

**PECO ENERGY COMPANY
STATEMENT NO. 3-R**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PECO ENERGY COMPANY – ELECTRIC DIVISION

DOCKET NO. R-2010-2161575

REBUTTAL TESTIMONY

WITNESS: ROBERT L. O'BRIEN

SUBJECT: PRESENTING PECO'S
OVERALL UPDATED
REVENUE REQUIREMENT
AND RESPONDING TO
CERTAIN PROPOSED
RATEMAKING
ADJUSTMENTS

DATED: AUGUST 3, 2010

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1 **4. Q. How is your rebuttal testimony organized?**

2 A. I first present PECO's updated revenue requirement and explain each of the
3 changes. Next, I address the adjustments proposed by other parties to which I
4 am responding.

5 **5. Q. Are you sponsoring all or portions of any exhibits in conjunction with**
6 **your rebuttal testimony?**

7 A. Yes, and I will describe those exhibits during the course of my update and
8 response to the other parties.

9 **6. Q. As developed herein, what is PECO's updated future test year revenue**
10 **requirement?**

11 A. PECO's updated future test year revenue requirement, as shown on PECO
12 Exhibit RLO-5, Schedule A-1, is \$4.9 billion, which translates into a proposed
13 increase in pro forma present rate revenues of \$293.9 million. This represents
14 an approximate \$22.4 million reduction in PECO's initial rate request.

15 **7. Q. Please describe PECO Exhibit RLO-5.**

16 A. PECO Exhibit RLO-5 is an update of PECO Exhibit RLO-1 and contains all
17 of the schedules included in Exhibit RLO-1. Each of the pages that have
18 changed is identified by the designation "UPDATE 8-3-10."

1 **8. Q. Have you also included a summary of the changes in a separate exhibit?**

2 A. Yes, I have. PECO Exhibit RLO-6, Schedule A contains a listing of each of
3 the changes reflected in PECO Exhibit RLO-5 and the approximate revenue
4 requirement value of such change.

5 **II. UPDATE OF COMPANY REVENUE REQUIREMENT**

6 **A. Measure Of Value/Rate Base**

7 **9. Q. Is PECO proposing any changes to its claimed Measure of Value, or rate**
8 **base?**

9 A. Yes, the Company is reducing its projected future test year (“FTY”) plant
10 additions and making commensurate revisions to its proposed accumulated
11 depreciation and annual depreciation expense. In addition, PECO is updating
12 its claims for four components that are based on 13-month historic averages
13 and to reflect derivative changes in cash working capital (“CWC”) attributable
14 to revisions made to various revenue, expense and tax claims. The four
15 components that are based on the 13-month average balances are (1) customer
16 deposits; (2) customer advances for construction; (3) materials and supplies;
17 and (4) prepaid expenses. In its March 31, 2010 rate filing, PECO utilized
18 data for the 13-month period ending December 2009. Data through June 2010
19 is now available.

1 **10. Q. Why is PECO reducing its claim for FTY plant additions?**

2 A. As Mr. Barnett explains in his rebuttal testimony (PECO Statement No. 2-R),
3 it is now apparent that two major projects -- the Peltz and Penrose substations
4 -- will not be completed and placed in service until 2011. I have therefore
5 removed the dollars associated with those projects -- totaling \$40.034 million
6 -- from the Company's FTY plant additions claim (see Exhibit RLO-5,
7 Schedule C-2, page 6, column 4, line 27A) and made the necessary
8 adjustments to accrued depreciation (Exhibit RLO-5, Schedule C-3, page 4,
9 column 3, line 27A) and annual depreciation expense (Exhibit RLO-5,
10 Schedule D-19, page 1, column 6, line 27A).

11 **11. Q. Why is the Company proposing to update the 13-month average balances**
12 **for the four items mentioned previously?**

13 A. I provided similar updates in my rebuttal testimony at Docket No. R 2010-
14 2161592, the pending rate proceeding involving PECO's gas operations, and,
15 to be consistent, am doing so here as well.

16 **12. Q. What is the Company's proposed update to its claims for customer**
17 **deposits and related interest expense?**

18 A. As shown on PECO Exhibit RLO-5, Schedule C-7, Line 15, the updated
19 amount for customer deposits is \$54.021 million, or a reduction of \$956,000
20 from the amount included in the initial filing. Interest on customer deposits

1 pro forma for the future test year (FTY) also decreased by \$90,000 to
2 \$970,000 as shown on PECO Exhibit RLO-5, Schedule D-14, line 29.

3 **13. Q. What is the Company's proposed update to its claim for customer**
4 **advances for construction?**

5 A. As shown on PECO Exhibit RLO-5, Schedule C-9, the updated amount for
6 customer advances is \$2.586 million, a decrease of \$182,000 from the amount
7 included in the Company's original filing.

8 **14. Q. What is the Company's proposed update to its claim for materials and**
9 **supplies?**

10 A. As shown on PECO Exhibit RLO-5, Schedule C-10, the updated amount for
11 materials and supplies is \$9.585 million, which is an increase of \$472,000
12 over the amount included in the original filing.

13 **15. Q. What is the Company's proposed update to its claim for prepaid**
14 **expenses?**

15 A. As shown on Exhibit RLO-5, Schedule C-4, page 10 of 10, the updated
16 amount is \$7.825 million, or a reduction of \$11,000 from the amount included
17 in PECO's initial rate filing.

1 **16. Q. Are you proposing any additional changes to the claimed measures of**
2 **value?**

3 A. Yes. In addition to changes in CWC that flow from revisions to revenue,
4 expense and tax claims discussed herein, I am proposing to adjust the CWC
5 payment lags for PJM and spot market purchases of electricity and the
6 Corporate Loan Tax (“CLT”) to address oversights identified during the
7 discovery process or in opposing party testimony.

