

**STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES**

**I/M/O The Merger of Exelon Corporation)
And PEPCO Holdings, Inc.) BPU Docket No. EM14060581**

DIRECT TESTIMONY OF

DAVID E. PETERSON

**ON BEHALF OF THE
DIVISION OF RATE COUNSEL**

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1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS**
3 **ADDRESS.**

4 A. My name is David E. Peterson. I am a Senior Consultant employed by
5 Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698
6 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk,
7 Maryland.

8
9 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE**
10 **IN THE PUBLIC UTILITY FIELD?**

11 A. I graduated with a Bachelor of Science degree in Economics from South Dakota
12 State University in May of 1977. In 1983, I received a Master's degree in
13 Business Administration from the University of South Dakota. My graduate
14 program included accounting and public utility courses at the University of
15 Maryland.

16
17 In September 1977, I joined the Staff of the Fixed Utilities Division of the South
18 Dakota Public Utilities Commission as a rate analyst. My responsibilities at the
19 South Dakota Commission included analyzing and testifying on ratemaking
20 matters arising in rate proceedings involving electric, gas and telephone utilities.

21
22 Since leaving the South Dakota Commission in 1980, I have continued
23 performing cost of service and revenue requirement analyses as a consultant. In
24 December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I
25 remained with that firm until August 1991, when I joined CRC. Over the years, I
26 have analyzed filings by electric, natural gas, propane, telephone, water,
27 wastewater, and steam utilities in connection with utility rate and certificate

1 proceedings before federal and state regulatory commissions. A copy of my
2 curriculum vitae is provided in Appendix A attached to this testimony.

3
4
5 **Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC**
6 **UTILITY RATE PROCEEDINGS?**

7 A. Yes. I have presented testimony in 145 other proceedings before the state
8 regulatory commissions in Alabama, Arkansas, California, Colorado,
9 Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Montana, Nevada,
10 New Jersey, New Mexico, New York, Pennsylvania, South Dakota, West
11 Virginia, and Wyoming, and before the Federal Energy Regulatory Commission
12 (“FERC”).

13
14 Collectively, my testimonies have addressed the following topics: the appropriate
15 test year, rate base, revenues, expenses, depreciation, taxes, capital structure,
16 capital costs, rate of return, cost allocation, rate design, life-cycle analyses,
17 affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

18
19 **Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN UTILITY**
20 **MERGER AND ACQUISITION PROCEEDINGS?**

21 A. Yes, I have. I presented testimony in connection with the following merger and
22 acquisition proceedings in New Jersey:

- 23 • The acquisition of Atlantic Energy, Inc. and Atlantic City Electric
24 Company by Delmarva Power and Light Company, BPU Docket No.
25 EM97020103;
26 • The acquisition of GPU, Inc. and Jersey Central Power & Light Company
27 by FirstEnergy Corp, BPU Docket No. EM00110870;

- 1 • The acquisition of Conectiv and Atlantic City Electric Company by Pepco
2 Holdings, Inc., BPU Docket No. EM01050308; and
3 • The acquisition of PSEG and Public Service Electric and Gas Company by
4 Exelon Corporation, BPU Docket No. EM05020106.

5 In addition, I have presented testimony in merger and acquisition proceedings
6 before the state regulatory commissions in Colorado, Maryland and New York.

1 **II. SUMMARY**

2 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

3 A. My appearance in this proceeding is on behalf of the New Jersey Division of Rate
4 Counsel (“Rate Counsel”).

5
6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

7
8 A. I have been advised by counsel that under New Jersey’s change in ownership and
9 control statute, N.J.S.A. 48:2-51.1, the Board is required to:

10

11 “...evaluate the impact of the acquisition on competition, on the rates of
12 ratepayers affected by the acquisition of control, on the employees of the
13 affected public utility or utilities, and on the provision of safe and
14 adequate utility service at just and reasonable rates.”

15

16 I was asked by Rate Counsel to review and to evaluate the impact of the
17 transaction proposed in Pepco Holdings, Inc.’s (“PHI”) and Exelon Corporation’s
18 (“Exelon”) (collectively referred to hereafter as “Joint Petitioners”) Joint Petition
19 on Atlantic City Electric Company’s (“ACE”) employees. I was also asked to
20 evaluate the Joint Petitioners’ request for approval of a General Service
21 Agreement (“GSA”) between ACE and Exelon Business Services Company
22 (“EBSC”), an Exelon affiliate service company, to govern transactions between
23 ACE and Exelon BSC. My testimony also addresses concerns regarding
24 corporate governance following the change in ownership.

25

1 **Q. WHAT DID YOU REVIEW IN PREPARATION FOR YOUR**
2 **TESTIMONY?**

3 A. I carefully reviewed the June 18, 2014 Joint Petition and the testimonies and
4 exhibits of the Joint Petitioners relating to the issues that I address herein. I also
5 reviewed the Joint Petitioners' responses to requests for data and information
6 submitted by Rate Counsel and the Board Staff again relating to the issues that I
7 address in my testimony.

