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

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1. Q: Please state your name and position, and business address.

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: Please state your educational background and professional qualifications.

A: I received a Bachelor of Science Degree in Business Administration with a concentration in Accounting from Drexel University in 1988 and a Masters in Business Administration with a concentration in Finance from the University of Delaware in 1996. I earned my Certified Public Accountant certification in the State of Pennsylvania in 1988.

In 1988, I joined Price Waterhouse as a Tax Associate. In 1991, I joined Delmarva as a Staff Accountant in the General Accounting section of the Controller's Department. In 1994, I joined the Management Information Process Redesign team as a Senior Accountant. In 1995, I joined the Conectiv Enterprises Business & Financial Management team as a Senior Financial Analyst. In 1996, I was promoted to Finance & Accounting Manager of Conectiv Communications, where I was later promoted to Finance & Accounting Director (in 1999) and Vice President – Finance (in 2000). In 2002, I joined the PHI Treasury Department as

Finance Manager. In 2006, I joined the PHI Regulatory Department and was promoted to my current position in October 2008, where my responsibilities include the coordination of revenue requirement determinations in New Jersey, Delaware and Maryland as well as coordinating various other regulatory compliance matters.

3. Q: <u>Have you previously presented testimony before a regulatory body</u>?

A: Yes, I have previously presented testimony as a witness before the Delaware Public Service Commission (the Commission) in Docket No. 09-414 / 09-276T.

4. Q: <u>What is the purpose of your testimony?</u>

A: The purpose of my testimony is to present and explain the basis for the development of certain adjustments used to develop the Company's Delaware Gas Revenue Requirement request as supported by Company Witness VonSteuben. Those adjustments are both described in my testimony and have supporting details that can be found in the workpapers, which accompany this filing. I provide additional detail to the alternative ratemaking proposals presented by Company Witness Wathen in this proceeding.

<u>Proforma Adjustments</u>

5. Q: <u>Please list the pro forma adjustments that you are sponsoring in this proceeding.</u>

A: The pro forma adjustments that I am sponsoring are included in Company Witness VonSteuben's overall revenue requirement request included in his direct testimony in this filing. The adjustments which I sponsor are as follows:

1) Adjustment No. 7 – Uncollectible Expense Normalization;

2) Adjustment No. 8 - Normalize Injuries and Damages Expense;

3) Adjustment No. 9 – Reverse Claims Adjustment Related to Prior Period;

4) Adjustment No. 11 – Pension Expense;

5) Adjustment No. 12 – Other Post Employment Benefit Expense (OPEB);

6) Adjustment No. 18– Advanced Metering Infrastructure (AMI): Net Operation & Maintenance Expense (O&M) Change;

7) Adjustment No. 19 – AMI: Net Plant Additions;

8) Adjustment No. 20 – AMI: Stranded Costs;

9) Adjustment No. 21 – AMI: Deferred Costs;

10) Adjustment No. 23 –Amortization of Actual Refinancing Transactions;

11) Adjustment No. 24 - Remove Post 1980 vintage Investment Tax Credit (ITC) Amortization;

12) Adjustment No. 26 – Recover Credit Facilities Expense; and

13) Adjustment No. 27 – Pension Regulatory Asset Amortization.

6. Q: <u>Why are you making these adjustments?</u>

A: These adjustments are being made to the test period to establish the rate effective period as a basis for providing just and reasonable rates. Many of these adjustments reflect the approved ratemaking treatment by the Commission. Other adjustments have been made to assure that the rate effective period reflects a matching of all elements of the ratemaking formula for known and measurable changes. Workpapers supporting each of these adjustments are included in Book 4 of this filing.

7. Q: <u>Please describe the adjustment made to normalize the Company's Uncollectible Expense, Adjustment No. 7.</u>

A: Consistent with the treatment included in Docket Nos. 03-127 and 05-304, I have normalized the Company's test period level of uncollectible expense using a three year average of this expense. This adjustment is detailed on Schedule JCZ-1 and results in a $251,000 increase to test period operating income.

8. Q: <u>Please describe the adjustment made to normalize Injuries and Damages Expense, Adjustment No. 8.</u>

A: Consistent with the treatment adopted in Docket Nos. 03-127 and 05-304, I am including an adjustment to normalize Injuries and Damages Expense using a three year period average of this expense. This adjustment will result in a $45,000 decrease to test period operating income and is detailed on Schedule JCZ-2.

