

Attachment A

Background Information

Traditional Cost of Service

The test period includes six months of actual data (July 1, 2018 to December 31, 2018) and six months of projected data (January 1, 2019 through June 30, 2019). Pepco proposes to increase existing retail rates for electricity distribution service in the District of Columbia by \$88.6 million representing an increase of approximately 22% in Pepco's distribution revenues. According to Pepco, the primary driver for the rate increase includes improving reliability, modernizing the distribution system, providing tools to assist customers in managing their energy usage, and advancing policy goals on reliability, resiliency, clean energy integration and addressing climate change. Pepco's earning is also significantly less than the authorized return on equity (ROE).¹

The requested rates are designed to collect \$489 million in total distribution revenues.² Pepco's proposal would add about \$9.55 to the monthly bill of the typical residential customer, who uses about 692 kilowatt-hours of electricity per month. Currently, the Customer Base Rate Credit (CBRC) is used to offset the customer charge levels for the Residential, MMA, GS ND, GS LV, GS 3A and TN classes. The current level will continue until it expires for these classes. No CBRC will be used to offset the proposed rate increases. In addition, Pepco proposes an overall rate of return of 7.81%, including 10.30% ROE, on a proposed rate base of \$2.184 billion³. Pepco's proposed test year in this proceeding is the 12 months ending June 30, 2019, based on 6 months of actual data and 6 months of forecasted data. Pepco requests that the new rates become effective on May 1, 2020.

Pepco's proposal in F.C. No. 1156 includes:

- Rate case related merger commitments;
- A Lead-lag study;
- An Appliance Saturation Study;
- A Weather Normalization Study;
- Merger related synergies and Costs to Achieve;⁴
- Test year and post-test year reliability projects (RM #1, #2, #3, #4 and #28); and
- Other cost of service items listed on Pepco (D)-1.

With regard to rate design, Pepco's proposal⁵ includes:

- Revenue allocation consists of three analyses: (1) Class Rates of Return Analysis; (2)

1 According to Pepco, its June 30, 2019 unadjusted earned ROE is only 5.81%, which is significantly below the authorized ROE of 9.525%, Pepco (B) at 50.

2 See Pepco (F)-12, page 2.

3 Pepco (D)-1, page 1.

4 RMA 34 referred to in Pepco (D)-1, at 3.

5 See Pepco (F), Witness Blazumas' testimony. Current RORs for R is -4.9%, for MMA is 8.9%. The other negative ROR class includes SL-E at -5.1%. At the high end, ROR for GS-3A is 23.4% and for TN is 17.3%. See Pepco (F) at 21.

Four-Step Method Revenue Allocation Analysis; (3) Proposed Rate Schedule Revenue Requirement;

- Increasing both customer charge and volumetric charge for the Residential (R) class with customer charge increasing from \$15.09 to \$18.86 per month, no demand charge is proposed;
- Recommending the continuation of a two-part MMA rate schedules for Master Metered Apartment (MMA) customers and an increase in both volumetric and customer charges;
- The customer charge for MMA will increase from \$11.84 to \$13.95;
- Continuing to apply the Bill Stabilization Adjustment (BSA);
- Through a four-step process, and historical allocations to different rate classes, Pepco allocates 35.09% of total revenue increase to the R class and allocates 2.1% of total revenue increase to MMA class.⁶ The unitized rate of return (UROR) for the classes would be moving closer to 1.0. Class ROR disparities are also reduced. For classes with URORs considered as extremely high as outliers such as GS-3A and TN classes, Pepco is not proposing any revenue increase;
- Based on the above revenue allocation, 37% of the revenue increase will be allocated to residential classes (R and MMA);
- Current Customer Base Rate Credit (CBRC) balance is around \$10.5 million after excluding the \$8.3 million reserved for senior and disabled citizen class. CBRC for residential (R) class will expire March 2021 and for MMA it will expire April 2025. No changes in CBRC per customer level is proposed;⁷
- A new tariff for senior citizens and disabled class to provide a \$7.50 credit monthly starting around February 2020;⁸ and
- A Weather-Normalization Study, and an updated Appliance Saturation Study.