8 **17. Q. Please describe the effect on PECO’s claim for CWC resulting from the**
9 **change in the PJM and spot market purchased electricity lag days.**

10 A. As described in the Company’s response to OCA-III-10 related to the spot
11 market purchases which also applies to the PJM purchases, this change
12 increases the purchased electricity payment lag from 6.5 to 12.5 days (see
13 Exhibit RLO-5, Schedule C-4, page 11), which, in turn, results in a decrease
14 in revenue requirement of approximately \$592,000.

15 **18. Q. Please describe the change in the lag days for the CLT.**

16 A. As explained by OTS witness Morrissey, the CLT is paid in arrears on April
17 15, following the end of a calendar tax year, not in advance as suggested by
18 the Company’s calculations. I have corrected this error on Exhibit RLO-5,
19 Schedule C-4, at page 9 of 11.

1 **B. Revenues**

2 **19. Q. What updates is PECO making to its claimed present rate revenues?**

3 A. There are several. First, the Company is revising its estimated FTY revenues
4 based on updated sales information previously provided in response to
5 Interrogatory OTS-RS-29. Second, the Company is including a rate for
6 forfeited discounts in its gross revenue conversion factor (“GRCF”) to capture
7 forfeited discounts associated with the proposed rate increase. Third, the
8 Company is revising the rate used to calculate the amount of forfeited
9 discounts at present rates. Finally, PECO is adjusting its claim for
10 miscellaneous service revenue to reflect a three-year average level and the
11 transfer of certain miscellaneous service revenues to the Company’s gas
12 operations.

13 **20. Q. Please explain the revision the Company is making to its estimated FTY**
14 **sales levels.**

15 A. The Company is increasing its estimated sales for the FTY using the updated
16 data provided in response to Interrogatory OTS-RE-29. This revision
17 increases base customer revenue, and thereby decreases PECO’s need for rate
18 relief, by approximately \$13 million and is explained by Mr. Barnett (PECO
19 Statement No. 2-R).

1 **21. Q. Mr. Yocca criticizes PECO for not reflecting the impact of the proposed**
2 **rate increase on forfeited discount revenues. Please comment.**

3 A. Mr. Yocca is correct that increased revenues theoretically give rise to
4 increased forfeited discounts. I recommend that this relationship be
5 recognized by including a rate in the gross revenue conversion factor
6 (“GRCF”), which is used to determine the amount of revenue increase
7 required. In this instance, I have utilized a rate of 0.344 percent, which will
8 be discussed later in my testimony. The calculation, incorporating this factor,
9 is shown at Exhibit RLO-5, Schedule D-20, page 2 and reduces PECO’s
10 revenue requirement by approximately \$1.011 million.

11 **22. Q. Does Mr. Yocca also recommend adjustments to forfeited discount**
12 **revenue at present rates and to miscellaneous service revenue?**

13 A. Yes, he does. However, because \$7.267 million of revenues from reconnect
14 fees and return check charges were erroneously included in the \$18.924
15 million of forfeited discounts on Exhibit RLO-1, Schedule D5, line 24 in
16 column 2, and not with the \$5.293 million of miscellaneous service revenue
17 on line 26 in column 2, I need to reclassify those dollars before evaluating the
18 merits of Mr. Yocca’s proposals.

1 **23. Q. Have you prepared a schedule showing that reclassification?**

2 A. Yes, I have. Exhibit RLO-5, Schedule D-5I, lines 1 to 14 shows the
3 reclassification necessary to put the reconnect fees and return check charges
4 into the correct accounts.

5 **24. Q. Does this reclassification alter the magnitude of Mr. Yocca's proposed**
6 **adjustments?**

7 A. No. As shown on line 14 in column 2, the total of the adjustments proposed
8 by Mr. Yocca is \$10.388 million before the reclassification. The total
9 adjustment after the reclassification, as shown in column 4, is the same
10 \$10.388 million.

11 **25. Q. Please describe the schedule.**

12 A. Column 2 of Schedule D-5I shows the amounts for forfeited discounts
13 (\$18.924 million on line 4) and miscellaneous service revenues (\$5.293
14 million on line 7) before the reclassification. The reclassification in column 3
15 moves \$7.267 million for reconnect fees and return check charges from
16 forfeited discounts to miscellaneous service revenue.

17 **26. Q. Turning then to Mr. Yocca's recommended adjustments, do you agree**
18 **with his proposal that forfeited discount revenue be quantified by**

1 **applying an experienced three-year (2007-2009) average forfeited**
2 **discount factor of 0.446 percent?**

3 A. No, I do not. Mr. Yocca justifies his use of a three-year average by claiming
4 that “it is short enough to disregard any irrelevant older data and long enough
5 to smooth out any monthly aberrations.” However, as shown on OTS Exhibit
6 No. 3, Schedule 5, the percentages for the years 2007 to 2009 decline
7 significantly each year -- from 0.565 percent in 2007 to 0.526 percent in 2008
8 and finally to 0.344 percent in 2009. By averaging data for those three years,
9 Mr. Yocca disregards the obvious downward trend.

10 **27. Q. What do you recommend?**

11 A. I recommend using the actual data for 2009, a factor of 0.344 percent, as the
12 base for calculating forfeited discount revenue at present and proposed rates.
13 The additional forfeited discount revenue at present rates utilizing this factor
14 approximates \$4.1 million, and is shown on Exhibit RLO-5, Schedule D-5I,
15 lines 15 to 19.

16 **28. Q. Have you reviewed Mr. Yocca’s testimony regarding miscellaneous**
17 **service revenue?**

18 A. Yes, I have. Mr. Yocca recommends that the Company increase present rate
19 revenues to reflect a three-year average of miscellaneous service revenue.

