any of its recent rate  
13 proceedings. The following table lists Delmarva actual rate case expenses incurred in the  
14 three immediately preceding rate proceedings.

15  
16 **Delmarva Rate Case Expense**

17 Docket No. 11-528 (electric)	\$280,472
18 Docket No. 10-237 (gas)	\$139,828
19 Docket No. 09-414 (electric)	\$157,325
20	
21 Average	\$192,542
22	

23 Obviously, Delmarva’s rate case expenses in these three prior rate proceedings were  
24 significantly influenced by settlements. It is not possible for me to speculate that this  
25 case will be resolved by a settlement; but the possibility of a settlement also cannot be  
26 ruled out. Therefore, I have adjusted Mr. Ziminsky’s forecasted rate case expense to  
27 reflect Delmarva’s average rate case expense incurred over the last three rate  
28 proceedings. This adjustment reduces Mr. Ziminsky’s requested annual rate case  
29 expense allowance by \$71,686, as detailed on Exhibit\_\_\_(DEP-1), Schedule 3, page 6.

30

1           **G.     AMI Additions**

2           **Q.     PLEASE EXPLAIN THE AMI-RELATED ADJUSTMENT THAT YOU SHOW**  
3           **ON EXHIBIT \_\_\_(DEP-1), SCHEDULE 3, PAGE 2b, COLUMN B.**

4           A.     I explained my objection to including Delmarva’s 2013 forecast of AMI plant additions  
5           in rate base in the previous section of my testimony. The adjustment that I show in this  
6           column removes the 2013 depreciation expense that Mr. Ziminsky had included as an  
7           adjustment to test period operating expenses. This adjustment is necessary to be  
8           consistent with my position on the rate base treatment for forecasted AMI-related  
9           investment.

10  
11           **H.     Credit Facility**

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

14           A.     Mr. Ziminisky explained in his testimony that on August 2, 2012, PHI renewed its credit  
15           facility, from which it receives short-term financing, for a five-year term. Thus, Mr.  
16           Ziminisky proposed an adjustment to amortize Delmarva’s allocated share of the start-up  
17           costs and the annual cost of maintaining the credit facility in rates.

18  
19           **Q.     DO YOU AGREE WITH MR. ZIMINSKY’S PROPOSED ADJUSTMENTS**  
20           **RELATING TO THE PHI CREDIT FACILITY?**

21           A.     No, I do not. Mr. Ziminisky states that the credit facility costs are recorded on  
22           Delmarva’s books as an interest expense. It is important to recognize that the credit  
23           facility costs are a cost associated with securing short-term debt financing. Short-term  
24           debt, however, is not included in the Company’s capital structure. Rather, under the  
25           Uniform System of Accounts, Delmarva first assigns short-term debt to construction  
26           work in progress. This assignment is recognized in the AFUDC rate, which Delmarva  
27           capitalizes to its construction accounts. Therefore, rather than including the PHI credit  
28           facility costs in current rates as Mr. Ziminisky proposes, the proper treatment of these

1 costs is to recognize them as an increase in the effective cost of short-term debt in the  
2 calculation of Delmarva's AFUDC rate. In that way, Delmarva will be appropriately  
3 compensated for its credit facility costs in the Company's AFUDC rate, which is the  
4 manner intended under the Uniform System of Accounts. I recommend that both the test  
5 year level of credit facilities costs as well as Mr. Ziminsky's PHI credit facility cost  
6 adjustments be reversed. My adjustments that accomplish this reversal are shown on my  
7 Schedule 3, page 2b, Column C.

8  
9 **J. Interest Synchronization**

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

12 A. This schedule shows the required adjustment to state and federal income taxes to  
13 synchronize the interest expense tax deduction with the debt portion of the overall return  
14 requirement that Mr. Parcell is recommending. The pro forma tax deduction for interest  
15 expense is the product of the weighted cost of debt and my rate base determination and  
16 results in a \$454,690 increase in income taxes currently payable.

17  
18 **K. AFUDC**

19 **Q. WHAT IS THE BASIS FOR THE AFUDC ADJUSTMENT THAT YOU SHOW**  
20 **ON EXHIBIT \_\_\_(DEP-1), SCHEDULE 3, PAGE 2B?**

21 A. I explained earlier in my testimony that Delmarva's claimed revenue requirement  
22 analysis includes CWIP in rate base. It also includes the test year AFUDC balance as a  
23 credit to operating income. Thus, in Mr. Ziminsky's revenue requirement analysis,  
24 AFUDC is a partial, albeit a non-compensatory, offset to the revenue requirements  
25 associated with including CWIP in rate base. Since it is my recommendation that CWIP  
26 be excluded from rate base, it is also appropriate to remove the AFUDC income credit.  
27 My adjustment to remove the test year AFUDC amount decreases test year operating  
28 income by \$294,086.

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**L. Summary of Revenue Requirement**

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

A. As shown on my Schedule 3, page 1, Delmarva calculated *pro forma* earnings under present rates of \$12,968,002 for the adjusted test period ended December 31, 2012. Together, the Commission Staff’s recommended income adjustments add \$1,339,068 to Delmarva’s claimed *pro forma* earnings. Thus, I calculate that Delmarva’s present revenues generate \$14,307,070 of earnings under *pro forma* conditions for the test period and a 6.23 percent return on the test year average rate base.

Commission Staff witness Mr. Parcell determined that Delmarva requires a 9.45 percent return on common equity capital and a 7.15 percent overall return on rate base. Rate levels will have to be increased by \$3,583,681 to produce a 7.15 percent overall rate of return for Delmarva. Therefore, I recommend that Delmarva’s proposed rate schedules be rejected and that the Company be ordered to file new rate schedules reflecting the lower revenue requirement that the Commission Staff has determined is necessary at this time.

**Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?**

A. Yes, it does.