ML 212676

ORDER NO. 88033

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR ADJUSTMENTS TO ITS RETAIL RATES FOR THE DISTRIBUTION OF ELECTRIC ENERGY	* * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND _____ CASE NO. 9424 _____

Issue Date: February 15, 2017

To: Parties of Record and Interested Persons

On July 20, 2016, Delmarva Power & Light Company ("Delmarva" or the "Company") filed with the Maryland Public Service Commission ("the Commission") a request to increase its electric distribution rates in the amount of $56,970,183.[1] The Commission docketed the matter and delegated it to the Public Utility Law Judge Division for consideration. On January 4, 2017, the Chief Public Utility Law Judge ("Chief Judge") issued a Proposed Order authorizing a maximum increase of $34,100,454 in Delmarva's electric distribution rate base, based on an authorized return on equity ("ROE") of 9.48%, and findings regarding the Company's: 1) Advanced Metering Infrastructure ("AMI") deployment; 2) rate base operating income and expenses; 3) depreciation rates; 4) cost of service; and 5) rate design.[2] On January 18, 2017, before the Proposed Order became final, Delmarva and the Maryland Office of

[1] Delmarva last filed an application to increase its rates in March 2013, prior to its parent Pepco Holdings, Inc.'s merger with Exelon Corporation.

[2] The Proposed Order also addresses other issues, such as the continuation of Delmarva's grid resiliency plan, storm costs, and reliability reporting.

People's Counsel ("OPC") noted their respective appeals and concurrently filed their supporting memoranda. Neither the Commission's Technical Staff ("Staff") nor the Maryland Energy Group – North East and Hanover Foods Company (together "MEG") filed any notice of appeal. All four parties filed reply briefs on February 1, 2017.

I. The Parties' Issues on Appeal

A. Delmarva

Delmarva appeals the Proposed Order and asks the Commission to reject the Chief Judge's findings with respect to: 1) the Company's authorized ROE; 2) the treatment of merger synergy savings and costs-to-achieve associated with the merger of Pepco Holdings, Inc. ("PHI") and Exelon Corp. in 2016; 3) depreciation-related issues concerning net salvage rates and the rebalancing of depreciation reserves; and 4) benefits associated with the Company's AMI system.

First, Delmarva contends that the ROE adopted by the Proposed Order is inconsistent with Commission precedent, given that the Commission has consistently identified a higher risk associated with a utility's electric operations as compared to its gas operations. Delmarva further avers that the authorized ROE is unsupported by the record and fails to consider the recent increase in the federal interest rates.

Second, Delmarva argues that the Proposed Order is inconsistent with Commission precedent favoring the symmetrical treatment of merger synergies and costs to achieve. Delmarva also argues that the Proposed Order's asymmetrical approach

violates the known and measurable requirement.

Third, Delmarva claims that the Chief Judge's determination regarding net salvage rates should be reversed. Delmarva argues that it met its burden of proof to support its proposed net salvage rates. The Company further argues that it should have been allowed to rebalance its depreciation reserves in light of "significant changes in depreciation that necessitate a rebalancing."

Lastly, Delmarva objects to the Proposed Order's exclusion of non-core AMI benefits presented by Delmarva regarding market efficiency improvements in determining if AMI is cost-beneficial. Delmarva also alleges a calculation error in the Chief Judge's finding with respect to the value of capacity mitigation for Dynamic Pricing ("DP").

B. OPC

OPC appeals the Chief Judge's decision in the Proposed Order, alleging error in the following respects: 1) the finding that Delmarva's AMI program was cost-effective;[3] 2) the exclusion of only 50% of the Company's Supplemental Executive Retirement Plan ("SERP") costs; and 3) the adoption of Staff's recommended ROE of 9.48% instead of OPC's recommended ROE of 8.60% or one in between the two recommendations.[4]

First, OPC claims that the record in this matter does not support the finding that Delmarva's AMI program is "cost-effective." OPC argues that the Chief Judge mistakenly included the avoided transmission and distribution ("T&D") expenditures related to Dynamic Pricing (hereinafter "DP T&D") in her benefit-to-cost ratio, where the

[3] For the purposes of this Order, the Commission will address the "cost-effectiveness" of AMI in terms of whether the program is cost-beneficial.
[4] OPC Mem. on Appeal at 1-2 (hereinafter "OPC Appeal at ___").

text indicates she intended to include only the avoided T&D costs related to the Energy Management Tools ("EMT") program (hereinafter "EMT T&D"). OPC also contends that the Chief Judge improperly included the benefits associated with EMT and excluded the costs associated with Dynamic Pricing. According to OPC, correcting these errors would reduce the benefit-to-cost ratio from 1.15 to 0.56.[5]

Next, OPC argues that the Proposed Order should have disallowed 100% of Delmarva's costs associated with its SERP program to maintain consistency with the Commission's recent treatment of Pepco's SERP-related costs in Case No. 9418. OPC notes that Delmarva adopted substantially similar arguments as Pepco and similarly failed to demonstrate why it should be allowed to recover all of its SERP costs.