1 **29. Q. Does the Company disagree with Mr. Yocca's proposal?**

2 A. No, it does not. Unlike the situation with the forfeited discount rate, here
3 these is no discernable upward or downward trend in the historical data. I
4 have therefore made an adjustment on Exhibit RLO-5, Schedule D-5I, lines 20
5 to 24 in the amount of \$372,000 to reflect the use of the three-year average for
6 miscellaneous service revenue of \$7.639 million shown on OTS Exhibit No.
7 3, Schedule 7, line 4. This adjustment, as described earlier, reflects the
8 reclassification shown on lines 1 to 14.

9 **30. Q. You previously mentioned that you had made an additional adjustment**
10 **transferring certain miscellaneous service revenue from PECO's electric**
11 **operations to its gas operations. Please explain.**

12 A. During discovery in the Company's gas rate proceeding at Docket No. R-
13 2010-2161592, it was determined that PECO had inadvertently included all
14 FTY revenue attributable to reconnection fees and return check charges in the
15 calculation of its electric distribution operations' revenue requirement. To
16 correct that oversight, I transferred (i.e., imputed) \$53,250 to the Company's
17 gas operations in updating PECO's revenue requirement in that case.
18 Accordingly, I have removed the same \$53,250 from the Company's electric
19 present rate revenues as shown on Exhibit RLO-5, Schedule D-5I, line 25.

1 **C. Operating Expenses**

2 **31. Q. Is PECO proposing any updates or changes to its operating expense**
3 **claims?**

4 A. Yes, there are several. First, the Company is reducing its injuries and
5 damages expense claim to accept the OTS' position. Second, the Company is
6 increasing its pro forma Philadelphia Water Department fees for storm water
7 management. Third, the Company is reducing its claimed pension expense by
8 \$239,000 to correct an error in its initial filing. Finally, PECO is removing
9 the Medicare Part D subsidy from the calculation of income taxes at present
10 rates.

11 **32. Q. What change is the Company making to its claim for injuries and**
12 **damages expense?**

13 A. PECO is reducing its proposed total electric injuries and damages expense
14 allowance by \$784,000 to reflect the updated loss factor provided in response
15 to Interrogatory OTS-RE-84. This revision is shown in Exhibit RLO-5 at
16 Schedule D-14, line 30 and results in a decrease in distribution operating
17 expenses of \$699,000.

18 **33. Q. Why is the Company increasing its pro forma FTY expense for the**
19 **Philadelphia Water Department ("PWD") fees?**

20 A. The Company has been notified that the PWD is increasing its annual charges
21 for storm water management. The Company is therefore increasing its FTY

1 operating expenses by \$494,437, which is the estimated increase in PWD
2 charges for 2011, the first year rates from this proceeding will be in effect.
3 The calculation of this adjustment is shown on Exhibit RLO-5, Schedule
4 D-11, column 5, line 10.

5 **34. Q. What is the adjustment the Company is proposing to its pension expense?**

6 A. The Company is reducing the estimated pension contribution amount for the
7 FTY by \$557,000, from \$71.746 million to the \$71.189 million shown on
8 Exhibit RLO-5, Schedule 9, page 1, line 8, to correct an error in its initial
9 filing. The expense portion of this adjustment is \$239,000 as shown on
10 Exhibit RLO-6, Schedule B, column 6.

11 **35. Q. Please describe the adjustment to the Medicare Part D subsidy.**

12 A. The adjustment, which is shown on Exhibit RLO-5, Schedule D-20, page 1 of
13 4, removes a tax deduction that was eliminated by the Healthcare Reform Act
14 signed into law on March 23, 2010.

15 **III. RESPONSE TO OPPOSING PARTY ADJUSTMENTS**

16 **A. Plant In Service**

17 **36. Q. Please describe the adjustments to plant-in-service proposed by OTS**
18 **witness Morrissey.**

19 A. Ms. Morrissey has proposed two adjustments to plant-in-service: (1) a
20 reduction of \$6.065 million, which represents the capitalized portion of her
21 recommended disallowance of a portion of the Company's FTY pension

1 expense; and (2) a reduction of \$2.792 million related to her proposed
2 disallowance of a portion of the Company's incentive compensation claim.

3 **37. Q. Should these adjustments be adopted?**

4 A. No, they should not.

5 **38. Q. Please address Ms. Morrissey's proposed adjustment to capitalized**
6 **pension costs.**

7 A. There are two reasons for rejecting this adjustment. First, for the reasons
8 explained by Mr. Allen (PECO Statement 11-R), Ms. Morrissey's underlying
9 pension expense adjustment is without merit and should be rejected, and,
10 therefore, no adjustment is appropriate. Second, the dollars that Ms.
11 Morrissey would disallow from plant-in-service were not included as part of
12 the Company's plant-in-service claim in the first place.

13 **39. Q. Why is Ms. Morrissey wrong in assuming that approximately 36.08**
14 **percent of PECO's \$48.228 million pension expense claim was**
15 **capitalized?**

16 A. Because my Schedule D-9, page 1 of 2, utilized a 36.08 percent / 63.92
17 percent split to determine the portion of PECO's pension cash contribution to
18 be expensed, Ms. Morrissey understandably assumed that what was not
19 expensed was necessarily included in the Company's plant-in-service claim
20 for the FTY. However, the pension costs included in the Company's capital
21 budget were based on Statement of Financial Accounting Standards No. 87

1 (“SFAS 87”) accrual values and not the estimated cash contributions upon
2 which the Company’s pension expense claim was constructed.

3 **40. Q. Have you prepared a schedule that quantifies the differences between the**
4 **cash contribution values used for expense purposes and the SFAS 87**
5 **values used for plant addition purposes?**

6 A. Yes, I have. Exhibit RLO-6, Schedule B shows a comparison by component
7 of the various elements of the total pension expense claim and the amounts
8 included as charges to construction.