8
9 **Q. PLEASE SUMMARIZE YOUR FINDINGS.**

10 A. I am advised that to approve the transaction, the Board must determine that
11 positive benefits will flow to ACE customers and to the State of New Jersey, as
12 required by N.J.A.C. 14:1-5.14.

13
14 Concerning the merger's impact on ACE employees, the Joint Petitioners have
15 committed to honor all existing collective bargaining agreements and that in the
16 two years immediately following the merger there will be no net reduction in the
17 employment levels at ACE due to involuntary attrition resulting from the merger
18 integration process. Beyond the first two years post-merger the Joint Petitioners
19 have no written plans regarding employees and staffing requirements. I am
20 satisfied that the proposed transaction will not have an adverse impact on ACE
21 employees during the first two years post-merger. I cannot speculate at this time,
22 however, on possible adverse impacts following that two-year period because the
23 Joint Petitioners have not made its plans known concerning ACE employment
24 levels following the second year post-merger. Therefore, I recommend that the
25 Joint Petitioners' proposed two-year commitments be extended to five years. In
26 this way, the Board can be more certain that ACE's employees will not be
27 adversely affected by the merger.

28

1 Approval of the GSA for ACE at this time is premature. The Joint Petitioners do
2 not have written plans outlining how and when PHI's existing Service Company
3 and Exelon BSC will be integrated. I also have concerns about the vagueness of
4 the cost allocation procedures that are contained in EBSC's GSA. Therefore, the
5 Board should not approve ACE's participation in Exelon BSC's GSA at this time.

6
7 The loss of control by ACE and by PHI in the proposed transaction may result in
8 adverse consequences in PHI's service territories and for ACE specifically. To
9 reduce that possibility, I recommend that PHI receive proportional representation
10 on Exelon's Board of Directors and that Exelon not be permitted to gain majority
11 control over the newly formed PHI LLC's Board of Directors.

12
13 The bases for these findings and recommendations are detailed in the following
14 sections of my testimony.

15
16
17 **III. IMPACT ON ACE EMPLOYEES**

18 **Q. PREVIOUSLY YOU STATED THAT THE BOARD IS REQUIRED TO**
19 **CONSIDER THE IMPACT OF THE PROPOSED TRANSACTION ON**
20 **ACE EMPLOYEES. HOW HAVE THE JOINT PETITIONERS**
21 **ADDRESSED THIS ISSUE IN THEIR MERGER PLAN?**

22 **A.** The Joint Petitioners' witness Mr. Denis P. O'Brien, Exelon's Senior Vice
23 President and Exelon Utilities' Chief Executive Officer, addresses ACE employee
24 issues in his Direct Testimony. Concerning ACE employees, the Joint Petitioners
25 pledge the following:

- 26
- 27 • There will be no net reduction in employment levels for ACE due to
28 involuntary attrition resulting from the merger integration process for two
years following consummation of the transaction;

- 1 • The Joint Petitioners will honor existing collective bargaining agreements
2 affecting ACE union employees;
3 • For two years following consummation of the transaction, the Joint
4 Petitioners will provide current and former ACE employees compensation
5 and benefits that, in the aggregate, are at least as favorable as the
6 compensation and benefits provided to those employees immediately
7 before the merger.¹

8
9 **Q. DOES THE TWO-YEAR COMMITMENT TO NOT REDUCE**
10 **EMPLOYEE LEVELS AT ACE APPLY TO BOTH COLLECTIVE**
11 **BARGAINING EMPLOYEES AS WELL AS NON-UNION EMPLOYEES?**

12 A. Yes. The Joint Petitioners have clarified that its commitment to not reduce ACE
13 employment levels for two years following consummation of the transaction is
14 intended to apply to both union and its non-union workers.²

15
16 **Q. DID YOU INQUIRE FURTHER ABOUT EACH OF THE JOINT**
17 **PETITIONERS' COMMITMENTS TO ACE EMPLOYEES?**

18 A. Yes, I did. In discovery it was learned that the Joint Petitioners have no plans to
19 reduce the number of ACE employees either during or after the two-year
20 commitment period.³ The Joint Petitioners have not instituted a hiring freeze
21 during the merger process; nor is one being contemplated.⁴ Further, the Joint
22 Petitioners have no plans to eliminate presently unfilled positions at ACE.⁵ Thus,
23 based on the their responses to Rate Counsel's inquires, as long as the Joint

¹ Direct Testimony of Denis P. O'Brien, pages 17-18.

² Joint Petitioners' response to RCR-EMPLOY-4.

³ Joint Petitioners' response to RCR-EMPLOY-5

⁴ Joint Petitioners' response to RCR-EMPLOY-2.

⁵ Joint Petitioners' response to RCR-EMPLOY-3.

1 Petitioners honor their commitments, the merger should not result in any adverse
2 impacts on ACE employees, as least for the first two years following
3 consummation of the transaction.