Lastly, OPC avers that the Proposed Order fails to provide a valid reason other than "gradualism" for giving less credence to OPC's ROE analysis. Instead, OPC objects to the Chief Judge's decision to adopt Staff's allegedly "result-oriented approach" in reaching an ROE close to 9.5%.[6]

We discuss the parties' arguments and responses in the appropriate sections below. Additionally, we address *sua sponte* two findings in the Proposed Order pertaining to: 1) the adjustment for 8 months of post-test year reliability plant costs; and 2) the increase in customer charges. For the reasons stated herein, we affirm in part the Proposed Order, except with respect to: 1) the Company's authorized ROE; 2) capacity pricing mitigation; 3) disallowance of Delmarva's SERP costs; and 4) the customer

[5] OPC Appeal at 4.
[6] *Id.* at 17.

charges. We hereby modify the Proposed Order accordingly, and the Proposed Order shall be entered as final subject to the modifications stated herein. Our decisions on appeal authorize Delmarva a total revenue increase of no more than $38,267,710 to take effect on February 15, 2017.[7]

II. Commission Decision

C. AMI Deployment

Delmarva and OPC each appeal findings in the Proposed Order related to the Company's AMI deployment. Specifically, OPC objects to the Chief Judge's determination that Delmarva's AMI system is cost-beneficial. Delmarva, on the other hand, agrees with the cost-beneficial conclusion but argues that the Chief Judge failed to follow the Commission's historic method of calculating Dynamic Pricing capacity mitigation and should have also included calculated non-core AMI benefits from wholesale market improvements. We address these arguments in turn.

1. Cost-effectiveness of AMI

OPC claims that the Chief Judge erroneously included the avoided T&D costs derived from Delmarva's Dynamic Pricing program as an AMI benefit instead of the avoided T&D costs derived from its EMT program. OPC cites language in the Proposed Order expressly adopting Staff's calculation, which according to the Order included only

[7] Attachments I and II to this Order reflect our adjustments to Delmarva's net operating income, rate base, and revenue requirement.

EMT T&D costs and not DP T&D.[8] Delmarva disagrees and counters that the error in question is due to a scrivener's error in the Proposed Order—namely, where the Chief Judge referenced EMT T&D in her reasoning, the language should refer to DP T&D.[9] Delmarva explains that Staff's calculation, as corroborated by Staff Witness Hurley, includes DP T&D costs and not EMT T&D.

We find that Mr. Hurley's testimony supports Delmarva's explanation. Mr. Hurley described Staff's calculation as follows:

> The net present value for T&D is $18 million related solely to demand reductions related to the dynamic pricing program. Staff has excluded the Avoided T&D for the CVR and EMT programs from the Core benefit analysis.[10]

While we agree with Delmarva that the language on page 35 of the Proposed Order referring to EMT T&D should refer instead to DP T&D, this error is harmless. The AMI benefits calculation later reflected on page 42 of the Proposed Order correctly includes the calculated DP T&D benefits, as intended by Staff. Furthermore, even if we were to adopt OPC's proposed adjustment to align the language of the Proposed Order, the total benefit-to-cost ratio would be adjusted from 1.15 to 0.98, all else remaining equal. In our view, a ratio of 0.98 would be considered "break-even" and cost-beneficial, especially given OPC's position in a recent rate case that a benefit-to-cost ratio of 0.99 was close enough to be deemed cost-beneficial.[11] As the Chief Judge observed in the

[8] OPC Appeal at 6 (citing Proposed Order at 35).
[9] Delmarva Reply Mem. on Appeal at 5 (hereinafter "Delmarva Reply Mem. at ___").
[10] Staff Ex. 18 (Hurley Direct) at 27.
[11] *See* Case No. 9418, *In the Matter of the Application of Potomac Electric Power Company for Adjustments to its Retail Rates for the Distribution of Electric Energy*, Order No. 87884, at 19-20 (Nov. 15, 2016).

Proposed Order, we have not required utilities to establish a particular cost-benefit ratio, only that they demonstrate that their system is cost-beneficial—a pass/fail proposition. We need not address specifically whether Delmarva, Staff or OPC has provided a cost-benefit ratio closer to our own liking because doing so would be a moot analysis. Rather, we simply agree with the Chief Judge that Delmarva has "passed the test."

OPC contends, however, that further reductions in calculated benefits are warranted insofar as Delmarva's EMT load reductions can be achieved without AMI. Where OPC has asserted the same argument in other rate cases involving AMI recovery, we have consistently denied this argument. This case is no different. Here, the Chief Judge concluded, based on the record, that Delmarva's EMT program adds value to customers and enables them to save more energy.[12] Moreover, the various energy conservation tools provided under the program are not supported by legacy meters.[13] We see no reason to disturb the Chief Judge's findings.

Similarly, we are not persuaded by OPC's argument that the costs of credits paid in Delmarva's Peak Energy Savings Credit ("PESC") program should be included in our cost-benefit analysis. Despite renewing this argument in Delmarva's case, OPC did not offer any new evidence or argument to distinguish this case from the other rate cases previously decided by this Commission. Where OPC relies on the prior reports of Company witness Faruqui, we find that its interpretation of Dr. Faruqui's previous statements is incorrect, inapposite and contradicted by Dr. Faruqui's specific testimony in

[12] Proposed Order at 31-32.
[13] *Id.*

this case. For the aforementioned reasons, we deny OPC's appeal with respect to the cost-effectiveness of Delmarva's AMI deployment.

Although we hold that Delmarva has "passed" the cost-benefit test for AMI deployment, we are also mindful of the economic impact the additional cost of AMI will have on the monthly distribution bills of Delmarva's residential and commercial customers. These customers will want and anticipate concrete savings and value added by their new meters. Accordingly, we expect that Delmarva will continue to demonstrate and communicate to its customers that the AMI program will result in direct monetary benefits and continue to develop ways to increase the types and amounts of such benefits that customers can receive in the future.

We continue to believe AMI has great potential to give customers access to information, control, and cutting-edge services, some of which may be supplied by innovative third parties. As we indicated to BGE and Pepco in awarding their cost recovery for AMI, we will remain vigilant with regard to Delmarva fully utilizing smart grid technology to optimize its AMI investment. We expect the Company to ensure that its customers will realize a demonstrable return on their investment in smart grid innovation. We look forward to reviewing the Company's progress on this important customer issue.