9 **41. Q. Please describe that schedule.**

10 A. Line 1 shows the derivation of the Company’s as-filed pension expense claim
11 in columns 3 to 5 [(\$71.746 million – Exhibit PECO RLO-1, Schedule D-9,
12 line 8) with an adjustment agreed to by the Company in column 6 (\$557,000 –
13 OTS Ex. No. 2, Sch. 2)] and the adjusted claim in column 7 in the amount of
14 \$71.189 million. Lines 2 to 4 show the allocated components of these costs to
15 the Company’s electric operations. Lines 5 to 7 break down Ms. Morrissey’s
16 proposed pension allowance, which includes the ERISA minimum (column 3)
17 but excludes the additional \$24.45 million contribution (column 4). Line 8
18 reflects the OTS recommended adjustment to expense of \$10,505,000 which
19 is the difference between lines 7 and 4 in columns 5, 7 and 9. Ms. Morrissey,
20 in her prepared testimony on page 10, lines 18 and 19 reflects an adjustment
21 amount to expense of \$10,745,000 which as shown on lines 9 and 10 of

1 Schedule B, combines the \$10,505,000 OTS adjustment with the \$239,000
2 adjustment agreed to by PECO.

3 **42. Q. What conclusions should be drawn from Schedule B?**

4 A. There are two conclusions. First, and as indicated in column 2 at line 11 and
5 column 8, line 3, only \$5.201 million of pension costs were capitalized and
6 included in PECO “Electric” FTY plant additions claim, not \$17.401 million
7 as assumed by Ms. Morrissey. Second, in order to place its expense claim and
8 its FTY plant additions claim on a consistent basis, the Company’s plant-in-
9 service claim must be increased by \$12.064 million, i.e., the difference
10 between the capital component of its cash contribution claim (\$17,265,000)
11 (column 7, line 3) and the SFAS 87 pension costs included in its capital
12 budget (\$5,201,000) (column 8, line 3). I have made this adjustment to the
13 plant account balances, as shown on PECO Exhibit RLO-5, Schedule C-2,
14 pages 6, column 7.

15 **43. Q. Please describe the second adjustment to plant-in-service proposed by**
16 **Ms. Morrissey.**

17 A. Ms. Morrissey recommends a 50/50 sharing of incentive compensation costs
18 between customers and shareholders and would, therefore, eliminate \$2.792
19 million, or one-half of the \$5.584 million of incentive compensation costs that
20 she assumes to have been capitalized. For the reasons explained by Mr.
21 Barnett (PECO Statement No. 2-R), there is no merit to Ms. Morrissey’s
22 “sharing” proposal.

1 **44. Q. Was the total amount of \$5.584 million identified by Ms. Morrissey**
2 **actually included in the Company's plant-in-service claim as part of this**
3 **rate application?**

4 A. No, it was not. Similar to the pension adjustment discussed earlier, the
5 Company's FTY additions to plant were based on budgeted costs related to
6 the incentive program and not the pro forma level of that cost. Based on the
7 responses to the data requests included in OTS Exhibit No. 2, Schedule 17, it
8 could be understood that reference to the claimed amount capitalized signified
9 that the amount was included in the Company's claimed plant-in-service.
10 However, as with the pension claim, that is not the case. Rather, the Company
11 included only \$2.691 million in its FTY plant additions claim for capitalized
12 incentive compensation costs. Since this amount is \$101,000 less than the
13 \$2.792 million that Ms. Morrissey would allow as an addition to plant, there
14 should be no reduction to plant-in-service under any circumstances. Finally, I
15 need to point out that Ms. Morrissey has double counted the incentive
16 compensation for Local 614 in the amount of \$875,000. The response to Part
17 A of Interrogatory OTS-RE-73 reflects the total amounts for all of PECO and
18 shows a total of \$4,708,375 which includes the \$875,000 for Local 614. Part
19 B of the response provides the amount specifically for Local 614 which was
20 included in the total. Ms. Morrissey was incorrect in adding those two
21 amounts in her determination that \$5.584 million was capitalized.

1 **45. Q. Please summarize your recommendation regarding the incentive**
2 **program reduction to plant-in-service proposed by Ms. Morrissey?**

3 A. The proposed reduction to plant-in-service of \$2.792 million should be
4 rejected because it would reduce the Company's claim for plant-in-service for
5 amounts that were not reflected in the claim.

6 **B. Cash Working Capital**

7 **46. Q. Please describe the adjustments to PECO's cash working capital**
8 **("CWC") claim proposed by the other parties?**

9 A. Mr. Effron recommends different payment assumptions for the determination
10 of the CWC for gross receipts tax ("GRT"); Ms. Morrissey recommends
11 different payment assumptions for Federal income tax and also proposes that
12 the PUC Assessment be treated as an operating expense for CWC purposes
13 instead of treating it as a prepaid expense like the Company.

14 **47. Q. Do you agree with Mr. Effron's proposal that PECO's CWC allowance**
15 **be based on an assumption that its pays 90% of its current year GRT**
16 **liability on March 15?**

17 A. No, I do not. The Company, mainly due to the significant fluctuations that
18 can occur with purchased power costs and weather-based usage, has elected to
19 pay its GRT on March 15, 2010 for the calendar year ended December 31,
20 2010 based on 100 percent of the actual GRT paid in 2008. Under this
21 provision of the GRT, the safe harbor alternative, there is no penalty or

1 interest in the event that price increases and/or weather changes substantially
2 increase the Company's revenue and require a substantial additional GRT
3 payment to be made. The fact is that, since projected price and weather
4 related revenues are volatile and could subject the Company to penalties and
5 interest payments, it is prudent for the Company to elect a payment option that
6 does not impose those risks.

7 **48. Q. Should the Company be forced to bear these risks when it comes to**
8 **projecting revenues for the GRT, as suggested by Mr. Effron?**

9 A. No, not in my opinion. I believe that the use of the safe harbor procedure
10 provided by the GRT payment rules is reasonable and Mr. Effron's
11 recommendation should be rejected.

