

PECO Statement No. 2:

Direct Testimony of Marissa Humphrey

**PECO ENERGY COMPANY
STATEMENT NO. 2**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION
v.
PECO ENERGY COMPANY – GAS DIVISION

DOCKET NO. R-2024-3046932

DIRECT TESTIMONY

WITNESS: MARISSA HUMPHREY

SUBJECT: PECO’S NEED FOR RATE RELIEF;
EFFORTS TO CONTROL CUSTOMER
COSTS AND REDUCE CUSTOMER BILLS;
OVERVIEW OF PECO’S ACCOUNTING
EXHIBITS AND BUDGETING PROCESS;
GAS SALES FORECAST; EXELON
BUSINESS SERVICES COMPANY; AND
THE CORPORATE ALTERNATIVE
MINIMUM TAX

DATED: MARCH 28, 2024

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1 Electric (“BGE”), Exelon Business Services Company (“EBSC”), Pepco Holdings
2 (“PHI”), and PECO. Prior to and following the 2012 merger of Exelon and
3 Constellation, I was named Director of Financial Planning & Analysis (“FP&A”)
4 at BGE. Beginning in 2014, I served as the Exelon Project Management Officer
5 for the Exelon/PHI merger and, upon the closure of that merger in 2016, I was
6 promoted to Vice President of PHI FP&A. After three years, I transitioned to
7 Vice President of the Exelon Utilities Finance team, and in 2020 I was named
8 Vice President of Regulatory Policy & Strategy at PHI. In 2022, I was promoted
9 to Senior Vice President, Chief Financial Officer and Treasurer of PECO. Prior
10 to joining Constellation Energy, I worked for several years in consulting and
11 healthcare finance.

12 **4. Q. What is the purpose of your direct testimony?**

13 A. The purpose of my direct testimony is to: (1) briefly explain PECO’s need for
14 rate relief; (2) summarize PECO’s efforts to control costs and reduce customer
15 bills since the Company’s last approved gas base rate increase in 2022;
16 (3) provide an overview of PECO’s principal accounting exhibits, as well as its
17 budgeting process; (4) describe PECO’s gas sales forecast; (5) describe the nature
18 and allocation of costs for services that PECO receives from EBSC; and
19 (6) discuss the Corporate Alternative Minimum Tax.

1 **II. NEED FOR RATE RELIEF**

2 **5. Q. Why is PECO seeking a rate increase at this time?**

3 A. As detailed in the testimony of Company witness Amy E. Hamilton (PECO
4 Statement No. 1), PECO is the largest combined natural gas and electric utility in
5 the Commonwealth. PECO’s gas operations serve a roughly 1,900 square-mile
6 area in southeastern Pennsylvania. In addition to its supply and storage facilities,
7 the Company’s distribution system is comprised of over 7,300 miles of gas mains,
8 approximately 480,000 gas services, and 28 gate stations. It takes considerable
9 expertise and significant capital investment and operations and maintenance
10 activities to provide PECO’s customers with safe and reliable service. Further,
11 PECO continuously strives to improve its system reliability and safety, customer
12 service, and service offerings to meet evolving customer expectations and needs.

13 Since PECO last requested a base rate increase for its gas operations in March
14 2022, PECO has continued to make substantial investments in new and
15 replacement utility plant. Between January 1, 2024 and December 31, 2025, the
16 end of the fully projected future test year (“FPFTY”) in this filing, PECO will
17 have invested \$786 million in additional gas distribution plant. Continued
18 investment in PECO’s gas distribution system is needed to safely and reliably
19 serve customers. The cost of doing so, however, has increased significantly. As
20 detailed further below, inflation and interest rates have risen at a historic pace,
21 which has raised the cost of investment and continues to increase the Company’s
22 labor, contracting, and materials expense. The Company has actively worked to
23 mitigate the impact of these increased costs, constraining controllable cost

1 increases below the rate of inflation. However, as explained in further detail
2 below and in the testimony of Company witness Paul R. Moul (PECO Statement
3 No. 5), without an increase in revenues, PECO's overall returns on capital and
4 common equity will be inadequate, impairing the Company's ability to continue
5 making the reasonable and prudent investments necessary to serve customers.

6 **6. Q. Please provide an overview of the significant capital investments made by the**
7 **Company since its prior rate request, and the investments planned through**
8 **December 31, 2025.**

9 A. As noted above, the Company is planning to invest \$786 million in additional gas
10 distribution plant between January 1, 2024 and December 31, 2025. These
11 investments undergo a thorough review and approval process as further explained
12 below in Section IV and in Ms. Hamilton's testimony regarding the Company's
13 capital investment planning process.

14 As discussed in detail in Ms. Hamilton's testimony, the Company's capital
15 investments are focused on system performance, capacity improvement, facility
16 relocation, new business projects, information technology ("IT"), and customer
17 operations. Many of these investments are made in coordination with the goals
18 and requirements of PECO's Long-Term Infrastructure Improvement Plan.