2. Dynamic Pricing

The Proposed Order provides that Delmarva's calculation of capacity mitigation for Dynamic Pricing[14] is overstated, due to certain changes in PJM wholesale market

[14] Delmarva's Peak Energy Savings Credit Program utilizes AMI-enabled Dynamic Pricing to empower residential customers to earn $1.25 for each kWh reduced during select summer hours of high electricity

rules that will reduce revenue from the program after May 2020.[15] As a result of this finding, the Chief Judge rejected Delmarva's capacity mitigation calculation and accepted the alternative calculation proposed by OPC witness Chernick. In its Appeal, Delmarva argues that the Chief Judge erred by utilizing OPC's alternative capacity mitigation calculation because it has not been approved by the Commission.[16] In contrast to OPC's methodology, Delmarva observes that its capacity mitigation value was based upon calculations approved by the Commission in several prior proceedings. Delmarva concludes that if the Commission agrees with the Chief Judge that Dynamic Pricing benefits should be excluded after May 2020, the Commission should utilize the Company's properly calculated values up until the year 2020 and then exclude the benefits thereafter. Staff similarly states that the capacity mitigation calculations entered into the record by Staff and Delmarva witnesses were based on the methodology approved in the Commission's EmPOWER Maryland cases and reaffirmed in subsequent proceedings.[17]

We agree with Delmarva that the Proposed Order should have utilized the methodology employed by the Company and Staff in calculating Dynamic Pricing capacity mitigation benefits up until 2020. While we do not disturb the Chief Judge's finding that Delmarva has not sufficiently demonstrated Dynamic Pricing benefits after the year 2020 to quantify them for purposes of our cost-benefit analysis, the Proposed Order should have adopted the capacity mitigation methodology approved by the

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demand. DPL Ex. 5 (Lefkowitz Direct) at 4. All Delmarva residential customers with activated AMI meters became eligible for the PESC Program during the summer of 2014. *Id*. at 48.

[15] Proposed Order at 38.

[16] Delmarva Mem. on Appeal at 19 (hereinafter "Delmarva Appeal at ___").

[17] Staff Reply Mem. at 13.

Commission for capacity mitigation benefits up until that year. The Commission approved the calculation in the EmPOWER Maryland cases[18] and reaffirmed the use of the methodology in BGE's most recent rate case.[19] Furthermore, the Commission recently denied OPC's Petition for Rehearing challenging the reasonableness of the methodology, finding that the calculation was not based on unreasonable assumptions.[20] Utilizing the Commission-approved methodology for calculating the value of capacity price mitigation benefits until 2020 increases the AMI benefit by $8,314,000 on a net present value basis.

3. Non-Core AMI Benefits

Delmarva argues on appeal that the Chief Judge failed to consider certain non-core AMI benefits—namely, wholesale market efficiency improvements arising from AMI-enabled hourly energy market settlements—in her overall calculation of AMI benefits.[21] According to Delmarva, these hourly settlements will lead to "reduced pricing hedge premiums and lower prices for Maryland customers," a benefit purportedly valued at $27.1 million on a net present value basis.[22] OPC in its Reply objects to these benefits, arguing that Delmarva waited until the evidentiary hearing to introduce the asserted benefits and that the Company's analysis was skewed.[23]

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[18] *See* Order Nos. 87082 and 87213.
[19] Case No. 9406, *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustments to its Electric and Gas Base Rates*, Order No. 87591 at 61 (Errata) (June 3, 2016) (rejecting OPC's proposal to use a different methodology for measuring capacity price mitigation benefits and highlighting the importance of using "consistent methodologies across energy conservation and demand response programs").
[20] Case No. 9153, *In the Matter of the Potomac Edison Company d/b/a Allegheny Power's Energy Efficiency, Conservation and Demand Response Programs Pursuant to the EmPOWER Maryland Energy Efficiency Act of 2008*, Order No. 87213 (Oct. 26, 2015).
[21] Delmarva claims that neither Staff nor OPC credibly challenged these benefits and the Company's calculations until their reply briefs filed after the evidentiary hearings. Delmarva Appeal at 17-18.
[22] Delmarva Appeal at 17.
[23] OPC Reply Mem. at 9-10.

Because we have already determined that Delmarva's AMI program is cost-beneficial, and therefore has "passed the test," it is unnecessary to further quantify the Company's purported benefits from market efficiency improvements. We nonetheless continue to urge our utilities to find non-core benefits associated with AMI.

D. Rate-making Adjustments

1. Merger Synergy Savings and Costs-to-Achieve

Delmarva claims that the Proposed Order abandons our "historical symmetrical treatment of merger synergies and costs-to-achieve" by adopting Staff's recommended adjustment, which purportedly creates an asymmetrical, annual "average net savings" derived from the estimated synergy savings from the first five years (post-merger) and a portion of actual and future costs to achieve.[24] Delmarva further argues that this approach "ignores the [Commission's] long standing position on known and measurable costs" in view of the fact that the Commission found those same synergies insufficiently reliable to constitute a benefit in the PHI-Exelon merger proceeding.[25] Lastly, Delmarva contends that Staff selectively excluded $1 million of costs-to-achieve, and its recommended adjustment would "result in a reduction of revenues which would exceed the expected merger savings in the early years of the five-year review period."[26] In the alternative, if the Commission affirms the Proposed Order on this issue, Delmarva requests clarification with regard to amortizing the total merger costs and savings over five years and approval to establish a regulatory asset to track merger costs and savings benefits.

[24] Delmarva Appeal at 10.
[25] *Id.*
[26] *Id.* at 11.