With regard to Pepco's Distribution Construction Program and Reliability Projects, Pepco's proposal includes:

- Detailed description for the reliability and non-reliability projects in response to the Commission's checklist specified in Order No. 16930, paragraph 485 and Order No. 17424, paragraph 520;⁹
- Cost recovery for multiple reliability projects included in Pepco (D) witness Ziminisky's testimony and Pepco (I) witness Clark's direct testimony which are included in Ratemaking Adjustments #1, #2, #3, #4 and #28;
- Plans to invest roughly \$1.591 billion in distribution capital over the next five years (2019-2023) in the District of Columbia. This includes Customer Driven, Reliability and Load projects from 2019-2023¹⁰; and
- Over the five-year period, Pepco anticipates investing \$943.2 million in the District of Columbia for planned reliability-related projects.

6 Pepco (F) at 19 and 20.

7 Pepco (F) at 49.

8 Pepco (F) at 36.

9 Pepco (I)-1.

10 Pepco (I) page i.

Performance Based Ratemaking: MRP and PIM

Pepco has identified a first-year revenue requirement increase of \$107 million reflecting a \$2.21 billion average rate base for a calendar 2020 test year, a second-year incremental revenue requirement increase of \$24 million, incorporating a \$2.37 billion average rate base for a calendar 2021 test year and a final incremental revenue requirement increase of \$31 million, with an average rate base valued at a \$2.57 billion for a calendar 2022 test year.¹¹ However, Pepco proposes to implement a “smoothing adjustment” to more evenly spread out the rate increase over a three-year period and mitigate the potential first-year rate impacts.¹² With the smoothing adjustment, Pepco is requesting \$85 million increase in 2020, \$40 million in 2021 and \$37 million in 2022. The Residential monthly bill impact for these three years are: \$8.57 increase on May 1, 2020, \$3.69 increase on January 1, 2021 and \$3.19 increase on January 1, 2022.¹³ Under the MRP, projected earned ROE for 2020 is 7.10%, 9.99% for 2021 and 10.30% for 2022.¹⁴

Pepco states that the Company cannot remain in a position to address emerging challenges on its distribution system without alignment between costs and revenues. The MRP improves the timing of cost recovery by the utility without the need to file annual rate cases. Pepco believes that this is important as the Company invests in grid modernization and the infrastructure required to facilitate the District of Columbia’s goals of climate action, transportation electrification and increased resilience.¹⁵ The forward-looking rates in the MRP lead to more gradual and deterministic rate increases for customers and enables them to make more informed decisions about potential investments in energy efficiency, distributed energy resources and/or other technologies or options. In addition, Pepco believes that the MRP proposed by Pepco will also drive administrative efficiencies for the Commission, the Company, and stakeholders by reducing the frequency of rate case filings by the Company. In addition to allowing Commission resources to be focused elsewhere, this will also lead to lower rate case expenses being included in the cost of service over time.¹⁶

The MRP also includes PIMs. The proposed MRP and PIMs are forms of performance-based ratemaking which intends to explicitly reward or penalize a utility based on its performance. The proposal includes six PIMs. Two of the PIMs relate to reliability (SAIFI and SAIDI reliability indices), two relate to customer service benchmarks (customer service level and customer service abandonment rate), one PIM is based on the interconnection review timeframe and the last one is CEMI-4 which is only a monitoring PIM¹⁷, according to Pepco.¹⁸ All the proposed PIMs have rewards and penalties based on Pepco’s performance for each.

11 Pepco (C) at 3 & 31. (For the revenue requirement and RMA for the MRP, see witness Wolverton’s testimony Pepco (C).)

12 Pepco (C) at 30.

13 Pepco (F) at 51.

14 Pepco (C) at 31.

15 Pepco (A) at 8.

16 Pepco’s Application at 6.

17 CEMI stands for Customers Experiencing Multiple Interruptions and is expressed as a percentage. CEMI-4 is defined as customers experiencing four or more interruptions over a 12-month period.