4
5 **Q. HAVE THE LABOR UNIONS WHO REPRESENT ACE EMPLOYEES**
6 **TAKEN A POSITION ON THE PROPOSED TRANSACTION?**

7 A. Yes, they have. The local chapters of the labor union that represent ACE's union
8 employees have each voiced support for the proposed transaction. ACE and PHI
9 recently negotiated a three-year extension of the collective bargaining agreements
10 with New Jersey Locals 210 and 1238 of the International Brotherhood of
11 Electrical Workers, who represent ACE's union employees. The extended
12 agreements each provide for a 2.5 percent increase in wages in each year during
13 the period 2017 through 2019. Moreover, if the proposed transaction meets all
14 required regulatory approvals, the 2.5 percent wage increases for the years 2017-
15 2019 are to be escalated by .5 percent to 3.0 percent.

16
17 **Q. HAVE THE JOINT PETITIONERS MADE ANY COMMITMENTS**
18 **CONCERNING ACE EMPLOYEES FOLLOWING THE TWO-YEAR**
19 **PERIOD AFTER CONSUMMATION OF THE TRANSACTION OR HAVE**
20 **THEY STATED THEIR PLANS GOING FORWARD AS IT CONCERNS**
21 **ACE EMPLOYEES?**

22 A. No. The Joint Petitioners stated that "Exelon does not have any current plans to
23 reduce employment levels at ACE after the expiration of the two year
24 employment commitment."⁶ It would be incorrect to assume, however, that
25 Exelon's statement in this regard constitutes a commitment of any sort to ACE
26 employees. Further, the Joint Petitioners state that they have no current

⁶ Joint Petitioners' response to RCR-EMPLOY-14.

1 employment plans following the end of the two-year commitment period.⁷ Thus,
2 I have no way to determine whether or not ACE employees will be adversely
3 effected by the proposed transaction beyond the end of the two-year commitment
4 period.

5
6 **Q. WHAT THEN DO YOU CONCLUDE ABOUT THE IMPACT OF THE**
7 **PROPOSED TRANSACTION ON ACE EMPLOYEES?**

8 A. My conclusion is necessarily incomplete. Based on the written commitments
9 offered by the Joint Petitioners to ACE employees for the two-year period post
10 consummation of the transaction, it appears that there will be no adverse impacts
11 on ACE employees. Furthermore, the labor unions representing ACE's collective
12 bargaining employees each support the proposed transaction. The unions'
13 agreement is based, in part, on a recently negotiated three-year extension to the
14 currently effective collective bargaining agreements. Thus, the unions seem
15 satisfied that its members will not be adversely effected by the proposed
16 transaction over the next three years.

17
18 In the longer term, however, we cannot be so assured that ACE employees will
19 not be adversely effected by the proposed transaction. This uncertainty primarily
20 arises from the fact that the Joint Petitioners thus far have not offered any
21 information on future employment plans or requirements for ACE. But, the
22 Board should have a strong interest in seeing to that whatever employment
23 decisions are made in the future, ACE maintains sufficient personnel to properly
24 manage, operate and maintain its system to insure adequate service quality and
25 reliability. Similarly, ACE employees should be treated fairly in any future
26 downsizing and that all employees whose positions are terminated should be

⁷ Joint Petitioners' response to RCR-EMPLOY-6.

1 given appropriate severance benefits. To insure that the proposed transaction
2 does not result in an adverse consequence for ACE employees in the longer term
3 post-merger, I recommend that two-year commitments offered to ACE employees
4 by the Joint Petitioner be extended to five years, post-merger. I also recommend
5 that the Board require the Joint Petitioners to pledge to maintain a regional
6 headquarters in New Jersey that is staffed with adequate personnel capable of
7 promptly addressing New Jersey and ACE concerns, including Staff with
8 sufficient authority and experience to manage and administer ACE's operations
9 and utility assets, customer service and regulatory affairs.

1 **IV. SERVICE COMPANY ISSUES**

2 **Q. IS ACE CURRENTLY A PARTICIPANT IN AN AFFILIATE SERVICE**
3 **AGREEMENT?**

4 A. Yes, it is. Presently, ACE receives centralized services from an affiliate service
5 company named PHI Service Company. The services that ACE receives from
6 PHI Service Company include executive management, procurement and
7 administrative, financial, insurance, human resources, legal, audit, customer
8 services, marketing, information technology, external affairs, environmental,
9 safety and internal consulting. These services are priced to ACE at cost under a
10 Service Agreement that has been approved by the Board. PHI Service Company
11 also provides similar services to Delmarva Power and Light Company, to Pepco,
12 and to PHI's unregulated affiliates. A copy of ACE's currently effective Service
13 Agreement with PHI Service Company was provided in response to RCR-SC-1,
14 and is reproduced herein as Attachment DEP-1.

15
16 **Q. DOES EXELON HAVE A SIMILAR TYPE OF SERVICE COMPANY?**

17 A. Yes. Exelon has an affiliate service company named Exelon Business Service
18 Company ("EBSC"). Exelon's service company provides a similar array of
19 services to its regulated and unregulated affiliates as does PHI Service Company.
20 A copy of EBSC's currently effective GSA was provided in the Joint Petitioners'
21 filing as Verified Joint Petition – Exhibit D.