OPC in its Reply argues that while the Company incurs costs-to-achieve before the rates in this case go into effect, synergy savings are also being realized.[27] Specifically, Delmarva will realize approximately one year of synergy savings—or $2 million—prior to the rate effective date. Moreover, OPC notes that the synergy savings were promised in the merger case as a condition of our approval of the merger.[28]

Staff argued in the below proceeding that the Company's adjustment "tends to backload the projected synergy savings and front load the [costs-to-achieve]."[29] In view of this argument, the Chief Judge rejected the Company's adjustment in favor of Staff's.[30] We agree. The adjustment adopted in the Proposed Order is the one that will best ensure that Delmarva ratepayers receive the same levelized savings irrespective of when the Company files its next rate case. Furthermore, as noted in the Proposed Order, this approach comports with our treatment of the same synergy savings and costs-to-achieve for Pepco in Case No. 9418. The Chief Judge did not find "any evidence in this record to make a ruling different than that of the Commission in Case No. 9418."[31] Likewise, on appeal, Delmarva has not persuaded us otherwise. Accordingly, we affirm the Proposed Order on this adjustment.

With regard to Delmarva's request in the alternative for "clarification regarding the mechanism for compliance to amortize the total merger costs and savings over five years[,]" we look to the Proposed Order and note, as OPC did in its Reply, that Staff did not amortize the total merger costs and synergy savings over five years. Instead, Staff

[27] OPC Reply Mem. at 2-3.
[28] *Id*. at 3.
[29] Proposed Order at 60 (citing Staff Initial Brief at 13).
[30] *Id*. at 61.
[31] *Id*.

averaged the synergy savings over five years. Thus, we find no further clarification on this point is needed.

2. SERP

On appeal, OPC argues that the Proposed Order erred in limiting the disallowance for SERP expense to only 50% "for due process reasons."[32] The Chief Judge adopted Staff's and OPC's original recommendations for 50% disallowance and noted that Staff and OPC later changed their positions and recommended 100% disallowance in their initial briefs, filed after the conclusion of the evidentiary hearing in this matter. The Chief Judge approved the 50% reduction, explaining that "this is the amount that Delmarva knew could be disallowed based on the evidence in the record at the close of the evidentiary hearing."[33]

OPC disagrees with the Chief Judge's finding that no prior "admonition" had been made to Delmarva prior to this case that SERP expenses would remain an evolving issue for future resolution. Instead, OPC contends that Delmarva's parent company, PHI, "was on *actual* notice of the Commission's admonition about SERP costs."[34] Notice was therefore imputed to the Company because Delmarva is a subsidiary of PHI. Delmarva supports the Chief Judge's decision and reasoning.

We find that OPC's reasoning sufficiently addresses the notice and due process

[32] *See* OPC Appeal at 13-14.
[33] Proposed Order at 69-70.
[34] OPC Appeal at 14 (original emphasis); *see also* Case No. 9336, *In the Matter of the Application of Potomac Electric Power Company for Adjustments to its Retail Rates for the Distribution of Electric Energy*, Order No. 86441, at 59-60 (July 2, 2014) (noting that other neighboring jurisdictions had already disallowed 100% of SERP expenses and stating that "the appropriate funding of SERP costs continues to be an evolving issue that [the Commission] will continue to review in future cases").

concerns raised in the Proposed Order. As stated in the Proposed Order, Delmarva's SERP expenses "flow from the very same PHI SERP that applies to the PHI and Pepco executives" and are "no different than those incurred by its sister company, Pepco."[35] Given that both Delmarva and Pepco use the same PHI SERP plan, notice to PHI that the Commission's disallowance could be 100% placed Delmarva on constructive notice that it would be required to demonstrate that its SERP program offered direct benefits to Maryland ratepayers. This is consistent with our treatment of Pepco's SERP costs in Case No. 9418.

In Case No. 9418, we disallowed 100% of Pepco's SERP-related costs largely because Pepco failed to meet its burden of proof.[36] Here, the Chief Judge assessed and reached the same conclusion as to Delmarva. There is no evidence in the record to support the Company's contention that it or PHI would not be able to attract highly qualified executives without offering SERP as part of the executive compensation package. Like Pepco, the Company failed to provide any analysis to support its position on this adjustment. Based on these findings, we agree with the Chief Judge in conclusion only that Delmarva has not met its burden of proof. However, we do not see why Delmarva's ratepayers should bear any portion of the Company's SERP expenses. Accordingly, and in keeping with our recent decision concerning the same flow-down benefit, we grant OPC's appeal on this issue and modify the Proposed Order to disallow 100% of Delmarva's SERP-related costs.

[35] Proposed Order at 68.
[36] In Case No. 9418, the Commission also considered the fact that two neighboring jurisdictions—D.C. and Delaware—similarly disallowed 100% of Pepco's SERP-related costs. Order No. 87884 at 53.

3. Post Test-Year Reliability Plan Adjustment

In the Proposed Order, the Chief Judge accepted for the rate-effective year two uncontested adjustments pertaining to reliability plant additions. Adjustment No. 14 adjusts the rate base for plant additions related to distribution reliability through the end of the historical test period, or March 31, 2016. Adjustment No. 15 adjusts the reliability plant balances for another eight months, post-test period, through November 2016. While no party appeals the Proposed Order's reliability plant adjustments, we find it appropriate to briefly clarify post-test period reliability plant recovery (Adjustment No. 15) in light of our continued emphasis on the historic test year requirement.

It is true that we have made exceptions to our historic test period methodology in prior rate cases to allow limited recovery of post-test period reliability investments made and placed into service prior to the evidentiary hearings. Although we do not disturb the finding of the Chief Judge, it should be clearly understood by the parties that the Commission is not abandoning the test year requirement. As we have stated in other rate cases, allowance of post-test period reliability expenses is an *exception* to the rule of allowing recovery only of reliability investments for the historical test period. We departed from traditional ratemaking principles in order to incentivize companies that exhibited poor reliability performance to make the necessary reliability infrastructure investments in an accelerated manner without having to wait until the next rate case. We never intended for this exception to be deemed as guaranteed or automatic. Hence, we will continue to closely examine these requests on a case-by-case basis. Moreover, we expect the same scrutiny by the utility companies, Staff and OPC in future rate matters.