1 7. Q. What is driving the increase in the Company’s operating and maintenance
2 (“O&M”) costs since its last gas base rate case?

3 A. The increased O&M costs are driven in large part by historically high inflationary
4 rates, which have caused a significant increase in the Company’s labor,
5 contracting, and materials expense. O&M costs have also grown as additional
6 plant has been placed in service that requires ongoing maintenance. In addition,
7 as described further in Ms. Hamilton’s testimony, the Company is incurring
8 additional O&M costs to enhance safety and reliability, address expanded leak
9 surveys and management of “One Call requests,” improve customer service, and
10 conduct leak surveys.

11 8. Q. Please describe the inflationary pressures PECO is experiencing in greater
12 detail.

13 A. Since the Company’s last gas rate case filing in 2022, the United States has
14 continued to experience a sustained and significantly elevated rate of inflation –
15 the highest in forty years.¹ As a result, actual inflation has greatly exceeded the
16 inflationary impacts assumed in the Company’s prior gas rate case. The
17 Company expected inflation to range from 2.0% to 2.1% over 2022-2023.
18 Instead, inflation spiked significantly, reaching 7.8% in 2022 and averaging

¹ See Databases, Tables & Calculators by Subject, Consumer Price Index for All Urban Consumers (CPI-U), All items in Philadelphia-Camden-Wilmington, PA-NJ-DE-MD, all urban consumers, not seasonally adjusted, U.S. Bureau of Labor Statistics, https://data.bls.gov/timeseries/CUURS12BSA0?amp%253bdata_tool=XGtable&output_view=data&include_graphics=true.

1 6.25% over that two-year period.² As a result, PECO has faced steadily
2 increasing costs, including material prices, contracting rates, and borrowing costs.
3 The inflationary pressures have also significantly pushed up prevailing interest
4 rates as shown by the increase in the thirty-year Treasury yield that serves as a
5 risk-free benchmark rate in many financial products, including thirty-year
6 maturity bonds that are typically issued by utility companies. From a low of
7 2.01% as of January 3, 2022 to 4.45% as of February 16, 2024, 30 Year Treasury
8 rates have increased at one of the fastest paces in the past thirty years.³

9 **9. Q. How has the high inflation environment impacted the Company’s borrowing**
10 **costs?**

11 A. The rise in inflation has directly impacted the Company’s borrowing costs. The
12 cost to fund the Company’s investments has increased significantly since the
13 Company’s last gas base rate case. As stated above, interest rates have increased
14 since the Company’s last rate case at one of the fastest paces in history, reaching
15 the highest point in well over ten years.⁴ These interest rate increases have
16 pushed up the Company’s average cost of borrowing from 3.92% in 2023, as
17 documented in the Company’s prior gas rate case filing, to 4.58% forecasted for

² The average 6.25% inflation rate was calculated as the average of the inflation rates in 2022 through 2023 (7.8%, and 4.7%, respectively) per the Consumer Price Index for All Urban Consumers (“CPI-U”) for Philadelphia, Pennsylvania.

³ See 30 Year Treasury Rates listed at Daily Treasury Par Yield Curve Rates, U.S. Department of the Treasury, https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=all.

⁴ *Id.*

1 2025. The Company's cost of debt is further detailed in the testimony of Mr.
2 Moul.

3 **10. Q. Please provide an overview of the Company's sales since its last gas base rate**
4 **case.**

5 A. Despite the need to incur increased costs to maintain safe and reliable service for
6 its customers and, where possible, improve such service, the Company expects
7 only a modest change in sales going forward. The Company's number of
8 customers is forecasted to increase by an average of 0.8% per year between 2023
9 and 2025. Sales are forecasted to grow at 1.4% annually over the same period.
10 The Company's modest growth in sales and customers does little to offset the
11 necessary investments the Company must make in its system and the rising cost to
12 operate and maintain it.

13 **11. Q. How have the Company's increased expenditures impacted its rate of return**
14 **in invested capital?**

15 A. Without an increase in revenues, PECO's gas operations are projected to produce
16 an overall return on investment capital of 5.80%, and a return on common equity
17 of 6.87%, during the twelve months ending December 31, 2025.⁵

18 As explained by Mr. Moul, such levels of return are inadequate under any
19 reasonable standard and below the rates of return generally afforded to public
20 utilities. Absent a rate increase, the erosion to PECO's projected returns would

⁵ See PECO Exhibit MJT-1, p. 1.

1 impair the Company’s ability to make all of the reasonable and prudent
2 investments in gas distribution infrastructure that are necessary to maintain and
3 enhance the provision of safe and reliable natural gas service to its customers.
4 Inadequate returns would also negatively impact PECO’s credit-coverage ratios
5 and its ability to maintain its investment-grade credit ratings, thereby increasing
6 the Company’s financing costs, and ultimately the cost to customers, as further
7 detailed below.