9. Q: <u>Please describe the Reversal of Prior Period Claims, Adjustment No. 9.</u>

A: The Company is removing an out-of-period adjustment included in its test period related to its General Reserve expense. In December 2006, the Company recorded an expense accrual of $1.3 million related to an estimate for a claims liability incident incurred but not reported. In December 2009, the liability was reversed and the expense was credited. Therefore, this adjustment as shown on Schedule JCZ-3 removes the $123,000 Gas-related amount from the Company's general reserve expense and thus represents a decrease to test period operating income.

10. Q: <u>Please describe the adjustment made for Pension Expense, Adjustment No. 11.</u>

A: Consistent with the Company's filing in Docket Nos. 03-127 and 05-304, I have adjusted the recorded test period level of pension expense to the estimated amount for year 2010 provided by the Company's independent actuary. This method follows the treatment included in the Company's filing in its last base rate filing and that was approved by the Commission in Docket No. 05-304. The Company will update the Actuary's estimate amount to the actual amount during the course of this proceeding. This adjustment is detailed on Schedule JCZ-4 and results in a $170,000 increase to test period operating income.

11. Q: <u>Please describe the adjustment made for Other Post-Employment Benefit (OPEB) Expense, Adjustment No. 12.</u>

A: Consistent with the Company's filing in Docket Nos. 03-127 and 05-304, I have adjusted the recorded test period level of OPEB expense to the level provided by the Company's independent actuary. This method follows the treatment included in the Company's filing in its last base rate filing and was included by Staff and DPA in their filings. This adjustment is detailed on Schedule JCZ-5 and results in a $367,000 increase to test year operating income.

12. Q: <u>Please describe the various adjustments made to incorporate AMI-related items for Adjustments No. 18 – No. 21.</u>

A: Per Order No. 7420 in PSC Docket No. 07-28, "In the Matter of the Filing of Delmarva Power & Light Company for a Blueprint for the Future Plan for Demand Side Management, Advanced Metering and Energy Efficiency":

> *The Commission approves the diffusion of 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.*

I will address the proposed rate-making related to AMI items. Company Witnesses Potts and Phillips describe the business purposes of these items in their direct testimonies and quantify the amounts associated with the Company's gas business. To reflect the costs and savings related to the deployment of AMI in terms of the Company's Gas operations during the rate effective period, the following adjustments are proposed:

1. Net Operating & Maintenance (O&M) Expense (Adjustment No. 18): adjustment to reflect both the a reduction of O&M expense associated with savings created by the deployment of AMI as well as the O&M incremental expense which arises associated with the deployment.

2. Net Plant Items (Adjustment No. 19): adjustment to reflect the inclusion of AMI-related plant in service, the removal of test period CWIP and associated Allowance for Funds Used During Construction (AFUDC) as well as depreciation and amortization expense for items such as Interface Management Units (IMU), Communication Equipment as well as Hardware and Software.

3. Stranded Costs (Adjustment No. 20): adjustment to reflect the recovery of a 15-year period of the retirement of remote gas indexes which are being replaced with the installation of the IMUs.

4. Deferred Costs (Adjustment No. 21): adjustment to the amortization of deferred costs and savings related to the infrastructure required to deploy AMI.

13. Q: <u>Please describe the proposed rate-making treatment related to net O&M expense change related to AMI, Adjustment No. 18.</u>

A: This adjustment reflects the rate effective period O&M savings and incremental expense related to AMI deployment. The savings relate to the decrease in manual meter reading costs and off-cycle meter reading costs. The incremental expense relates to hardware and software maintenance fees as well as other AMI-related expenses which are not currently in the test period. This adjustment is detailed on Schedule JCZ-6 and reflects a $574,000 increase to test period operating income.

14. Q: <u>Please describe the proposed rate-making treatment related to plant items related to AMI, Adjustment No. 19.</u>

A: This adjustment reflects the rate effective period net plant additions related to AMI deployment. The net plant includes IMUs, communication equipment as well as hardware and software. This adjustment is detailed on Schedule JCZ-7 and reflects a $687,000 decrease to test period operating income as well as a $12.030 million increase to test period rate base.