E. Depreciation

1. Net Salvage

The Chief Judge concluded that Delmarva failed to meet its burden of proof with regard to its net salvage accrual rates, given that the Company used proprietary software to calculate results that the other parties could not reproduce.[37] On appeal, Delmarva disputes this finding and argues that the Company disclosed the applicable formulas and supporting calculations for its net salvage accrual rates, consistent with the Commission's statement in Case No. 9096 that supplying the formulas was adequate. Thus, according to Delmarva, all parties had access to the information needed to duplicate the Company's net salvage accrual rates. OPC disagrees with this contention and further distinguishes the facts of Case No. 9096 from this case, arguing that Staff's witness in the former disclosed substantially greater information:

> In Case No. 9096, [Staff's witness] provided, in a filed schedule, a complete calculation of the [Statement of Financial Accounting Standards No.] 143 net salvage calculations for one account, showing the complete formulae for each individual column in a spreadsheet calculating SFAS 143 present value net salvage.[38]

Although Delmarva contends that it has satisfied its burden of proof simply by providing formulas and calculations supporting its rates, we disagree. As the Chief Judge correctly stated in the Proposed Order, the Company "has the burden of proof to justify any costs for which it seeks recovery from ratepayers" and, therefore, "has the burden to demonstrate the accuracy of its analysis, including how it arrived at its recommended net

[37] Proposed Order at 100.
[38] OPC Reply Mem. at 5.

salvage accrual rates."[39] We share the Chief Judge's concern that Delmarva chose to rely on proprietary software for its rates. Use of such software impairs our ability to test the Company's data. While Delmarva may have provided key formulas and calculations to the parties, the reality is that no one else was able to replicate the Company's results, including Staff.[40] Because Delmarva has not convinced us that it has satisfied its burden of proof, we deny the Company's appeal on this issue.

2. Rebalancing Depreciation Reserves

Delmarva also argues that the Chief Judge improperly denied its request to rebalance the depreciation reserve accounts when, according to the Company, rebalancing is necessary because of "significant changes impacting depreciation" since the last rebalancing in 2012. Delmarva refers to certain changes directed by the Commission in Case No. 9285,[41] wherein the Commission reviewed for the first time Delmarva's implementation of SFAS 143 present value net salvage calculations since the Commission changed methods for estimating future net salvage in Case No. 9093.[42]

We have generally opposed rebalancing depreciation reserves unless there have been significant changes that have occurred in recent cases affecting both depreciation rate formulations and account reserves. In Case No. 9285, we agreed with Delmarva that significant changes had occurred—namely, the implementation of the Present Value

[39] Proposed Order at 100.
[40] OPC argues in its Reply that Delmarva failed to reveal the SFAS 143 calculations themselves. OPC Reply Mem. at 5.
[41] *See generally* Case No. 9285, *In the Matter of the Application of Delmarva Power & Light Company for Authority to Increase its Rates and Charges for Electric Distribution Service*, Order No. 85029 (July 20, 2012).
[42] In Case No. 9093, the Commission addressed how future net salvage should be estimated for Delmarva, rejecting the Straight-Line Method in favor of the Present Value Method. *See* Case No. 9093, *In the Matter of the Application of Delmarva Power and Light Company for Authority to Revise its Rates and Charges for Electric Service and for Certain Rate Design Changes*, Order No. 81518, at 17 (July 19, 2007).

Method—which affected both depreciation rate formulations and account reserves. We held that under those circumstances "it [was] appropriate to rebalance depreciation account reserves prospectively in order to align those reserves with expected future retirements and salvage accruals."[43] We cautioned, however, that "it may not be necessary or appropriate in every instance to adjust account reserves."[44]

In the Proposed Order, the Chief Judge found that rebalancing was unnecessary in this instance given that there have not been any significant changes since 2012 to justify rebalancing.[45] We agree. Delmarva does not recommend or indicate any recent changes to the previously approved depreciation system.[46] Instead, the Company generally notes our methodology requirements in Case No. 9285, the passage of time since the last rebalancing, and certain parameter adjustments proffered by Company Witness White. However, the mere passage of time and general compliance with our Present Value Method requirement do not, by themselves, reflect the type of significant changes in the Company's depreciation accounting that would warrant adjusting account reserves. We therefore deny the Company's appeal on this issue.

Lastly, Delmarva brings to our attention a discrepancy between the Chief Judge's acceptance of Staff's recommended net salvage rates and the subsequent denial of the Company's request to rebalance the depreciation reserves. According to Delmarva, Staff did not object to Dr. White's redistribution of the Company's depreciation reserves in his 2015 depreciation study. Instead, Staff based its recommended net salvage rates, in part,

[43] Order No. 85029 at 55.
[44] *Id*.
[45] Proposed Order at 106.
[46] Proposed Order at 103.

on those rebalanced reserves.[47] To resolve the conflict, Delmarva asks the Commission to adopt the Company's formulation of net salvage accrual rates. OPC does not dispute the discrepancy but recommends that the Commission direct Staff to recalculate its net salvage rates based on recorded book depreciation reserves instead of Dr. White's rebalanced reserves. Staff does not take a position. Delmarva and OPC agree that the "correct" formulation of net salvage accrual rates—i.e., one that excludes the impact of rebalancing reserves—is not in the record of this proceeding.