8 **12. Q. Why is it important for PECO to maintain its investment-grade credit rating**
9 **and minimize its borrowing costs?**

10 A. Maintaining PECO’s investment grade credit ratings is important to reducing
11 customer costs. PECO projects that it will need to invest approximately \$786
12 million in gas distribution plant between January 1, 2024 and December 31, 2025.
13 A meaningful portion of these planned investments will be financed with debt and
14 other forms of capital. The Company’s credit ratings will impact the cost it will
15 need to pay to attract such capital, and ultimately such costs will be borne by
16 PECO’s gas customers. Therefore, it is important that the Company maintain its
17 favorable credit metrics in order to minimize customer costs.

1 economies of scale in many specialized services. Additionally, and as discussed
2 in Section IV below, PECO has rigorous cost-control processes that it performs
3 on a monthly and annual basis to ensure that its spend is aligned with its
4 operational plan.

5 **16. Q. Please describe PECO's efforts to control its O&M expenses in further detail.**

6 A. PECO actively manages its O&M expenses while maintaining, and, where
7 possible, improving, high levels of reliability and customer service in the face of
8 evolving customer expectations. PECO works proactively to identify initiatives
9 to further improve productivity through best practices across the organization,
10 leveraging new technologies, and improving efficiency through initiatives like
11 regional work bundling for contractors. PECO also strives to make prudent
12 investments that will minimize costs in the long-term. Accordingly, it is PECO's
13 practice to prioritize the replacement of natural gas infrastructure partly on the
14 basis of leak performance. This minimizes long-term O&M expenditures related
15 to main repairs and surveying. As discussed in greater detail in Ms. Hamilton's
16 testimony, PECO's replacement strategy has resulted in a significant reduction for
17 incoming gas leaks since 2018. This reduction in leak volume has enabled the
18 company to reduce the growth in costs associated with leak repair, a significant
19 driver of overall O&M costs.

20 In addition, and as described in Section IV of my testimony, PECO actively
21 manages the creation of its budget, taking reasonable and prudent steps to
22 minimize its O&M expenses and mitigate inflationary impacts on its customers.

1 Notably, PECO's projected annual O&M growth rate since 2023 is nearly 30%
2 lower than the recent average inflation rate of 6.25% in the Consumer Price
3 Index. While higher than in recent years, customers continue to benefit from
4 PECO's efforts to keep that growth rate well below increases in the Consumer
5 Price Index.

6 **17. Q. What steps has PECO taken to manage its employee benefit costs?**

7 A. PECO actively manages its employee benefit costs to achieve savings to the
8 maximum extent practicable. The Company does this by evaluating trends in
9 benefits and identifying and implementing cost-reduction measures while
10 maintaining competitive compensation and benefit packages to successfully
11 attract and retain employees. As an example, the Company has actively taken
12 initiatives to manage its healthcare costs, which nationally have been trending
13 above the rate of inflation.

14 The Company has a self-insured healthcare program for employees. Therefore,
15 the Company's projected cost increases are based on assumed employee
16 participation, administrative costs, and actual claims experience trended to the
17 next year based on projected medical-price inflation. The Company engages
18 Willis Towers Watson, a national health plan consulting firm, to complete the
19 actuarial underwriting for its health plans in order to set premiums and determine
20 the cost projections.

21 PECO has undertaken several initiatives to manage its medical rates, i.e., medical
22 cost per employee, including collaborating with our vendor partners to offer

1 population health management programs such as a diabetes program for high-risk
2 members; promoting lower-cost care options, including behavioral telehealth
3 visits and virtual physical therapy sessions; implementing utilization management
4 guidelines for our prescription drug formulary; conducting plan audits to ensure
5 contract compliance; and obtaining competitive contract renewals. For example,
6 in 2023 the Company completed a detailed review of its pharmacy benefit
7 manager (prescription drug benefit), as well as the pricing models and contract
8 terms existing in the market, to ensure that the Company receives competitive
9 coverage and pricing. This process resulted in projected premium savings that are
10 being shared between the Company and its employees to help offset increases in
11 medical plan rates. As a result of this initiative and other cost-management
12 strategies, the Company expects its 2024 projected medical care cost trend of 5%
13 to remain well below the 8.9% national-average increase projected by Willis
14 Towers Watson and below the near 7% increase projected for the medical plans
15 disclosed in the 2024 survey of health plan cost trends by The Segal Group, Inc.⁶

16 **18. Q. What steps has PECO taken to minimize its borrowing costs?**

17 A. PECO works closely with its banking partners to understand market conditions at
18 the time of issuance of debt to determine what tenor and timing will ultimately
19 generate the most investor demand, thereby securing a lower interest cost for the

⁶ See 2024 Global Medical Trends Survey, Willis Towers Watson, <https://www.wtwco.com/en-se/insights/2023/11/2024-global-medical-trends-survey>; What Are the Projected Health Plan Cost Trends for 2024? The Segal Group, Inc., <https://www.segalco.com/consulting-insights/2024-health-plan-cost-trend-survey#:~:text=Key%20health%20plan%20cost%20trend%20survey%20findings&text=Per%2Dperson%20cost%20trend%20for,drugs%20replacing%20lower%2Dcost%20therapies>.