15. Q: <u>Please describe the proposed rate-making treatment related to stranded costs related to AMI, Adjustment No. 20.</u>

A: This adjustment reflects the 15-year amortization of the stranded costs of $3.4 million related to remote gas indexes which will be retired as part of the

AMI deployment. This amount reflects the net book value of these assets at the end of the test period. The 15-year period was selected as it is the current uncontested position by all parties in the Company's Delaware Electric Distribution case, Docket No. 09-414, related to the recovery of AMI deferred costs. This adjustment is reflected on Schedule JCZ-8 as a $4,000 decrease to test period operating income as well as a $131,000 decrease to test period rate base.

16. Q: <u>Please describe the proposed rate-making treatment related to deferred costs related to AMI, Adjustment No. 21.</u>

A: Based on the Commission's directive to diffuse AMI into the Company's Delaware distribution infrastructure, expressed in Order No. 7420 issued on September 16, 2008 in Docket No. 07-28, the Company will have incurred an estimated $989,000 through June 2010 of costs, on a Delaware Gas basis, related to developing the infrastructure to support the AMI initiative. The Company's adjustment in this case reflects the amortization these actual AMI and related deferred costs over a 15-year period with the unamortized amount included in rate base. The selection of a 15-year period is consistent with the same issue's uncontested position of Staff, Division of Public Advocate (DPA) and Delmarva in the Company's current Delaware Electric Distribution Case, Docket No. 09-414. In his direct testimony, Company Witness Potts provides support for the deferred expenditures. This adjustment is detailed on Schedule JCZ-9 and results in a $65,000 decrease to test period operating income as well as a $938,000 increase to test period rate base.

The Company will continue to place into a deferred account the incremental labor costs, lease expense, depreciation, and amortization costs associated with the on-going AMI-related activity as allowed by this Commission in Order No. 7420 until final rates in this proceeding become effective. Any known and measurable utility cost savings resulting from AMI deployment will also be reflected in the deferred account using that same period. The net balance in the deferred account accrues a return based on the Company's most recently authorized rate of return. The deferred amount is subject to review in the context of this base rate proceeding, and upon Commission approval, is being proposed to be recovered by the Company over a 15-year period.

17. Q: Please describe the Amortization of Actual Refinancing transactions, Adjustment No. 23.

A: I have included in this filing the earnings and rate base treatment of refinancings that was allocated to the Gas business. This ratemaking treatment is consistent with the approved treatment that has been included in prior Commission decisions, beginning in Docket No. 86-24. Lower cost rates in the Company's capital structure resulting from the Company's refinancings provide a benefit to customers. This adjustment is detailed on Schedule JCZ-10 and reflects a $122,000 decrease to test period operating income and a $1.487 million increase to test period rate base.

18. Q: <u>Please describe the proposed rate-making treatment related to the removal of Post 1980 Vintage ITC Amortization, Adjustment No. 24.</u>

A: Consistent with the ratemaking approved on Docket Nos. 84-23, 91-24 and 94-22, I have removed post-1980 vintage Investment Tax Credit (ITC) amortizations. This adjustment reflects the requirements of the Economic Recovery Tax Act of 1981 (ERTA) on post-1980 vintage projects for rate case purposes. The Company has been amortizing ITC on a property service life basis. Under ERTA, Delmarva is an Option One Company for ratemaking purposes for post-1980 vintages. The related ratemaking treatment is to deduct the post-1980 accumulated unamortized balance from rate base, and at the same time, not include the related post-1980 vintage amortizations as a reduction of operating expenses. This adjustment is detailed on Schedule JCZ-11 as a $50,000 decrease to test period operating income.

19. Q: <u>Please describe the adjustment made to recover Credit Facilities Expense, Adjustment No. 26.</u>

A: This adjustment provides for recognition in the cost of service for the test period cost of the Company's share of the PHI credit facility. This $1.5 billion credit facility is vital to the day-to-day working capital needs of the Company. An adjustment is necessary due to the accounting for this cost in the Company's financial statements as interest expense, which is not incorporated in the embedded cost of debt and therefore, without this adjustment, would not be included in rates at all.