12 **49. Q. Please describe the adjustment proposed by Ms. Morrissey regarding**
13 **Federal income tax payments.**

14 A. Ms. Morrissey is apparently under the impression that the Company has the
15 option of making five installment payments in satisfaction of its Federal
16 income tax liability. This is shown on her OTS Exhibit No. 2, Schedule 19,
17 page 3 of 3 where she displays quarterly payments of 22.5 percent on April
18 15, June 15, September 15 and December 15, 2010 and a final payment of 10
19 percent on March 15, 2011.

1 **50. Q. Is that payment schedule correct?**

2 A. No, it is not. Currently, a calendar year corporation must make payments of
3 estimated taxes on April 15, June 15, September 15 and December 15 of the
4 year the tax is due. There is no longer a provision that allows corporations to
5 pay the final ten percent in the year following the tax year.

6 **51. Q. Do you agree with Ms. Morrissey's second adjustment, namely to remove**
7 **the PUC Assessment from the prepaid expense schedule and to include it**
8 **in the calculation of tax payment lag days?**

9 A. No, I do not.

10 **52. Q. Please explain.**

11 A. As she states on page 35 of her testimony, Ms. Morrissey believes that the
12 PUC Assessment should be treated "as a tax on prior year's revenues for
13 ratemaking purposes." In other words, Ms. Morrissey contends that the
14 Assessment is paid in arrears, not in advance. However, unlike the Corporate
15 Loan Tax where the liability for the tax is incurred in the prior year, e.g.,
16 2010, and paid in the subsequent year, i.e., 2011, the PUC Assessment is not a
17 liability until the year in which it is assessed. Rather, in this instance, the
18 Commission determines the amounts it requires in the current year, 2010, and
19 requires the utilities to pay that amount on April 15th of that same year. The
20 fact that the Commission uses utility revenues from the prior year to

1 determine the distribution of those assessments among the utilities does not
2 make the prior year the service period.

3 **C. Revenues**

4 **53. Q. At pages 12-16 of his testimony, OTS witness Yocca, citing the**
5 **Company's response to Interrogatory OTS-RS-28, expresses concern that**
6 **PECO may be claiming negative other operating revenues of (\$9,545,000).**
7 **Have you reviewed this issue?**

8 A. Yes. PECO provided a corrected response in the course of answering
9 Interrogatory OTS-RS-29 and reflected the \$9.545 million in other operating
10 revenue.

11 **D. Miscellaneous General Expenses**

12 **54. Q. OTS witness Morrissey has proposed the disallowance of \$3.543 million,**
13 **or approximately 55%, of the Company's claim for Miscellaneous**
14 **General Expenses recorded to FERC Account 930.2. Please respond to**
15 **this recommendation.**

16 A. Ms. Morrissey contends that the Company has not adequately explained the
17 projected increase in Account 930.2 for the FTY. On that basis, she proposes
18 that the Company's expense allowance be set at \$2.902 million, which is the
19 average of the amounts booked to Account 930.2 during the three-year period
20 2007-2009 and considerably less than the amount PECO actually incurred
21 during the historic test year (see table at OTS Statement No. 2, p. 22).

1 **55. Q. Do you agree that PECO has not explained the estimated increase in**
2 **Miscellaneous General Expenses?**

3 A. No, I do not. As I explained in my direct testimony (PECO Statement No. 3,
4 p. 17), the Company budgets by cost element and, for purposes of preparing
5 this rate filing, distributed those cost elements to FERC Accounts based, for
6 the most part, on the distribution of costs during 2009. More costs were
7 distributed to Account 930.2 because PECO budgeted increases in various of
8 the cost elements that I distributed to that Account.

9 **56. Q. What budgeted cost elements were distributed to Account 930.2?**

10 A. As PECO indicated in its response to Interrogatory OCA-III-50, and
11 particularly Attachment OCA-III-50(b) and (c) to that response, the costs
12 distributed to Account 930.2 consist almost entirely of Other Operating
13 Expenses.

14 **57. Q. Has the Company explained why it budgeted a higher level of Other**
15 **Operating Expenses for 2010 than it booked in 2009?**

16 A. Yes. In response to Interrogatories OCA-VII-23 and OCA-IX-15, the
17 Company explained that the increase from 2009 to 2010 was primarily
18 attributable to a \$4.9 million increase in Injuries and Damages Expense; a
19 reduction in reimbursable project expenses of \$4.4 million (including the one-
20 time Elroy capacity credit); higher fuel prices of \$1.1 million; and inflation
21 and other expenses of \$1.4 million. Because of these changes, budgeted Other

1 Operating Expenses rose by about \$11.8 million, from \$25.954 million in
2 2009 to \$37.715 million in 2010, and the portion of these costs distributed to
3 Account 930.2 increased commensurately.

4 **58. Q. Do you have any other comments regarding Ms. Morrissey's proposed**
5 **adjustment?**

6 A. Yes. As I indicated in my prior answer, Injuries and Damages Expenses are
7 included in the \$37.715 million of Other Operating Expenses, a portion of
8 which were then distributed to Account 930.2. However, PECO has reduced
9 its Injuries and Damages Expenses by \$784,000 (699,000 for the distribution
10 operations) to reflect updated loss factors. In addition, the increase in Other
11 Operating Expenses due to the decline in reimbursable project work is
12 addressed in the rebuttal testimony of Phillip S. Barnett (PECO St. No. 2-R),
13 where Mr. Barnett responds to an adjustment proposed by Mr. Effron.