1 benefit of customers. In June 2023, PECO successfully priced a \$575,000,000,
2 ten-year first mortgage bond (“FMB”) offering at a spread of 120 basis points
3 over the ten-year U.S. Treasury for an all-in coupon rate of 4.90%. The deal was
4 well received by investors and the strength of PECO’s name and credit profile
5 continue to drive strong investor demand, permitting PECO to tighten the credit
6 spread from the initial launch. The transaction resulted in the third lowest credit
7 spread (i.e., 120 basis points) and fifth lowest coupon for ten-year FMB utility
8 transactions in 2023 at the time of issuance. Additionally, instead of issuing
9 thirty-year bonds in 2023, in light of the unusually high Treasury rates, the
10 Company opted for a ten-year bond to reduce interest expense borne by
11 customers.

12 **19. Q. How has PECO assisted customers in lowering their natural gas usage and**
13 **energy costs?**

14 A. The Company’s gas energy efficiency and conservation programs offer residential
15 customers a mix of rebates to encourage them to upgrade to high efficiency
16 appliances. The Company’s Safe and Efficient Heating Program further provides
17 qualifying low-income customers no-cost direct installation measures, such as
18 natural gas furnace and boiler tune-ups and replacements, after that customer has
19 received a Low-Income Usage Reduction Program (“LIURP”) audit or free
20 energy check-up under PECO’s Act 129 energy efficiency and conservation plan.
21 In addition, the Company’s neighborhood gas pilot seeks to reduce customer costs
22 by enabling them to switch to less costly natural gas as a fuel choice. Over 2,000
23 homes have taken advantage of this program. Company witness Jacqueline F.

1 Golden (PECO Statement No. 10) discusses the LIURP program, and the
2 neighborhood gas pilot and gas energy efficiency offerings are discussed in
3 further detail in Company witness Doreen L. Masalta’s testimony (PECO
4 Statement No. 9).

5 **20. Q. What other programs does PECO have to support its low-income customers?**

6 A. In addition to its gas energy efficiency and conservation offerings, PECO has a
7 suite of low-income-focused programs available to better support the Company’s
8 most vulnerable customers. As discussed in more detail in Ms. Golden’s
9 testimony, PECO has:

- 10 • Implemented a new CAP Percentage of Income Payment Plan program as
11 of December 2022, providing eligible customers with a fixed maximum
12 monthly bill equal to what the CAP customer can afford for utility service
13 (subject to further program requirements). This program provides a
14 substantially higher discount to customers than was previously available,
15 thereby reducing CAP customers’ bills.
- 16 • Proposed to change the maximum allowable Matching Energy Assistance
17 Fund (“MEAF”) grant in order to expand the impact of MEAF and increase
18 the number of customers eligible for the program.
- 19 • Continued to conduct outreach and education to customers regarding the
20 Low-Income Home Energy Assistance Program (“LIHEAP”), a Federally-
21 funded grant program that provides supplemental payments to eligible
22 customers’ accounts, and supports its customers seeking LIHEAP grants.

1 **IV. OVERVIEW OF PECO'S PRINCIPAL ACCOUNTING**
2 **EXHIBITS AND BUDGETING PROCESS**

3 **21. Q. Please provide an overview of PECO's principal accounting exhibits.**

4 A. PECO's principal accounting exhibits are Exhibits MJT-1, MJT-2, and MJT-3,
5 which represent PECO's revenue requirement for the FPFTY, future test year
6 ("FTY"), and historical test year ("HTY"), respectively, and are sponsored by
7 Company witness Michael J. Trzaska (PECO Statement No. 3). Exhibit MJT-1
8 includes PECO's claimed measures of value (i.e., rate base), basic accounting
9 data, a detailed development of the major components of the Company's rate base
10 claim, detailed adjustments required to place FPFTY revenues and expenses on a
11 ratemaking basis, and a discussion of FTY and HTY data. As explained by Mr.
12 Trzaska, Exhibits MJT-2 and MJT-3 follow a similar format, and each of the three
13 exhibits is based, in part, upon data provided by other PECO witnesses.

14 **22. Q. Please describe PECO's budgeting process.**

15 A. One of the key goals of the annual planning process is to integrate and align
16 PECO's operational, regulatory, and financial plans. The operational plan
17 includes goals focused on achieving at least top quartile safety performance,
18 reliability, and customer satisfaction. The operational plan is also consistent with
19 statutory and Pennsylvania Public Utility Commission ("Commission")-imposed
20 regulatory requirements. The Company sets spending targets in its financial plan
21 to achieve its operational goals and comply with such regulatory requirements.
22 As I explained earlier, the Company attempts to minimize its O&M expenses to

1 the extent possible and has generally been successful in controlling these
2 expenses at a lower compound annual growth rate than the rate of inflation.