This credit facility, which terminates in 2012, allows the Company to borrow in the commercial paper market. Moreover, this market has been the Company's primary source of short-term liquidity for years, assuring investors that the Company has a committed line of credit with banks in the event of a liquidity problem. In tight credit periods, such as today, where the commercial paper market cannot be relied upon due to liquidity concerns, the credit facility provides the Company a backstop borrowing mechanism to handle day-to-day cash requirements. It also allows the Company to issue Letters of Credit, if needed.

20. Q: <u>How are the costs of the credit facility assigned to Delmarva?</u>

A: Each of the three distribution utilities, Delmarva, Pepco and Atlantic City Electric, share one-third of the utility-related ($625 million) portion of the credit facilities. PHI is assigned the remaining $875 million. The assignment of the facility to the utilities is based on historical maximum needs of the utilities. Costs of the credit facility are assigned to Delmarva based on its share of the utility portion of the facility.

21 Q: <u>What costs are included in your adjustment?</u>

A: As shown on Schedule JCZ-12, costs include both amortization of the start-up costs of the credit facility as well as annual fees paid to maintain the facility. This adjustment results in a $28,000 decrease to test period operating income as well as a $58,000 increase to test period rate base.

22. Q: <u>Please describe the adjustment made to Pension Regulatory Asset Amortization, Adjustment No. 27.</u>

A: The purpose of this adjustment is to address the appropriate ratemaking related to Delmarva's 2009 pension expense relative to the level currently in effect in Gas base rates as set as an uncontested position by Staff, DPA and the Company in the settlement for Docket No. 06-284 in April, 2006. This matter was first raised 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". In Order No. 7727 dated January 7, 2010, this regulatory asset consideration pertaining to Delaware gas customers will be decided as part of the Company's next gas base rate case, which this filing represents.

In terms of this filing, the significance of the impact of this increase in pension expense on the Company is addressed in the pre-filed direct testimony of Company Witness Wathen. My direct testimony addresses the proposed process by which a regulatory asset would be set up on a prospective basis for the difference between the amounts recovered through the volatility mitigation surcharge (Rider VM) and the 2009 level of pension expense; however, the proposed process does not address the regulatory treatment of the aforementioned difference between the actual 2009 pension expense and the comparable pension expense amount recovered through the currently effective rates. This adjustment provides support for the ratemaking associated with this 2009 pension expense change from the expense level currently included in Gas base rates.

23. Q: <u>Have you quantified the regulatory asset needed to capture the difference between the level of pension expense incurred by the Company in 2009 and the pension expense recovery included in the currently effective rates?</u>

A: Yes. The starting point for determining 2009 pension expense is the report provided by the Company's actuary, Watson Wyatt Worldwide. This report is attached as Schedule JCZ-13 and provides a summary of the pension cost for 2009 as determined by the actuary. Line 6 of Appendix C of Schedule JCZ-13 shows the assignment of this pension cost to both Delmarva, in the amount of $13.438 million, as well as to the PHI Service Company, in the amount of $53.875 million. Schedule JCZ-14 provides a detailed comparison of actual 2009 Delaware Gas pension expense to the pension expense inherent in currently effective rates. The difference between these two amounts represents the basis for the $4.090 million regulatory asset stated on Schedule JCZ-15, Line 5 – the same Schedule also displays my recommended ratemaking treatment of this balance which is a five year amortization with the unamortized balance included in rate base. The adjustment reflects a $485,000 decrease to test period operating income and a $2.184 million increase to test period rate base.

24. Q: <u>How was the level of pension expense reflected in current Delaware Gas rates determined?</u>

A: The $(177,000) of pension income shown on Schedule JCZ-14, Line 12 is based on the amounts reflected in the Company's filing in Docket No. 06-284. In that filing, the Company's Ratemaking Adjustment No. 11, which reflects the 2006 actuarially-determined amount, was uncontested by Staff and DPA.

25. Q: <u>Please discuss how the Company proposes to recover the 2009 pension-related regulatory asset.</u>

A: The Company proposes that the $4.090 million be amortized over a five-year period as shown in Schedule JCZ-15, Line 8.

26. Q: <u>Why is the Company requesting special treatment for pension expense as opposed to its treatment as set forth in Docket No. 06-284?</u>

A: As Company Witness Wathen states in his pre-filed direct testimony, the Delaware Gas pension expense dramatically increased in 2009. The increase was a direct result of the adverse overall economic conditions, which were not of the Company's making and were clearly out of the Company's control.