Our decision to affirm the Chief Judge's denial of Delmarva's rebalancing request does not directly bear on Staff's net salvage rate calculations but, rather, implicates Staff's depreciation rates, which according to Staff Witness Smith were based on Dr. White's theoretical rebalancing of depreciation reserves. Mr. Smith testified that he used the approved SFAS 143 Present Value Method to develop his recommended net salvage rates and used the net salvage percentages proposed in Dr. White's depreciation study.[48] Mr. Smith did not use Dr. White's proposed rates and amounts. It is only with regard to Staff's depreciation rates that Mr. Smith stated he used Dr. White's redistributed reserve calculations to calculate his own redistributed reserve amounts.[49] The Chief Judge voided Dr. White's rebalanced reserve calculations, however, which we affirm on appeal. Whereas the record of this proceeding does not discuss the formulation of rates without the rebalancing of the reserve accounts, we believe that the appropriate calculation of depreciation rates, in view of the rebalancing denial, should be based on the Company's recorded book depreciation reserves.

[47] Delmarva Appeal at 16.
[48] Staff Ex. 24 (Smith Direct) at 4.
[49] Smith Direct at 9.

On appeal, Delmarva provides "corrected" depreciation rates for Staff, based upon book depreciation reserve amounts.[50] We find these revised depreciation rate calculations sufficiently resolve the conflict in the Proposed Order. Under the revised rates, Delmarva's depreciation adjustment increases to $4,628,734. This in turn reduces the Company's net operating income and increases its total revenue requirement.[51]

F. Return on Equity

Delmarva and OPC separately allege that the Chief Judge improperly set Delmarva's ROE at 9.48%, a 33-basis point reduction from the Company's current ROE of 9.81%. Delmarva argues that the authorized ROE is inconsistent with purported Commission precedent recognizing that "a utility's electric operations present a slightly elevated risk to investors compared to natural gas operations, and investors in the electric utility will therefore require a slightly higher return to compensate for that risk."[52] Delmarva further argues that a 30-basis point reduction in its ROE is further inconsistent with the Commission's emphasis on gradualism and recent increases in short-term and long-term interest rates.[53]

OPC argues that the Chief Judge erred in adopting Staff's recommended ROE, which OPC Witness Woolridge criticized as "results-oriented." OPC also objects that the Proposed Order gave less credence to Dr. Woolridge's analysis and testimony that

[50] *See* Delmarva Appeal, Attachment B.
[51] In finalizing the Order, we noted that a typographical error occurred in the exhibits in the record related to calculating the annualized depreciation expense. In some instances, the net salvage value was not added to the plant accrual rate; thus, the revenue requirement in the Proposed Order was approximately $4 million too low, which we correct herein.
[52] *See* Delmarva Appeal at 3 (quoting Case No. 9299, *In the Matter of the Application of Baltimore Gas & Electric Company for Adjustments to its Electric and Gas Base Rates*, Order No. 85374, at 77 (Feb. 22, 2013)).
[53] Delmarva notes that the Federal Reserve increased its short-term interest rates on December 14, 2016.

"authorized ROEs for distribution-only electric utilities (like Delmarva) have been about 20 basis points below those for integrated electric utilities."[54]

We find that Delmarva's reliance on our comparative risk observations in BGE's rate cases is misguided. Our comments in Case No. 9299[55] and again in Case No. 9406[56] were intended to distinguish between BGE's electric and gas distribution operations because "combining BGE's separate operations to produce a single return for the Company would lead to cross subsidization of services."[57] Unlike BGE, however, Delmarva has no gas distribution operations. Likewise, Delmarva's assertion that we must treat it the same as BGE in this instance is equally untenable. Delmarva has not pointed us to, nor are we aware of, any rule, regulation or precedent that would require us to grant the Company the same ROE as another electric utility or one higher than any gas utility in Maryland.

We turn now to consider the salient question of whether the authorized ROE of 9.48% should be affirmed. The Chief Judge thoroughly reviewed and discussed the parties' respective ROE methodologies. Their respective ROEs and ROE ranges can be summarized in the following table:

[54] OPC Appeal at 17 (citing OPC Ex. 18 (Woolridge Direct) at 8).
[55] Case No. 9299, Order No. 85374.
[56] Case No. 9406, Order No. 87591.
[57] Order No. 85374 at 77.

Method	Delmarva	Staff	OPC
DCF (Constant Growth)	8.89% to 9.72%	9.36%	8.40% to 8.70%
DCF (Multi-Stage)	9.40% to 10.99%	n/a	n/a
CAPM	9.14% to 12.99%	9.61%	7.90% to 8.0%
ECAPM	10.16% to 13.65%	n/a	n/a
Risk Premium	10.04% to 10.47%	n/a	n/a
Flotation Adjustment	12 bp	n/a	n/a
ROE Recommendation	10.60%	9.48%	8.60%

The Chief Judge also considered among other things the Company's risk profile, the capital market environment, the equity returns authorized by other jurisdictions, and the fact that Delmarva will not issue its own stock. Despite the Chief Judge's thoughtful considerations, it is concerning to us that the adopted ROE represents a 33-basis point reduction in the Company's current ROE. We have historically followed principles of gradualism when implementing major rate design changes, noting more recently that implementing gradual movement in lowering a utility's ROE could be appropriate "to lessen the impact on the company and investors."[58] As to Delmarva, we do not fault the Chief Judge's reasoning and decision to reject Delmarva's requested ROE in favor of a lower ROE. However, we find that gradualism warrants a lesser reduction in Delmarva's ROE. Consequently, we find that an ROE of 9.60% is both adequate and appropriate for Delmarva, considering the risks associated with its electric distribution

[58] *See* Order 87884 at 101.

operations in Maryland, the capital market conditions at the time of this proceeding, and the fact that Delmarva does not issue its own stock.