3 The planning process starts with a review and update of PECO's operational and
4 regulatory goals and initiatives to determine if changes are required for the future.
5 Any significant changes in such goals and initiatives are taken into consideration
6 when updating the Company's Long Range Plan ("LRP"). The LRP consists of a
7 five-year outlook and is updated with key assumptions (e.g., inflation rates,
8 interest rates) and with detailed input provided by "responsibility areas" (e.g., Gas
9 Operations and Customer Operations). Each responsibility area reviews its
10 historic expense levels, current and anticipated employee staffing levels,
11 performance assessments, regulatory requirements, operational goals, specific
12 projects, and other factors and develops a responsibility area-specific LRP. The
13 individual responsibility area LRPs are typically submitted for review by each
14 department in June of each year and are carefully analyzed for consistency,
15 completeness, and appropriateness. The responsibility area LRPs are then
16 consolidated into a single LRP and delivered to PECO's senior management (i.e.,
17 the Chief Executive Officer, Chief Operating Officer, and Chief Financial
18 Officer) for review and approval in September.

19 Once that LRP has been updated and approved, its data is thoroughly scrutinized
20 to formulate a detailed two-year budget. The two-year budget is developed by
21 responsibility area, similar to the LRP process described above. The Company
22 then develops its financing plan to ensure that PECO can maintain investment-
23 grade credit ratings. Based on that plan, PECO determines the amount it can

1 borrow to fund its spending plans and the dividend levels that will achieve its
2 targeted capital structure. The consolidated budget is then submitted to PECO
3 senior management for review and approval. The PECO board reviews and
4 approves the Company's capital, O&M, dividend, and financing plan annually.

5 **23. Q. Is that the end of the process?**

6 A. No. Although the budget, as approved, remains in place throughout the year and
7 is not formally amended, it is reviewed and updated on a monthly basis to reflect
8 estimates derived from the Company's latest data. Actual results are then
9 compared to both the original budget and the latest estimates. Any significant
10 variances are thoroughly investigated to determine why the Company's actuals
11 have departed from its estimated budget and actions are taken as appropriate.

12 **24. Q. Do the personnel in each of the responsibility areas develop their budgets by**
13 **Federal Energy Regulatory Commission ("FERC") account?**

14 A. No, the responsibility areas do not budget by FERC account. Rather, the
15 responsibility area budgets are prepared on the basis of business activities (i.e.,
16 GAAP⁷ basis) and related cost elements such as payroll, employee benefits,
17 outside services, etc.

⁷ GAAP stands for generally accepted accounting principles.

1 **25. Q. Has PECO’s budgeting process been reviewed by the Commission?**

2 A. Yes. PECO’s budgeting process was reviewed by the Commission during its
3 Focused Management and Operations Audit of PECO in 2022 (“2022 Audit”).⁸
4 The Commission’s auditors found no deficiencies or weaknesses in the way
5 PECO prepares its budgets.

6 **26. Q. Mr. Trzaska presents the budgeted data for the twelve months ending**
7 **December 31, 2025 on a FERC account basis in Schedules B-2, B-3, and B-4**
8 **of Exhibit MJT-1. How were those figures derived?**

9 A. As Mr. Trzaska explains more fully in his testimony, he analyzed PECO’s
10 recorded FERC account balances for the twelve months ending December 31,
11 2023 to determine their composition (e.g., payroll, benefits, rent) and then
12 distributed the FPFTY budgeted costs to the appropriate FERC account based on
13 his findings. The results of Mr. Trzaska’s proposed distribution of costs were
14 then reviewed and confirmed with members of my staff.

15 **27. Q. Do Exhibits MJT-1, MJT-2, and MJT-3 contain all of the data needed to**
16 **evaluate PECO’s claimed revenue requirement?**

17 A. No. While MJT-1, MJT-2, and MJT-3 present, in considerable detail, the
18 Company’s rate base, revenue, expense and tax claims, much of the supporting
19 data is provided in the separately bound volumes comprising the Company’s

⁸ See Focused Management and Operations Audit of PECO Energy Company, Docket No. D-2021-3023906 (issued July 2022).

1 responses to the Commission's rate case filing requirements at 52 Pa. Code §§
2 53.52, 53.53, 53.62, 53.64, and 56.56 and supplemental data requests issued by
3 the Commission's staff. I note that, consistent with the approach to develop
4 responsibility area budgets on the basis of business activities (GAAP basis) as
5 described above, many of the Company's responses to the filing requirements and
6 supplemental data requests that accompany this rate filing were prepared on the
7 basis of business activities (GAAP basis). As a result, there may be differences
8 between those responses and figures in MJT-1, MJT-2, and MJT-3, which were
9 prepared on a FERC account basis.