These pension costs can be viewed in a similar way as to how storm damages are treated for regulatory purposes. Storm damages can dramatically increase or decrease from year to year and they are not in the Company's control as to their annual level of expense. My proposed ratemaking similarly provides for recognition of this increase in expense that has had a significant impact on Delmarva's financial statement and was not in the Company's control.

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, 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. the impacts of these discount rate and investment return relationships can be seen in terms of PHI's pension. 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 $10 million.

27. Q: Please discuss the differences between pension expense and pension funding.

A: A large role is 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.

Pension expense is determined by actuaries based on plan provisions and demographics, interest and discounting assumptions and the performance of the plan assets, and is reported in accordance with Generally Accepted Accounting Principles.

Pension funding is governed by ERISA (Employee Retirement Income Security Act) and the Pension Protection Act of 2006 with complicated formulas and tests that the Company's actuary interprets and calculates on behalf of the Company. To provide sufficient funds to meet future payment obligations of its Pension Plan, the Company invests the funds within the Pension Plan in various investment vehicles atypical of a standard pension plan (mostly equities and fixed income instruments). Generally, the Company's policy is to ensure that the pension plan is funded, at least, to the level of the benefits that the Company's employees have accrued for service to date (the Accrued Benefit Obligation); however, the actual amount and timing of the funding contribution is primarily determined by the funding rules and regulations. In fact, because of the economic impact on the Company's pension fund, Delmarva funded $10 million into the plan in 2009.

28. Q: <u>How have the Company's Gas customers been impacted by the Company's pension plan expense in recent years?</u>

A: Since the last base rate case (Docket No. 06-284), the actual pension expense included in customer rates has been a credit, or pension income, of $(177,000) as shown in Schedule JCZ-14, Line 12. This credit resulted in customers enjoying the benefit of the over-funded pension plan. Thus, customers have benefited from the strong performance of the pension plan assets in the form of this pension income, which resulted in lower gas base rates for customers.

<u>Rider VM</u>

29. Q: <u>Please discuss the innovative price mitigation alternative in Company Witness Wathen's testimony related to pension, OPEB and uncollectible expense.</u>

A: Schedule JCZ-17 presents the effect on the Company's revenue requirement of the potential rate increase mitigation strategy discussed by Company Witness Wathen in his direct testimony. As noted by Company Witness Wathen, costs incurred for pension, OPEB, and uncollectible expenses can be extremely volatile for reasons that are largely beyond the control of the Company.

To mitigate the effect of potentially large year-to-year changes, the Company is proposing to collect the rolling three-year average of these three expenses in the form of a rider. Company Witness Janocha has included in his testimony and the tariffs a Volatility Mitigation Rider (Rider VM) that will be reset annually, with any difference between the annual rider amount and the actual expense for each year to be deferred as a regulatory asset/liability with that asset/liability balance providing a return component at the Company's authorized rate of return.

Schedule JCZ-17 shows the effect in this proceeding of collecting the three-year average pension, OPEB and uncollectible expenses through such a rider, as opposed to reflecting the 2010 expense.

30. Q: <u>Have you provided a demonstration of how the Company's proposed Rider VM mechanism will work?</u>

A: Yes. Schedule JCZ-18 presents a sample Rider VM calculation for the following year, assuming that pension, OPEB, and uncollectible expenses fall in 2011 to 80% of their 2010 forecasted levels. Calculation of the regulatory asset/liability under this scenario is also presented.

31. Q: <u>Please discuss the regulatory asset/liability created by the proposed operation of the surcharge.</u>

A: As previously noted, the cumulative differential between annual pension/OPEB/uncollectible expense and the annual surcharge level will remain in the regulatory asset to be reflected in rate base in the Company's next base rate proceeding. At that time, depending on the amount of the deferred balance, it could be amortized back through the surcharge over a Commission-specified period of time. In the interim, should the balance become either a positive or negative $10 million, a component should be added to the surcharge mechanism to amortize that $10 million balance through the surcharge over a three-year period, and a new regulatory asset/liability for the differential between the actual annual expense and the surcharge level would be created.

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

A: Yes, it does.