On appeal, Delmarva does not oppose removing the six-basis point flotation adjustment previously awarded to the Company in Case No. 9285, as it would be consistent with our ROE award to Pepco in Case No. 9418.[59] In the Proposed Order, the Chief Judge denied Delmarva's request for flotation costs because Delmarva does not issue its own stock and is now a component of Exelon. We agree and further find that the previous flotation adjustment of six basis points awarded to Delmarva is no longer appropriate. This does not end our discussion, however.

The Chief Judge also reasoned that an ROE around 9.5% would be consistent with the approved equity returns in other jurisdictions as well as the Commission's authorized ROE of 9.55% for Pepco. In its Reply Memorandum, Staff indicated that the national averages for authorized ROEs were 9.6% in 2015, 9.52% during the first six months of 2016, and 9.64% for the first nine months of 2016.[60] An ROE of 9.60% therefore matches the average authorized ROE in 2015 and is within four basis points of the average ROE for two-thirds of 2016.

We previously held in Case No. 9418 that current market conditions favored a cost of equity lower than 9.62%. Here, the Chief Judge reached similar conclusions in rejecting the Company's requested ROE. She gave little weight to Delmarva Witness

[59] *See id*. at 100. In Case No. 9418, we also considered the risks associated with Pepco's electric distribution operations in Maryland and the then-current market environment.

[60] Staff Reply Mem. at 10. In response to Delmarva's comparative risk argument, Staff explains that "a higher ROE for electric utilities as compared to gas utilities is often justified, in part, due to the higher risks faced by electric utilities that own and operate power plants (referred to here as integrated utilities); these integrated utilities are in States where the utilities have not been required to divest their power plants." *Id*. at 11.

Hevert's predictions of an upward trend in interest rates.[61] We are similarly unpersuaded by Delmarva's argument that the Chief Judge should have considered the recent change in Federal Reserve rates. The noted interest rate change occurred after the close of the evidentiary record in this case. Moreover, as the Chief Judge concluded, the increase in the Federal Reserve rate "is small and not enough to justify the increase in Delmarva's ROE proposed by [the Company]."[62] Given the above-stated ROE trends and record evidence supporting the Chief Judge's conclusions regarding Delmarva's risk profile and financial strength, we believe the market can sustain an ROE of 9.60%. It is unlikely that the ROE we authorize for Delmarva will deter investors of Exelon or hurt the Company's access to credit.

We also find that an ROE of 9.60% falls within Delmarva's Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") ranges and, in particular, toward the upper end of the Company's constant growth DCF range. Although Staff witness VanderHeyden did not provide separate ROE ranges for his DCF and CAPM calculations, his DCF and CAPM ROE calculations effectively represent the upper and lower boundaries for his recommended ROE, which is an average of his two calculations. An ROE of 9.60% also falls within these boundaries, albeit closer to Mr. VanderHeyden's CAPM calculation.[63]

[61] Proposed Order at 152-53.
[62] *Id*. at 153.
[63] This should not be interpreted as any preference by this Commission for the CAPM method of calculating the cost of capital. Indeed, we have repeatedly stated that we are unwilling to rule that there can be only one correct method for calculating an ROE. *See, e.g.*, Order No. 87884 at 97.

Finally, this ROE further complies with the standards for *Bluefield*[64] and *Hope*[65]. It is comparable to the returns investors can expect to earn on investments of similar risk in the current market. It is sufficient to assure confidence in Delmarva's financial integrity and enable the Company to receive a fair return commensurate with its risk. It is further adequate to sustain Delmarva's credit so that the Company can continue to attract needed capital at reasonable rates and provide safe and reliable service to customers.

G. Rate Design and Customer Charge

In its application, Delmarva proposed that the fixed customer charge for the residential class be increased to $12.00 per month, with the remaining revenue requirement for residential service to be recovered through seasonal volumetric rates. For each of the non-residential classes, Delmarva proposed that the increase in the revenue requirement be apportioned to gradually shift the recovery of distribution costs from the volumetric rate component to the customer and demand charge components.[66] In contrast, Staff did not support an increase to the residential customer charge and recommended that the fixed charges for the other schedules not go beyond the percentage increase in the new revenue requirement.[67] Nevertheless, because the Chief Judge found that the Base Cost of Service Study ("COSS") submitted by Delmarva inappropriately allocates AMI meter costs as customer-related, she rejected the Base COSS for use in the

[64] *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 692-93 (1923).
[65] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).
[66] DPL Ex. 22 (Santacecilia Direct) at 11.
[67] Staff Ex. 28 (Blaise Direct) at 18.

rate design and accepted in its place OPC's method of allocating the revenue requirement.[68] OPC's methodology resulted in an increased customer charge for the residential class of $9.49 per month.[69] Although the Chief Judge acknowledged that the Commission generally prefers increasing the volumetric rates of residential customers rather than the fixed customer charge, she determined that a customer charge of $9.49 per month was not unreasonable.[70]

We find that the Chief Judge's proposed increase in the residential customer charge is excessive. Augmenting the customer charge from the current $7.94 to the proposed $9.49 represents a significant percentage increase of nearly 20% and could interfere with important Commission policy goals that have been consistently emphasized in Commission decisions. See, for example, Order No. 86994 (reversing the decision of the Public Utility Law Judge to raise Choptank's residential customer charge from $10 to $17 per month, finding that an increase of $1.25 per month was "more consistent with the principle of gradualism").[71]

In Pepco's most recent rate case, we rejected the company's proposal to elevate its customer charge from $7.39 to $12.00. We found instead that the charge should be set at $7.60, representing a modest 2.84% increase.[72] In that case, we stated that determining the appropriate customer charge is not an exact science, but rather requires the balancing