22
23 **Q. WHAT ARE THE JOINT PETITIONERS REQUESTING IN THIS**
24 **PROCEEDING WITH RESPECT TO SERVICE COMPANY MATTERS?**

25 A. The Joint Petitioners request Board authorization for ACE to become a party to
26 Exelon's existing GSA so that ACE may begin to receive services from EBSC
27 following consummation of the transaction.

- 1 **Q. GIVEN THAT BOTH PHI AND EXELON EACH HAVE AN AFFILIATE**
2 **SERVICE COMPANY ALREADY, HAVE THE JOINT PETITIONERS**
3 **SHARED THEIR PLANS ON HOW THE TWO SERVICE COMPANIES**
4 **WILL BE INTEGRATED FOLLOWING CONSUMMATION OF THE**
5 **TRANSACTION?**
- 6 A. No. The Joint Petitioner’s ultimate goal appears to be to consolidate, to integrate,
7 and to migrate all of the functions presently being performed by PHI Service
8 Company to EBSC. That process, obviously, cannot be completed overnight and
9 it will not be completed at the time the transaction is consummated. In response
10 to a request by Rate Counsel the Joint Petitioners stated: “The details of the
11 actual integration and consolidation of the PHI Service Company and the Exelon
12 Business Service Company (“EBSC”) post-Merger has not yet been determined.”⁸
13 Further, the Joint Petitioners’ witness on service company matters, Mr. Carmin V.
14 Khouzami, testified: “The PHI Service Company will remain in place for an
15 undetermined period of time during post-merger integration. As integration
16 proceeds and systems and functions are combined in phases, ACE may receive
17 different services from the EBSC and the PHI Service Company until all shared
18 corporate support functions are consolidated under the EBSC.”⁹ Corporate
19 governance services will likely be among the first services to be consolidated into
20 EBSC, as it is a required service under the GSA to be purchased by ACE and all
21 other corporate affiliates.
22

⁸ Joint Petitioners’ response to RCR-SC-6.

⁹ Direct Testimony of Carmin V. Khouzami, pages 33-34.

1 **Q. WHAT ARE YOUR CONCERNS REGARDING THE JOINT**
2 **PETITIONERS' REQUEST TO ALLOW ACE TO SIGN ON TO THE**
3 **EBSC'S GSA?**

4 A. My concerns are timing related and also substantive. As to timing, for the
5 foreseeable future ACE will be a party to two centralized service agreements; one
6 for PHI Service Company and the other for EBSC. Given that the two service
7 agreements are not identical, the Joint Petitioners have not stated what changes, if
8 any, to the existing PHI Service Company Service Agreement are necessary if and
9 when the services are available from EBSC. Nor have they reconciled which
10 agreement will be controlling for ACE in the interim before all services are
11 consolidated at EBSC. For example, PHI Service Company's cost allocation
12 procedures are specifically identified for each service in Appendix A to the
13 Service Agreement. Such allocation procedures were previously approved by the
14 Board. To the extent that EBSC's allocation procedures differ from those of PHI
15 Service Company, the related costs may be allocated to ACE in a manner that is
16 not consistent with the method that the Board approved in authorizing PHI
17 Service Company's Service Agreement. Additionally, even if PHI Service
18 Company's corporate governance services are expected to be migrated to EBSC
19 first, because such services are considered a required service under EBSC's GSA,
20 there is a possibility that ACE may be double-billed for corporate governance
21 services until such time that all corporate governance services are actually
22 transferred to EBSC.

23
24 **Q. YOUR PREVIOUS RESPONSE ADDRESSED TIMING ISSUES THAT**
25 **ARE NOT RESOLVED IN THE JOINT PETITION. WHAT ARE YOUR**
26 **SUBSTANTIVE CONCERNS WITH EBSC'S GSA?**

27 A. My substantive concern with allowing ACE to sign on to EBSC's GSA is that the
28 GSA is much too vague as to cost allocation procedures for indirect costs relative

1 to the PHI Service Company's Board-approved Service Agreement. To
2 understand my concern, please refer to PHI Service Company's allocation
3 procedures that are specified in Appendix A to the Service Agreement,
4 reproduced herein as Attachment DEP-1. Under each type of centralized service
5 that is provided there is a specific allocation method to be used for unassignable
6 and indirect costs. Compare that level of specificity to EBSC's GSA. Within
7 EBSC's GSA there is an array of methods listed to be used for allocating
8 unassignable and indirect costs rather than one specific method as is the case with
9 PHI Service Company's Service Agreement. The array of allocations methods
10 within the GSA, however, are not aligned with the types of centralized services to
11 which they are applied. For example, PHI Service Company's Service
12 Agreement requires the Service Company to bill indirect costs associated with
13 accounts payable using the Transactions Processed Ratio.¹⁰ That same level of
14 specificity for allocation methods for accounts payable services performed by
15 EBSC is not spelled out in the GSA. Rather, within the GSA, under
16 Administrative and Management services (of which accounts payable is a part),
17 EBSC can seeming choose from any of the six allocation methods shown for that
18 category of service.¹¹ Incidentally, the GSA does not even have a Transactions
19 Processed Ratio that would be compatible with PHI Service Company's Service
20 Agreement which would apply to accounts payable services. Similar vagueness's
21 and inconsistencies are prevalent between the two service companies' service
22 agreement; yet none of them are reconciled in the Joint Petition.