14 **E. Rate Case Expense**

15 **59. Q. Please respond to Ms. Morrissey's recommendation that rate case**
16 **expenses be normalized over a five-year period rather than a two-year**
17 **period.**

18 A. Ms. Morrissey first notes that it has been quite some time -- indeed, dating
19 back to the 1980s -- since PECO last sought base rate relief for its electric
20 operations. She then arbitrarily recommends a five year period for the
21 normalization of rate cases in the proceeding. I utilized and still continue to
22 support a two-year normalization period for rate case expense. It is my

1 understanding that, prospectively, PECO intends to make base rate filings for
2 its electric operations on an approximate two-year cycle. Given the declining
3 customer usage that PECO will continue to experience due to the load
4 reductions required by Act 129 and Mr. Barnett's testimony that PECO's
5 electric operations will need to invest nearly \$1.7 billion over the next five
6 years (PECO St. No. 2, pp. 3-4), a two-year filing cycle seems to be a
7 reasonable expectation.

8 **F. Other Employee Benefits Expense**

9 **60. Q. Mr. Effron has recommended that the Company's operating and**
10 **maintenance expenses be reduced by \$138,000 to reflect the disallowance**
11 **of PECO's claimed annualization of increases in other employee benefits**
12 **expense. Please comment.**

13 A. Mr. Effron contends that the specific amount and timing of the FTY increase
14 is not "known and measurable" and that the adjustment proposed by PECO,
15 which relies on a trending of 2009 and 2010 cost levels, is not reliable.
16 However, he does not dispute, nor can he, that employee benefit costs are in
17 an upward spiral. Given that history of rising costs, I believe PECO's
18 annualization adjustment is reasonable and, in all likelihood, understates the
19 costs that PECO will incur during the rate-effective period.

20 **G. Allocation Of A&G Costs**

21 **61. Q. Mr. Effron has recommended an approximate \$3.2 million adjustment to**
22 **PECO's claim for administrative and general ("A&G") expenses based**

1 **on a reallocation of costs between the distribution and transmission**
2 **functions. Please address this proposal.**

3 A. In allocating costs between distribution and transmission, PECO utilized a
4 factor based on total operating and maintenance expense (“O&M Factor”),
5 except in the case of costs distributed to FERC Accounts 920 and 926 where
6 the Company used a factor based on salaries and wages (“S&W Factor”). Mr.
7 Effron contends that use of the S&W Factor to allocate all A&G expenses
8 would be “more appropriate” because that is how PECO’s current
9 transmission rates were developed.

10 **62. Q. Do you agree?**

11 A. No. I do not. First, PECO’s current transmission rates were established in
12 1995, i.e., prior to functional unbundling in Pennsylvania, and much has
13 changed since then. Second, FERC does not require companies to utilize an
14 S&W Factor to allocate all A&G costs and, in its next FERC rate filing,
15 PECO intends to propose the use of multiple allocation factors as it has done
16 here. Third, in my opinion, PECO’s use of an S&W Factor to allocate
17 Account 920 and Account 926 costs and an O&M Factor to allocate all other
18 A&G expense makes sense from a cost-causation standpoint.

19 **63. Q. Why?**

20 A. The costs recorded in Accounts 920 and 926 comprise Administrative and
21 General Salaries (Account 920) and Employee Pensions and Benefits

1 (Account 926). Hence, an S&W Factor should be used to allocate these costs
2 between distribution and transmission functions. The remaining A&G
3 expenses include such items as Office Supplies and Expenses, Outside Service
4 Employed, Injuries and Damages and Miscellaneous General Expenses.
5 These types of costs are not driven solely by the level of salaries and wages
6 and, consequently, should be allocated on the basis of an overall O&M Factor,
7 which includes a salaries and wages component.

8 **H. General Advertising Expense**

9 **64. Q. Ms. Morrissey has proposed the disallowance of the \$1.861 million of**
10 **general advertising expenses appearing in FERC Account 930.1 on your**
11 **Exhibit RLO-1, Schedule D-4, page 3. Please comment.**

12 A. Ms. Morrissey's recommendation is based on her understanding that the
13 \$1.861 million in question (1) comprises dollars to be spent on PECO's 2010
14 energy efficiency program and (2) are properly recoverable through the
15 Company's Energy Efficiency and Conservation Program Surcharge ("EE&C
16 Surcharge"). To avoid "duplicate recovery," Ms. Morrissey would remove
17 the \$1.861 million from the calculation of PECO's base rate revenue
18 requirement.

19 **65. Q. Is Ms. Morrissey correct?**

20 A. Ms. Morrissey is correct that the Company is actively promoting its EE&C
21 Program. She is also correct that dollars that focus on how customers can
22 save energy, save money and support energy efficiency are included in

1 PECO's claimed revenue requirement. However, she is incorrect that the
2 \$1.861 million allocated to FERC Account 930.1 relate to the Company's
3 EE&C Program. In addition, and notwithstanding Ms. Morrissey's concerns
4 to the contrary, there is no risk of double recovery.

5 **66. Q. Please explain.**

6 A. In broad terms, PECO's budgeted advertising dollars can be broken down into
7 three categories: (1) promotional and image advertising unrelated to the
8 EE&C Program; (2) advertising related directly to the EE&C Program; and
9 (3) informational and instructional advertising. The first category of costs is
10 typically booked to FERC Account 930.1, but are not recoverable from
11 customers and, consequently, were removed from PECO's claimed revenue
12 requirement. The second category of costs were included in the \$80.4 million
13 of operating expense removed from PECO's claimed revenue requirement on
14 Exhibit RLO-1, Schedule 3, page 2, column 17, line 70. Those costs will be
15 recovered through the Company's EE&C Surcharge. That leaves the
16 informational and instructional advertising, which is booked to FERC
17 Account 909. Because of the importance of the Company's EE&C initiatives
18 and the Company's desire to reinforce the benefits of EE&C initiatives to its
19 customers, PECO intends to utilize approximately \$2 million of 2010
20 informational and instructional advertising dollars to provide additional
21 support to the program. Recovery of these dollars will not be included in the
22 Company's claim for recovery in PECO's EE&C Surcharge.