10 **28. Q. How does the Company's approach to determining plant additions for rate**
11 **base reflected in Mr. Trzaska's testimony differ from the capital budgeting**
12 **process you describe above?**

13 A. With respect to capital budgeting, the Company accounts for capital expenditures
14 in the period when such expenditures are made. The Company determines plant
15 additions based upon when plant is expected to be placed into service. This can,
16 and often does, differ from the period in which capital spending occurs. In
17 determining plant additions for rate base, PECO included only the plant that it
18 expects will actually be placed in service by the end of the FPFTY. I note,
19 however, that the larger projects with which that plant is associated for PECO's
20 budgeting purposes may show an overall project completion date that is beyond
21 the end of the FPFTY, as components of a project may extend beyond the FPFTY.

1 **29. Q. In Paragraph 24 of the Joint Petition for Settlement of PECO’s 2022 gas base**
2 **rate case, PECO agreed that it would provide comparisons of its actual**
3 **expenses and rate base additions for the twelve months ended December 21,**
4 **2023 to its projections in its 2022 case. Has PECO provided these**
5 **comparisons?**

6 A. Yes. PECO provided the Commission’s Bureau of Technical Utility Services, the
7 Commission’s Bureau of Investigation and Enforcement, the Office of Consumer
8 Advocate, and the Office of Small Business Advocate with an update on its Gas
9 Division’s actual capital expenditures, plant additions, and plant retirements by
10 month for the twelve months ending December 31, 2023.⁹ As described therein,
11 the Company’s actual capital expenditures, capital additions, and retirements were
12 greater than its projections in the 2022 gas base rate proceeding.

13 With respect to O&M expense, PECO spent \$149.8 million in 2023 in comparison
14 to the 2023 budget of \$143.8 million provided in the 2022 base rate case. The
15 variance is primarily due to increased contractor costs and the volume of leak
16 surveys, new security control programs to comply with cybersecurity directives
17 issued by the Transportation Security Administration, and IT projects to enhance
18 customer experience.

⁹ See Docket No. R-2022-3031113.

1 with the Exelon Senior Manager of Load Forecasting, the PECO Director of
2 Financial Planning and Business Analysis, and senior management for their
3 approval.

4 **32. Q. What is the economic outlook for the PECO service territory and how does**
5 **this impact your sales growth expectations?**

6 A. IHS Markit, which is an external vendor that provides economic data to the
7 Company, projects that between 2022 and the end of the FPFTY, annual growth
8 in gross metropolitan product (“GMP”) and employment will be 1.8% and 0.8%,
9 respectively.¹⁰ The Philadelphia metropolitan area is coming out of a period of
10 economic recovery, with GMP and employment growing faster than historical
11 trends while facing record-high inflation. Efforts to reduce inflation are expected
12 to slow the economy and ease labor markets in the coming years. This economic
13 outlook is one of several drivers impacting the Company’s forecasts.

14 **33. Q. Please describe the results of the Company’s sales forecast.**

15 A. Between the HTY and the FPFTY, the Company forecasts total weather normal
16 gas sales to grow 1.4% annually, with 1.3% annual growth in Residential sales
17 and 1.5% annual growth in Commercial & Industrial sales. This modest growth
18 in sales is expected to be driven by customer growth, economic growth, and lower
19 gas prices.

¹⁰ Data from IHS Markit for Philadelphia, PA categorized under “Metropolitan level” as of August 2023.

1 Over the same period, the number of PECO customers is forecasted to grow by
2 0.8% per year, with 0.8% annual growth in Residential customers and 0.8%
3 annual growth in Commercial & Industrial customers. Based on the Company's
4 sales and customer forecasts detailed above, use per customer ("UPC") during
5 that same period is forecasted to see moderate growth.

6 **VI. EXELON BUSINESS SERVICES COMPANY**

7 **34. Q. Does PECO procure certain shared services from an affiliated service**
8 **company?**

9 A. Yes. Like many other energy holding company enterprises, Exelon created a
10 service company, the EBSC, following the merger of PECO and the former
11 Unicom Corporation, to house specific support functions that it believed could be
12 staffed more efficiently and economically on a centralized basis.