23

¹⁰ See Attachment DEP-1, Appendix A, page 2 of 11, paragraph III,b,2.

¹¹ See Verified Joint Petition – Exhibit D, Service Agreement Schedule 2, Schedule 2-1.

1 **Q. HOW SHOULD THE BOARD PROCEED RELATIVE TO SERVICE**
2 **COMPANY MATTERS?**

3 A. Generally speaking, EBSC’s existing GSA does not reflect what the Board has
4 required ACE and other New Jersey utility service company agreements to
5 contain. What the Board has required of ACE and the other New Jersey utilities
6 in the past, and what it should require of EBSC now is a more clearly defined
7 matrix of specified services provided by the service company and the associated
8 allocation method(s) to each specific service category. Further, in prior
9 proceedings involving approval of service company agreements, the Board has
10 considered it important that there be incentives within the agreement for the
11 service company to increase the relative level of directly billed charges, as
12 opposed to allocated charges, and to limit the use of discretionary and often
13 arbitrary allocation method to apportion costs among participating companies.
14 There is no commitment or incentive in the existing GSA, however, to increase
15 the percentage of directly billed costs relative to those that are allocated.

16
17 Because operations of the service company are integral to the synergies the Joint
18 Petitioners anticipate, the Board should not allow ACE to sign on to the GSA in
19 its present form. As it now stands, the Joint Petitioners cannot tell the Board
20 definitively what services EBSC will provide and when, or how EBSC will
21 charge client companies, including ACE, for services it will render post-merger.
22 Thus, there is no basis for Board approval of the GSA. The Board should direct
23 the Joint Petitioners to present to the parties a detailed operating plan and
24 timetable for PHI Service Company/EBSC integration, along with a detailed
25 matrix showing how member companies will be billed for each service, similar to
26 that contained in PHI Service Company’s currently effective Service Agreement.
27 A revised GSA identifying the specific services offered and the allocation
28 method(s) to be used should be included in the presentation.

1
2 **Q. IS THERE ANYTHING ELSE THAT THE BOARD SHOULD REQUIRE OF**
3 **THE JOINT PETITIONERS PRIOR TO GRANTING APPROVAL OF**
4 **THE GSA?**

5 A. Yes. Any erosion of the Board's regulatory authority over ACE and the rates that
6 its charges New Jersey customers should be considered an adverse consequence
7 of the proposed transaction and contrary to public interest. To avoid adverse
8 consequences, I recommend the following conditions relating to EBSC be
9 attached to the Board's approval of the transaction:

10
11 1) EBSC costs shall be directly charged whenever practicable and
12 possible and affirmative steps shall be taken to increase direct billings
13 relative to current billings. ACE shall report about direct and indirect
14 charges by function quarterly and respond to questions concerning
15 such reports. In its next base rate proceeding, ACE shall file testimony
16 addressing EBSC charges and the bases for such charges, as well as
17 the modifications to procedures and systems that are being made to
18 increase direct billings.

19
20 2) No later than the end of the second calendar quarter of each year
21 ("Reporting Year"), ACE will provide the Board, Board Staff and Rate
22 Counsel with the following reports:

23
24 a. The equivalent of the FERC Form 60 Report that describes
25 EBSC direct billings versus allocated costs for each operating
26 utility company in the Exelon system. In addition, EBSC shall
27 provide a further breakdown for ACE, which identifies the total
28 amounts charged, separately stating direct and indirect charges
29 to ACE for each service function.

30
31 b. The cost allocation percentages and supporting work papers for
32 the Reporting Year based on the estimated plan factors for the
33 Reporting Year. Such report shall compare these estimated
34 plan factors and cost allocation percentages for the Reporting
35 Year to those actual allocation factors and percentages used in
36 the previous year and highlight all modifications and
37 specifically identify those that occurred during the course of the

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year due to significant events based on the prior year's actual results of EBSC's charges for each allocation factor for each Exelon affiliate. ACE shall explain any change to allocation factors to ACE that are more than five percentage points. ACE shall also make available on request any prior months' variance reports regarding EBSC's billings to ACE.

- 3) ACE shall also provide copies to Board Staff and Rate Counsel of the portions of any internal or external audit reports (including any currently pending) performed by or for EBSC, pertaining directly or indirectly to Exelon's determinations of direct billings and cost allocations to its affiliates, but only after the audit is complete and the report is final. Such material shall be provided no later than 30 days after the final report is completed. If after review of such material, Board Staff or Rate Counsel determines that review of the remainder of such audit report is warranted, ACE shall make the complete report available for review in ACE's New Jersey office or at the Board.
- 4) ACE and EBSC shall promptly notify the Board, Board Staff and Rate Counsel when it has received notice that the SEC, the FERC, or the state regulatory commissions in any state in which an affiliate utility company operates are preparing to perform an audit of EBSC. EBSC shall provide copies of the portions of all audits highlighting the findings and recommendations and ordered changes to the GSA pertaining directly or indirectly to EBSC's determinations of direct billings and cost allocations to its affiliates, as well as any sections addressing ACE. If after review of such material, Board Staff or Rate Counsel determines that review of the remainder of such audit report is warranted, ACE shall make the complete report available for review in ACE's New Jersey office or at the Board.
- 5) ACE shall promptly notify the Board, Board Staff and Rate Counsel when it has received notice that the SEC, the FERC, or any of the state regulatory commissions wherein Exelon utility affiliates operate is rendering a specific decision affecting EBSC, including any generic rulemakings.
- 6) For assets that EBSC acquires for use by ACE, the same capitalization/expense policies shall apply to those assets that are