1 **67. Q. Does that mean that the \$2.015 million allocated to FERC Account 909 as**
2 **informational and instructional advertising (Exhibit RLO-1, Schedule D-**
3 **4, page 3, line 83) needs to be “normalized”?**

4 A. No. The \$2.015 million allocated to FERC Account 909 is entirely in line
5 with the level of expenditures booked to that Account in the historic test year
6 and the level that the Company expects to spend in future years. Viewed
7 differently, PECO fully expects to spend approximately \$2.015 million
8 annually on other types of informational and instructional activities during the
9 rate effective period.

10 **68. Q. But did not the Company indicate in response to Interrogatory OTS-RE-**
11 **87 that the \$1.861 million appearing in Account 930.1 represented 2010**
12 **EE&C Program expenditures?**

13 A. Yes, it did, but that was in error. Moreover, and as I explained in my rebuttal
14 testimony in PECO’s pending gas rate proceeding at Docket No. R-2010-
15 2161592, the dollars distributed to Account 930.1 do **not** represent
16 promotional or image advertising either because all dollars associated with
17 those activities were, in fact, removed from the Company’s budgeted
18 operating expenses before I allocated the budgeted cost elements to FERC
19 accounts. Unfortunately, I failed to take that into account and, as a result,
20 inadvertently allocated certain costs to Account 930.1 that, in fact, did not
21 constitute advertising expense and that should have been allocated to other
22 accounts.

1 **69. Q. Please continue.**

2 A. As I explained in my direct testimony, the Company budgets by expense
3 category or cost element, such as salaries & wages, contracting, other
4 operating expenses etc., and does not budget by FERC account. One of my
5 assignments was to use the prior year's actual expense distribution by FERC
6 account and distribute the FTY budget amounts from the cost element
7 categories to the FERC accounts. The 2009 actual expenses and the 2010
8 budget expenses by cost element are shown on Exhibit PECO RLO-6,
9 Schedule D, page 1. The distribution of the 2010 cost element amounts to the
10 FERC accounts is shown on Exhibit PECO RLO-6, Schedule D, pages 3 to
11 18. The actual distribution of the 2009 cost element totals by FERC account
12 is contained in Exhibit PECO RLO-6, Schedule D pages 9 to 14. If there were
13 no changes in the items included in the cost element expenses for 2010 from
14 those recorded in 2009, the distribution of the 2010 would have contained
15 some promotional or image advertising. However, this is where the error was
16 made. As shown on Schedule C, page 1, lines 44 to 55, the Company
17 removed cost element items that are normally not included in setting rates for
18 regulated utilities. These include advertising, charitable contributions and
19 lobbying expenses. This resulted in a reduction in the cost element expense
20 for the FTY from \$692,166,000 on line 56 to the total cost element expenses
21 for the FTY of \$683,864,000 as shown on line 44 in column 2. The removal
22 of these cost elements is further detailed on page 2 of Schedule D.

1 **70. Q. If promotional advertising costs were removed in the 2010 cost element**
2 **schedule, how did FTY 2010 expenses get allocated to FERC Account**
3 **930.1?**

4 A. The allocations to FERC Account 930.1 in the FTY occurred because I did not
5 remove similar expenses for 2009 from the base in determining the
6 distribution of the cost elements in the FTY. The fact that those expenses
7 were left in the base caused an allocation to appear in the FTY FERC Account
8 930.1 . The advertising expenses in 2009 shown as \$1,441,000 on Exhibit
9 RLO-6, Schedule D, page 12, column 10, line 70 and the \$315,000 on page
10 13, column 25 on line 70 should have been removed from the 2009 base data
11 since the similar advertising expenses were removed from the FTY expenses
12 to be allocated. If this had been done, the \$1,757,000 in 2009 on line 50, page
13 14 for advertising expenses would not have been in the base of the
14 \$526,861,000 used to distribute the FTY expense and there would not be any
15 amount in the FTY for FERC account 930.1. This would be correct because,
16 as shown on Exhibit RLO-6, Schedule D, page 1, lines 49 and 50, a total of
17 \$1,517,000 was already removed from the FTY expenses. In other words,
18 costs that should have been allocated to other FERC accounts were
19 improperly allocated to FERC Account 930.1.

20 **71. Q. If you correct the distribution, would the total FTY expenses change?**

21 A. No. The only change would be in the distribution of the FTY cost element
22 expenses to FERC accounts.

1 **72. Q. Have you prepared another distribution correcting the error?**

2 A. Yes, I have. The corrected distribution is contained in Exhibit PECO RLO-6,
3 Schedule D pages 15 to 26. As can be seen, the total amount for the FTY cost
4 element expenses on page 17, line 1 in column 36, of \$683,864,000 is the
5 same as that shown for the cost element FTY expenses on page 1 of Schedule
6 D and also on page 5, line 1, column 36 of the original distribution
7 calculations. However, the amount for the 2009 cost element expenses of
8 \$526,861,000 which is shown on page 1 of Schedule D, line 44, column 1 and
9 also on the original distribution on page 5 of Schedule D, column 36, line 2
10 has been changed to \$525,105,000 as shown on the corrected calculation on
11 page 17 of Schedule D on line 2 in column 36.

12 **73. Q. How has this change corrected the allocation error?**

13 A. The reduction of the \$1,756,000 ($\$526,861,000 - \$1,756,000 = \$525,105,000$)
14 was made to the 2009 charges to FERC account 930.1 as shown on Schedule
15 D, page 24 line 70 in column 32. This removed the advertising expenses from
16 the 2009 data. Once the advertising expenses are removed, there is no
17 allocation to FERC account 930.1 in the FTY. This can be seen by comparing
18 the FTY allocated data in the original allocation of \$1,861,000 on Schedule D
19 page 8 line 70, column 36 with the corrected allocation shown on Schedule D,
20 page 17 line 70, column 36 which reflects a zero amount. Since the FTY cost
21 element expenses have not changed from the \$683,864,000 there is no change
22 in the FTY expenses, only a correction for the allocation to accounts.