13 **35. Q. What types of services does the EBSC make available and to whom?**

14 A. The EBSC is designed to provide a range of what would typically be regarded as
15 in-house services in the case of a stand-alone utility. In broad terms, those
16 services fall into the following categories: IT; supply; finance; human resources;
17 government and regulatory affairs and public policy; legal and corporate
18 governance; utility operations; real estate; executive services; communications;
19 and security. The EBSC offers its services to PECO and other affiliated members
20 of the Exelon family of utility companies, which include Atlantic City Electric
21 Company, Baltimore Gas and Electric Company, Commonwealth Edison

1 Company, Delmarva Power & Light Company, and Potomac Electric Power
2 Company.

3 **36. Q. Is PECO required to utilize the EBSC's services?**

4 A. No, PECO is not required to use the EBSC's services. Under the terms of the
5 General Services Agreement ("GSA") between PECO and the EBSC, which was
6 approved in the PECO/Unicom merger proceeding at Docket No. A-
7 110550F0147, PECO has the discretion to determine whether and to what extent
8 to utilize the EBSC's services in all areas except corporate governance.

9 **37. Q. What role does the EBSC play in PECO's natural gas distribution**
10 **operations?**

11 A. PECO's overall approach is to use its own personnel or independent contractors to
12 staff the day-to-day operations of its natural gas delivery system, as well as its
13 customer-service functions (e.g., call center and billing services). Other services,
14 such as employee-benefits administration, mass purchasing, insurance, and
15 treasury, to name a few, are provided by the EBSC. Certain highly specialized
16 services, for which it would not be cost effective to maintain the required
17 expertise at either PECO or the EBSC, are obtained through contracting with
18 outside firms.

19 **38. Q. What is the principal advantage of the service company structure?**

20 A. The EBSC enables PECO to realize economies of scale and scope that, in my
21 judgment, could be very difficult to achieve on an individual-company basis.

1 Indeed, if PECO were to try to maintain a full complement of comparably
2 qualified personnel on its own payroll, the total cost PECO would incur to obtain
3 the same level and quality of service it receives from the EBSC likely would be
4 considerably higher.

5 **39. Q. How does the EBSC price the services it provides to PECO?**

6 A. The GSA provides that the services furnished by the EBSC to PECO are to be
7 billed at the EBSC's cost. Prior to the enactment of the Energy Policy Act of
8 2005, the Exelon utility companies were subject to the affiliate-transaction and
9 cost-allocation rules prescribed by the United States Securities and Exchange
10 Commission ("SEC") under the Public Utility Holding Company Act of 1935
11 ("PUHCA"), which generally mandated that service companies, such as the
12 EBSC, offer their services to affiliates at fully distributed cost. The "at cost" rules
13 were incorporated into the GSA, and their continued use in the provision of non-
14 power goods and services has been approved by the FERC, which assumed some
15 of the SEC's oversight responsibilities when PUHCA was repealed, in part,
16 several years ago.

17 **40. Q. How is the cost of services provided to PECO determined?**

18 A. Direct charges are made for services where possible. Otherwise, costs are
19 allocated on the basis of the allocation factors/methodologies identified in the
20 GSA, which were previously reviewed and approved by the SEC. These
21 allocations and methodologies were also reviewed as part of the Commission's

1 2022 Audit, and the Commission’s auditors found no issues with respect to
2 PECO’s cost allocation methodology.

3 **41. Q. How does PECO satisfy itself that the services it procures from the EBSC are**
4 **provided at a competitive price?**

5 A. PECO takes several steps to ensure that the services it procures from the EBSC
6 are provided at a competitive price. First, PECO and the management of EBSC
7 work together to identify PECO’s needs and to define service priorities and major
8 new initiatives. As a consequence, PECO has meaningful input into the
9 development of the EBSC’s budget for the upcoming year, and I, as PECO’s
10 Chief Financial Officer, ultimately approve the service level arrangements
11 (“SLAs”). SLAs are annual agreements between the EBSC and Exelon’s
12 operating companies (including PECO) entered into under the express authority of
13 the Commission-approved GSA that detail the specific services that the EBSC
14 will provide during the following year, including the scope of services, unit cost
15 expectations, and performance measures. Services are grouped by function so
16 that budgeted and actual costs can be tracked.

17 Second, the EBSC’s monthly billings are carefully scrutinized by PECO
18 personnel. Variances between actual and budgeted charges are reviewed by
19 PECO personnel with their EBSC counterparts to ensure that all costs are properly
20 justified.

21 In addition, for functions that are not already outsourced, PECO obtains extensive
22 information regarding the composition of the EBSC’s costs, which PECO can

1 then review for reasonableness. This “Market Testing Analysis,” developed in
2 conjunction with the Commission’s management auditors, is a formal approach
3 for evaluating the cost effectiveness of using the EBSC’s shared services. This
4 analysis is performed on an annual basis, and, along with allocation factors and
5 methodologies used for EBSC costs, was reviewed as part of the Commission’s
6 audits of the Company in 2014 and 2022. In 2017, the Commission conducted a
7 Management Efficiency Investigation to evaluate PECO’s implementation of
8 recommendations from the 2014 Audit.¹¹ The Commission again examined
9 PECO’s affiliated interest and cost allocations processes and concluded that
10 PECO (and EBSC) had taken steps to verify that “shared services are being
11 provided in an efficient and cost-effective manner and/or improvement
12 opportunities are identified to ensure service offerings are fair and reasonable.”
13 PECO has also worked to implement recommendations made by the Commission,
14 including those related to its payroll and accounts payable systems and the sharing
15 of benchmarking reviews among EBSC, PECO, and other Exelon companies.