18 Pepco (B) at 39.

The MRP is a transition away from a historic test period recovery to a **future three-year test period recovery**. First, the Company's request includes recovery of capital investments since the Company's last rate case filing (Formal Case No. 1150) was based on a test period ending December 31, 2017. Second, the Company is proposing a three-year multi-year plan that forecasts the expected capital investments and operating and maintenance costs through 2022. Pepco projects it will spend \$608.7 million over the 2018-2019 period and \$957.2 million over the 2020-2022 period on upgrades and improvements to the Company's District of Columbia distribution system¹⁹ which it is seeking to recover through the MRP.

The MRP includes an annual reconciliation to ensure Pepco is recovering only prudently incurred costs. According to Pepco, the MRP will improve regulatory efficiency and lower customer costs. The MRP also includes a re-opener provision which allows the Commission or parties to petition to re-open the review of the MRP, if a problem cannot be resolved through other avenues of the plan.²⁰

Pepco's proposal includes a 25-basis points "deadband" around its projected earned ROE. In the event the actual ROE is higher than the upper bound of the "deadband", the difference would be allocated 75% to customers and 25% would be retained by the Company.²¹ The annual reconciliation is structured such that adjustments that share overearnings with customers are "automatic," while rate adjustments due to falling below the lower bound target ROE requires a request from Pepco and explicit review and approval from the Commission.²²

Unforeseen cost increases or decrease outside the utility's control with a level greater than \$1 million will be addressed in the next rate case through a deferral regulatory asset treatment.²³

Pepco projects its O&M expense for the planning period as part of its Long Range Plan (LRP) process, as described in the testimony of Company Witness Barnett. Pepco projects its O&M expense first by department, project, and cost category. This projection is "mapped" to FERC O&M expense accounts, which are used in rate case filings including this MRP. For the MRP, Pepco is presenting 2018 actual O&M expense and 2019-2022 projected O&M expense from its LRP. The projections of Pepco's 2019-2022 O&M expenses are supported by multiple Company witnesses' testimonies: **including** witnesses Barnett, Sullivan, Ortega, Fisher, Maxwell, Poncia and Calabrese.²⁴

The rate design for MRP is included in witness Blazunas' testimony (Pepco (F)). The Company is not proposing any structural changes to the rate design for any rate schedule over the course of the MRP.

19 See Pepco (I) at 14.

20 Pepco (B) at 32.

21 Pepco (C) at 41.

22 Pepco (J) at 6.

23 Pepco (C) at 33.

24 See Pepco (L) at 7, Pepco (M) at 8, Pepco (N) at 4, Pepco (O) at 6, Pepco (P) at 6, Pepco (Q) at 4, and Pepco (R) at 10.

With the MRP, Pepco proposes to continue the Bill Stabilization Mechanism (BSA).²⁵ In the first year of the rate plan, Pepco is requesting to increase the fixed monthly charge for residential customers by \$3.47, from \$15.09 to \$18.56. The Company is proposing to increase the customer charge by \$3.47, \$1.62, and \$1.42 for Rate Year 1 (RY1), RY2, and RY3, respectively. This would result in the customer charge for RY3 being equal to 80% of the 2019 Test Period Unit Cost for Schedule R of \$27.67.²⁶

For MMA customers, the customer charge will increase from \$11.84 to \$13.91 for RY1. The Company is proposing to increase the customer charge by \$2.07, \$0.99, and \$0.89 for RY1, RY2, and RY3, respectively. For each year in the MRP, the Pepco's proposed rate design will allocate 37% of the total revenue increase to the residential classes (including R and MMA residential classes). Pepco is asking the Commission to issue a final order by May 1, 2020.

25 Pepco (F) at 34.

26 Pepco (F) at 35.