1 **I. Customer Education Expense**

2 **74. Q. Have you reviewed the testimony of Ms. Morrissey concerning her**
3 **proposal to remove \$1.664 million from FTY expenses reflected in FERC**
4 **account 910?**

5 A. Yes, I have. Ms. Morrissey recommends the removal of the \$1.664 million
6 from FERC 910 because she believes these costs represent expenses that
7 should be recovered through PECO's Consumer Education Plan surcharge.

8 **75. Q. Is this adjustment correct?**

9 A. No, it is not. Ms. Morrissey is recommending the removal of an allocated
10 amount from the FTY without supporting the amount of the removal using
11 changes in the cost elements from the actual cost element expense for 2009
12 and the budget cost element expense for the FTY 2010.

13 **76. Q. Would you agree that the major cost element change for FERC 910 is**
14 **from the other operating expenses?**

15 A. Yes, I do.

16 **77. Q. What is the basis of the \$1.664 million Ms. Morrissey proposes to**
17 **remove?**

18 A. The \$1.664 million in 2010 is an allocated amount using the \$1.145 million of
19 other operating expenses charged to FERC 910 in 2009 times the increased in
20 the other operating expense category from actual 2009 to budget 2010.

1 **78. Q. Have you prepared a schedule showing these changes?**

2 A. Yes, I prepared PECO Exhibit RLO-6, Schedule E

3 **79. Q. Please describe Schedule E.**

4 A. Schedule E is an update of the Company's response to OCA-III-50 (a) which
5 is shown in columns 1 to 5. Column 6 reflects the actual charges by cost
6 element to FERC 910 and column 7 reflects the change in those cost elements
7 by applying the percent change for each appropriate cost element in column 3
8 to the actual charges to FERC 910 shown in column 6. The result of this
9 allocation is shown in column 7. This is a similar summary to that provided
10 by Ms. Morrissey on OTS Exhibit No. 2, Schedule 11.

11 **80. Q. Has the Company addressed the issue related to this type of adjustment**
12 **in prior testimony?**

13 A. Yes. As previously discussed, simply removing an allocated amount from the
14 FTY does not mean that the total expenses should be reduced. As was the
15 case with FERC account 930.1, correcting the allocation related to that
16 account merely changed the allocations to all other accounts but did not
17 change the total expenses because the total for the cost elements did not
18 change.

19 **81. Q. Would you agree that the cost element that creates the majority of the**
20 **difference between 2009 actual and 2010 allocated expenses in FERC 910**

1 **is other operating expenses on line 21?**

2 A. Yes, I would.

3 **82. Q. What did you determine when you reviewed the actual charge for**
4 **\$1,145,000 in 2009 as shown in column 6 on line 21?**

5 A. I determined that the \$1,145,000 represented six months of amortization of
6 consumer education costs as shown in footnote 1 at the top of page 2 of OTS
7 Exhibit No. 2, Schedule 11. I also determined that the similar amortization
8 amount for the FTY 2010 was not included in the cost element other operating
9 expenses, but was included in the amount of \$2.646 million as regulatory
10 amortization reflected outside of the cost elements on PECO Exhibit RLO-1,
11 Schedule B-2, line 9, Amortization of Regulatory Expense. This same
12 amount, \$2.646 million, is reflected in revenue at present rates to offset the
13 expense for the amortization in the FTY. The fact that the \$1.145 million for
14 the six months in 2009 was not matched with the \$2.646 million in 2010 has
15 caused this confusion.

16 **83. Q. How would you correct this mismatch between where the amortization**
17 **for the consumer education costs was recorded in 2009 (FERC 910) and**
18 **where it was budgeted in the FTY 2010 (FERC 405)?**

19 A. First, I would remove the \$1,145,000 amortization expense from the 2009
20 expenses used to distribute the FTY 2010 cost element expenses. This is
21 necessary since there is a specific amount budgeted for the 2010 FTY

1 amortization expense for consumer education costs which should be
2 specifically matched with the 2009 amortization. Second, I would show the
3 2009 actual amortization of \$1,145,000 and the budgeted 2010 FTY
4 amortization in the same account so they can be compared and do not affect
5 the cost element distribution for the 2010 FTY expenses.

6 **84. Q. Have you prepared a schedule showing that removal and comparison?**

7 A. Yes, I have. PECO Exhibit RLO-6, Schedule F shows the results of removing
8 the amortization from the cost element distribution and then showing the
9 comparison of the amortization separately for each year. Column 1 data
10 agrees with the budget amount shown on PECO Exhibit RLO-1, Schedule B-
11 2, line 6 in total for the O & M expense (\$2,802,282,000) and also shows that
12 there is no amount for amortization of the consumer education costs, which
13 are included in the amortization of regulatory expenses (\$885,646,000) also
14 shown on Schedule B-2, line 9. Column 4 shows the same data for the
15 historic year and reflects that the amortization for the consumer education
16 expense was included in the total O & M expense and not in the amortization
17 of regulatory expense.

18 **85. Q. How does the Company record the actual consumer education costs that**
19 **are ultimately recovered through the Customer Education Plan**
20 **Surcharge?**

21 A. As explained in the Commission's Order at Docket No. M-2008-2032274,
22 page 12, the consumer education costs are initially recorded in the FERC

1 Account 182.3 and then amortized to FERC Account 910 when recovered in
2 revenue through the default service rates.

3 **86. Q. What do you conclude from these schedules, comparisons and recording**
4 **requirements?**

5 A. I conclude that the \$1,145,000 for the amortization of the consumer education
6 costs should be removed from the process for the allocation of the FTY cost
7 elements, which therefore eliminates the need for the \$1,664,000 adjustment
8 proposed by Ms. Morrissey, which adjustment should then be eliminated.

9 **87. Q. Does this complete your rebuttal testimony?**

10 A. Yes, it does.