16 **42. Q. What is PECO’s claim in this proceeding for EBSC services?**

17 A. PECO has included \$32.6 million in its FPFTY expense claim for charges from
18 EBSC. A breakdown of those costs is attached as PECO Exhibit MH-1.

¹¹ See PECO Energy Company Management Efficiency Investigation Evaluating the Implementation of Selected Management Audit Recommendations from the 2014 Focused Management and Operations Audit, Docket No. D-2016-2562303 (August 2017).

1 **VII. CORPORATE ALTERNATIVE MINIMUM TAX**

2 **43. Q. How does the enactment of the Inflation Reduction Act (“IRA”) impact**
3 **PECO?**

4 A. The IRA implemented a new corporate alternative minimum tax (“CAMT”)
5 beginning in 2023 that imposes a 15% tax on adjusted financial statement income
6 (“AFSI”) on “applicable corporations.” Applicable corporations will now be
7 required to pay the greater of 15% of their AFSI or their regular federal tax
8 liability. Based on current tax guidance and forecasted projections, PECO is
9 subject to the CAMT.

10 **44. Q. Is PECO an “applicable corporation” under the CAMT?**

11 A. Yes. The CAMT states that if a corporation’s average annual AFSI exceeds \$1
12 billion over the preceding three-year period, then the corporation and its
13 subsidiaries are applicable corporations. Although PECO does not meet that \$1
14 billion threshold on a standalone basis, PECO is a subsidiary of Exelon
15 Corporation. Strictly for purposes of determining if Exelon exceeds the \$1 billion
16 in average profits, Exelon must include all of its subsidiaries, including PECO,
17 because Exelon is considered a “single employer group” under the tax rules. If a
18 single employer group in the aggregate exceeds the \$1 billion profits threshold,
19 each corporation that is part of that single employer group is considered an
20 “applicable corporation” and separately subject to the CAMT. Under the tax
21 rules, when a subsidiary ceases to be a member of an affiliated group of
22 corporations, the departing subsidiary is entitled to its CAMT credit carryforward

1 and can utilize that credit in future tax years when its regular tax exceeds its
2 CAMT liability.

3 **45. Q. For CAMT purposes, how is AFSI determined?**

4 A. For purposes of calculating AFSI, the starting point is financial statement net
5 income under GAAP. The GAAP financial statement net income is then adjusted
6 for federal income taxes, accelerated tax depreciation, pension and other
7 postemployment benefits. As a result, for purposes of determining AFSI, federal
8 income taxes, accelerated tax depreciation, pension, and other postemployment
9 benefits are treated the same with respect to the calculation of the regular federal
10 income tax liability.

11 **46. Q. Why does PECO's CAMT liability exceed its regular tax liability?**

12 A. Under tax law, certain expenditures capitalized for GAAP financial statement
13 purposes qualify for accelerated tax deductions, such as tax repairs and certain
14 overhead capitalization. As a result, these expenditures are expensed in the
15 calculation of the regular tax liability sooner than for CAMT, which results in a
16 lower regular tax liability than under the CAMT calculation.

17 **47. Q. How does PECO calculate the CAMT?**

18 A. The Company calculated the CAMT based on its standalone separate company
19 books and records.

1 **48. Q. How is the Company expected to account for the CAMT in its financial**
2 **statements?**

3 A. For income tax accounting purposes, a current income tax liability and current
4 income tax expense will be recorded for the CAMT liability but will be equally
5 offset by recording a deferred tax asset and a reduction to deferred income tax
6 expense to reflect the CAMT credit carryforward. As a result, there is no net
7 incremental income tax expense associated with the CAMT. Corporations are
8 entitled to a tax credit equal to the amount by which the CAMT liability exceeds
9 the regular tax liability. This amount can be carried forward indefinitely and used
10 in future years when the regular tax liability exceeds the CAMT liability. The
11 credits are not permitted to be carried back to prior years. For income tax
12 accounting purposes, a deferred tax asset is established for the CAMT credit
13 carryforward.

14 **49. Q. Why is it appropriate to include the deferred tax asset related to CAMT in**
15 **rate base?**

16 A. Accelerated tax deductions related to utility property generate cash tax benefits
17 that reduce the cost of capital. For rate making purposes, rate base is adjusted
18 downward to reflect the lower cost of capital attributable to accelerated tax
19 deductions. The CAMT has the effect of reducing the realization of the tax
20 benefits associated with accelerated tax deductions, such as tax repairs and certain
21 other overhead capitalization adjustments (tax repair and certain overhead
22 capitalization deductions do not reduce CAMT). The Accumulated Deferred