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applicable under the Board's standards for assets acquired directly by ACE.

- 7) For depreciable assets that EBSC acquires for use by ACE, the depreciation expense charged to ACE by EBSC shall reflect the same depreciable lives and methods required by the Board for similar assets acquired directly by ACE. In no event shall depreciable lives on plant acquired for ACE by EBSC be shorter than those approved by the Board for similar property acquired directly by ACE.
- 8) For assets that EBSC acquires for use by ACE, the rate of return shall be based on ACE's authorized rate of return, unless EBSC is able to finance the asset at a lower cost than ACE. In such cases, the lower cost financing will be reflected in EBSC's billings to ACE, and the resulting benefit will be passed on to ratepayers.
- 9) Board Staff and Rate Counsel shall be assured reasonable and convenient access to the books and records of EBSC and other Exelon companies that transact business with ACE, and supporting documentation thereof, but only to the extent relevant to transactions with ACE.
- 10) The Board and the Rate Counsel will be sent copies of any and all "60-day" letters, and supporting documentation, sent by EBSC to the FERC concerning a proposed change in the GSA.
- 11) ACE shall continue to submit to the Board's jurisdiction on issues regarding the New Jersey ratemaking treatment of EBSC's costs that are assigned or otherwise allocated to ACE and borne by ACE customers. ACE shall not raise a Federal preemption defense when challenging the appropriateness of a Board ruling on a cost allocation issue concerning the GSA.
- 12) ACE shall file petitions for approval of any modifications to the GSA, including changes in methods or formulae used to allocate costs, with the Board at the same time it makes a filing with the FERC.
- 13) Board Staff and Rate Counsel shall have the right to review the GSA and related cost allocations in ACE's future base rate cases, in conjunction with future competitive service audits, in response to any

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changes in the Board's affiliate relations standards, and for other good cause shown.

14) ACE shall have the right to opt out of any EBSC service that it determines can be procured in a more economical manner, is not of a desired quality level, or for any other valid reason, including Board Orders, after having failed to first resolve the issue with EBSC, and ACE shall not be penalized for any such decision to opt out.

15) ACE agrees that the Board under its authority pursuant to the Electric Discount and Energy Competition Act may review the allocation of costs in sufficient detail to analyze their reasonableness, the type and scope of services that EBSC provides to ACE and the basis for inclusion of new participants in EBSC's allocation formula. ACE and EBSC shall record costs and cost allocation procedures in sufficient detail to allow the Board to analyze, evaluate, and render a determination as to their reasonableness for ratemaking purposes.

1 **V. CORPORATE GOVERNANCE**

2 **Q. WILL ACE'S PARTICULAR INTERESTS BE REPRESENTED ON**
3 **EXELON'S BOARD OF DIRECTORS FOLLOWING THE MERGER?**

4 A. No, not necessarily. It is not unusual in corporate mergers that the acquiring
5 company (in this case Exelon) offer the acquired company (in this case PHI) seats
6 on newly constituted Board of Directors. In fact, following Exelon's acquisition
7 of Constellation Energy Group, Inc. in March 2012, four members from
8 Constellation's Board of Directors were seated on Exelon's Board. In this
9 proposed transaction, however, Exelon has made no commitment, nor is there any
10 plan, to offer a seat on its Board of Directors to members of PHI's existing Board
11 of Directors. Not seating any of PHI's Board members on Exelon's Board
12 following consummation of the transaction raises a concern that Exelon's Board
13 of Directors will not have a keen enough focus on PHI regional issues and
14 requirements, including those of ACE. Therefore, former PHI Directors should
15 be proportionally recognized on Exelon's newly constituted Board of Direction.

16
17 **Q. HAVE THE JOINT PETITIONERS ESTABLISHED ANY OTHER**
18 **VEHICLE FOR PHI AND ACE TO VOICE ITS LOCAL AND REGIONAL**
19 **INTERESTS TO EXELON?**

20 A. Yes. Rather than offering Exelon Board seats to PHI, the Joint Petitioners have
21 developed a plan to bring more local autonomy (at least in appearance) to PHI
22 affiliates, including ACE. At merger closing, PHI will cease to be a corporation
23 and will be converted into a limited liability company ("LLC"). As an LLC, PHI
24 will have its own Board of Directors. Presently, the Joint Petitioners plan to
25 establish seven seats on the LLC's Board of Directors. Three of those seats are to
26 be filled with outside members from within ACE's, Delmarva Power and Light
27 Company's, and Pepco's service areas. The remaining four LLC Board members
28 will consist of a combination of officers or directors from Exelon and officers

1 from one or more PHI or PHI utility affiliates. Also, the LLC Board of Directors
2 will select directors for ACE, for Delmarva Power, and for Pepco. Those utility
3 directors, in turn, will select officers for each of the three utilities.