[68] Proposed Order at 173.
[69] *Id*. at 182.
[70] *Id*.
[71] Case No. 9368, *In the Matter of the Application of Choptank Electric Cooperative Inc. for Authority to Revise its Rates and Charges for Electric Service*, Order No 86994, at 7 (May 21, 2015).
[72] Order No. 87884 at 110-11.

of several important considerations. For example, the Commission places emphasis on Maryland's public policy goals that encourage energy conservation and efficiency. We also found that maintaining relatively low customer charges "provides customers with greater control over their electric bills by increasing the value of volumetric charges."[73] In contrast to volumetric rates, no matter how hard customers attempt to conserve energy or respond to the incentives created by newly installed AMI meters, they cannot reduce fixed customer charges.[74] Additionally, we expressed concern with how fixed charges would impact low income customers. Finally, we observed that low customer charges provide value to net metering customers, because utility tariffs allow customers to net the energy produced by their qualifying energy systems against the volumetric portion of their bills, but not their fixed monthly customer charges.[75]

In order to preserve these important public policy objectives, and to be consistent with the customer charges approved in other proceedings,[76] we authorize Delmarva to increase its residential customer charge to $8.17. That figure represents a 2.84% increase from the Company's existing charge of $7.94—the same percentage increase we allowed in the Pepco rate case.[77] The rest of the revenue requirement allocated to the residential customer class will be collected through the residential class' volumetric rates. Similarly, with respect to the non-residential customer classes, we direct that the fixed charges

[73] *Id*. at 110.
[74] During the public hearings in this matter, customers expressed concern that they could not act to decrease the fixed cost portion of their bills. *See* Oct. 25, 2016 Public Hr'g Tr. at 26 ("captive customers … can't avoid the increases in the standing delivery distribution charges….") and Oct. 27, 2016 Public Hr'g Tr. at 20, 26 (noting that customers consider a variety of measures to decrease energy bills, including purchasing efficient appliances, insulating their homes, and decreasing the use of lights).
[75] Order No. 87884 at 111.
[76] The currently authorized residential customer charges in Maryland are the following: BGE: $7.90; Choptank: $11.25; Pepco $7.60; Potomac Edison: $5.00; and SMECO: $9.50.
[77] Case No. 9418, Order No. 87884 at 111.

(customer and demand charges) *each* increase by 2.84%, with the rest of the revenue requirement attributable to each class to be collected through each class' respective volumetric rates.

III. Conclusion

After considering the evidence in the record, we find that the Proposed Order should be affirmed in part and reversed in part. For the reasons stated herein, the Proposed Order is modified accordingly, consistent with this Order.

IT IS THEREFORE, this 15th day of February, in the year Two Thousand and Seventeen, by the Public Service Commission of Maryland,

ORDERED: (1) That the Proposed Order of the Chief Public Utility Law Judge, issued on January 4, 2017, is affirmed in part and reversed in part, and modified accordingly consistent with the findings of this Order;

(2) That Delmarva Power and Light Company's ("Delmarva") Appeal of the Proposed Order is hereby granted in part and denied in part, consistent with the reasons stated herein;

(3) That the Office of People's Counsel's ("OPC") Appeal of the Proposed Order is hereby granted in part and denied in part, consistent with the reasons stated herein;

(4) That Delmarva is hereby directed to file tariffs for the distribution of electric energy in Maryland, which shall increase rates by not more than $38,267,710, for service rendered on or after February 15, 2017, subject to acceptance by the Commission,

consistent with the findings of the Proposed Order, as modified herein; and

(5) That all motions not granted herein are denied.

/s/ W. Kevin Hughes

/s/ Harold D. Williams

/s/ Jeannette M. Mills

/s/ Michael T. Richard

/s/ Anthony J. O'Donnell
Commissioners

Attachment I

DELMARVA POWER & LIGHT COMPANY
CASE NO. 9424

Operating Income

Per Book Balance	$26,630,799
Uncontested Adjustments	461,551
Uncontested Balance per Proposed Order	$27,092,350
Pro Forma Wage And FICA Expense	$ (603,388)
Amortized Rate Case Expenses	$ (41,947)
ProForma Uncollectibles Expenses	$ 542,344
Reflect New Depreciation Rates	$ (4,628,734)
Amortization of AMI Regulatory Asset	$ (3,674,077)
Amortization of Legacy Meters	$ (925,054)
Reflect Merger Synergies Net of CTA	$ 2,388,846
Remove 50% of Employee Act. Expenses	$ 109,320
Remove 100% of Serp Expenses	$ 585,250
RE-amortize Hurricane Irene Expenses	$ 447,248
RE-amortize COPCO Acquisition Expenses	$ 2,788,880
Amortization - Solution One Transition Expense	$ 767,283
Annualize Late Payment Revenues	$ 72,366
Interest Synchronization	$ 428,319
Net Operating Income	**$ 25,349,006**

Attachment II

DELMARVA POWER & LIGHT COMPANY
CASE NO. 9424

Revenue Requirement

Rate Base	$ 707,246,234
Rate of Return	6.74%
Required Income	$ 47,668,396
Adjusted Income	$ 25,349,006
Income Deficiency	$ 22,319,390
Conversion Factor	1.71455
Revenue Requirement	**$ 38,267,710**

Rate Base

Per Books Balances	$ 654,011,714
Uncontested Adjustments	
Uncontested Balance per Proposed Order	$ 690,940,503
New Depreciation Rates	$ (466,048)
Amortization of AMI Regulatory Asset	$ 11,337,086
Reflect Synergies and CTA	$ 2,467,651
Adj. COPCO Acquisition Amortization	$ 2,788,880
Amortization - Solution One Transition Expense	$ 863,194
Pro Forma Cash Working Capital Allowance	$ (685,032)
Adjusted Rate Base	**$ 707,246,234**