4
5 **Q. WHAT ARE YOUR CONCERNS ABOUT THE PROPOSED**
6 **CORPORATE GOVERNANCE STRUCTURE?**

7 A. Ideally, Rate Counsel would like to see PHI have proportional representation of
8 some sort on Exelon's Board of Directors following the merger in order to
9 preserve ACE and PHI regional interests in Board matters. Apparently, the Joint
10 Petitioners believe that establishing the LLC and a separate Board of Directors for
11 PHI is adequate representation for PHI's utility affiliates, including ACE. That is
12 not necessarily the case, however. As an initial matter, Exelon's Board of
13 Directors will have final approval for ACE's capital and operating budgets,
14 regardless of the approvals given by PHI's Board of Directors. This same sort of
15 veto power exists on PHI's present Board. That is, despite ACE's
16 recommendations to PHI, PHI's Board of Directors has final say as to ACE's
17 capital and operating budgets. Also objectionable is the fact that Exelon can gain
18 "super power" status with respect to ACE and PHI's other utility affiliates by
19 manipulating membership on the LLC's Board of Directors. The majority (i.e.,
20 four out of seven) of the LLC's new Board members will consist of "some
21 combination of officers or directors of Exelon and officers of one or more of PHI
22 or the PHI Utilities"¹². Thus, without requiring at least two Board members to
23 come from PHI or the PHI Utilities, Exelon can gain super power status by
24 controlling both the LLC's Board of Directors and its own. Therefore, I
25 recommend that that Exelon not be given super power status by "stacking the
26 deck" on the LLC's newly created Board of Directors. This can be accomplished

¹² Direct Testimony of Denis P. O'Brien, page 7.

1 by requiring that at least two seats on the LLC's Board of Directors be offered to
2 officers of PHI or the PHI Utilities. Under this structure, Exelon will have only
3 two seats on PHI's Board of Directors following the merger.

4

5 **Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?**

6 **A. Yes, it does.**

APPENDIX A

QUALIFICATIONS OF

DAVID E. PETERSON

**STATEMENT OF EDUCATION AND EXPERIENCE
FOR
DAVID E. PETERSON**

Senior Consultant
Chesapeake Regulatory Consultants, Inc.
10351 Southern Maryland Blvd. Suite 202
Dunkirk, Maryland 20754-9500
410.286.0503

Email: davep@chesapeake.net

Mr. Peterson is employed as a public utility rate consultant by Chesapeake Regulatory Consultants, Inc. Mr. Peterson has over thirty-seven years of experience analyzing regulated public utility ratemaking and service matters including three years as a member of a state regulatory commission staff and thirty-four years as a consultant. Mr. Peterson specializes in utility revenue requirement and cost of service analyses. He has presented testimony in more than 140 proceedings before twenty state regulatory commissions, the Delaware House Energy Subcommittee, and the Federal Energy Regulatory Commission. Utilities addressed in Mr. Peterson's analyses and testimonies have included electric, natural gas, propane, telephone, water, steam and sewer companies.

EMPLOYMENT

1991 - Present	Senior Consultant Chesapeake Regulatory Consultants, Inc. Annapolis, Maryland
1980 - 1991	Consultant Hess & Lim, Inc. Greenbelt, Maryland
1977 - 1980	Rate Analyst South Dakota Public Utilities Commission Pierre, South Dakota
1977	Research Assistant Economics Department South Dakota State University Brookings, South Dakota

As a rate analyst and consultant, Mr. Peterson has served a diverse group of public utility consumers and governmental agencies on utility ratemaking and service-related issues. Clients have included state regulatory commissions and their staffs, consumer advocate agencies of state governments, federal agencies, municipalities, privately owned, municipally owned and cooperatively owned utilities, civic organizations, and industrial consumers.

EDUCATION

December 1983 Master of Business Administration
University of South Dakota
Vermillion, South Dakota

May 1977 Bachelor of Science Degree in Economics
South Dakota State University
Brookings, South Dakota

EXPERT TESTIMONY

Among the issues that Mr. Peterson has addressed in testimony are the appropriate test year, construction work in progress, cash working capital lead/lag studies, rate base, excess capacity, revenues, expenses, depreciation, income taxes, capital structure, rate of return, cost allocation, rate design, customer service charges, flexible rates, life-cycle analyses, cost tracking procedures, affiliate transactions, mergers, acquisitions and the consequences of industry restructuring. Mr. Peterson has presented testimony to the following regulatory bodies.

Alabama Public Service Commission
Arkansas Public Service Commission
California Public Utilities Commission
Colorado Public Utilities Commission
Connecticut Public Utilities Control Authority

Delaware Public Service Commission
Indiana Public Service Commission
Kansas State Corporation Commission
Maine Public Utilities Commission
Maryland Public Service Commission

Montana Public Service Commission
Nevada Public Service Commission
New Jersey Board of Public Utilities
New Mexico Public Service Commission
New York Dept. of Environmental Protection

New York Public Service Commission
Pennsylvania Public Utility Commission
South Dakota Public Utilities Commission
West Virginia Public Service Commission
Wyoming Public Service Commission

Delaware House of Representatives (Energy Subcommittee)
Federal Energy Regulatory Commission

In addition, Mr. Peterson has presented several utility training seminars, including the following:

Consolidated Tax Savings and Income Tax Normalization
Presented to Delaware Public Service Commission 2006

Public Utility Ratemaking Principles
Presented to Washington Utilities and Transportation Commission 2011

Electric Cost Allocation and Rate Design
Presented to Colorado Office of Consumer Counsel 2012

Public Utility Revenue Requirements
Presented to Delaware Public Service Commission 2012

Electric Cost Allocation and Rate Design
Presented to Delaware Public Service Commission 2013

ATTACHMENT DEP-1

**In the Merger of Exelon Corporation and Pepco Holdings, Inc.
BPU Docket No. EM1406-0581
Response of the Joint Petitioners**

Data request dated: August 22, 2014

Response dated: September 5, 2014

Responsible Witness: PHI

RCR-SC-1:

Please provide a complete copy of ACE's currently effective agreement with PHI Service Company.

Response:

See RCR-SC-1_Attach01.

SERVICE AGREEMENT EXTENSION AND MODIFICATION

This Service Agreement Extension and Modification (this "Extension") is effective the 1st day of January, 2011 (the fifth anniversary of the effective date of the Service Agreement effective January 1, 2006 (the "Service Agreement")), by and between PHI Service Company, a Delaware corporation and a mutual service company (the "Service Company") and the associate companies (the "Client Companies"), which are parties to the Service Agreement and are comprised of Pepco Holdings, Inc., a utility holding company, and certain of its subsidiaries.

WHEREAS, Section 3.1 of the Service Agreement provides that upon each five-year anniversary of the Service Agreement, the parties may extend the Service Agreement, with or without modifications, for an additional five years by mutual written agreement to such an extension; and

WHEREAS, January 1, 2011 is the five-year anniversary date of the Service Agreement for all parties to this Extension with the exception of (1) Conectiv North East, LLC, Atlantic Generation, Inc., Thermal Energy LP, Potomac Capital Investment Corporation and Pepco Energy Services, Inc., each of which has a five-year anniversary date of January 1, 2014, and (2) Delaware Operating Services Company and Conectiv Energy Supply, Inc., each of which has a five-year anniversary date of July 1, 2015;

WHEREAS, the parties to the Service Agreement with the January 1, 2011 five-year anniversary date (hereafter referred to as the "Expiring Service Agreement") wish to extend the Service Agreement, and all of the parties to this Extension wish to modify certain paragraphs of the Service Agreement, as well as Appendix A and Appendix B thereto;

WHEREAS, the Service Company and the respective Client Companies having 5-year anniversary dates of January 1, 2014 and July 1, 2015 wish to further modify each respective Service Agreement so that it will expire, unless extended pursuant to Section 3.1, thereof on January 1, 2016;

NOW, THEREFORE, the parties to the Expiring Service Agreement hereby agree to extend the Service Agreement pursuant to the terms of Section 3.1 thereof, for an additional period of five years until January 1, 2016, and all parties to this Extension agree to the following modifications as permitted by Section 3.1 of the Service Agreement:

1. Section 2.1 of the Service Agreement shall be modified as follows:

As compensation for the services to be rendered hereunder, each Client Company shall pay to the Service Company all costs which reasonably can be identified and related to particular services performed by the Service Company for or on Client's behalf, such costs to be determined in accordance with Rule 91 the cost accounting manual for the Pepco Holdings Inc. system and other applicable rules and regulations ~~under the Public Utility Holding Company Act of 1935 which have been subsequently adopted by the Act, including the regulations of the Federal~~

Energy Regulatory Commission (“FERC”) regarding the Uniform System of Accounts for Centralized Service Companies. Where more than one Client Company is involved in or has received benefits from a service performed, costs will be directly assigned, directly charged or allocated, as set forth in Appendix A hereto, between or among such companies on a basis reasonably related to the service performed.

2. Section 2.2 of the Service Agreement shall be modified as follows:

It is the intent of this Service Agreement that the payment for services rendered by the Service Company to the Client Companies under this Service Agreement shall cover all the costs of its doing business (less the cost of services provided to associated companies not a party to this Service Agreement and other non-associated companies), including but not limited to, salaries and wages, office supplies and expenses, outside services employed, insurance, injuries and damages, employee benefits, miscellaneous general expenses, rents (including property leased from Client Companies for use by the Service Company), maintenance of structures and equipment, depreciation and amortization, and compensation for use of capital ~~as permitted by Rule 91 under the Public Utility Holding Company Act of 1935 which has been subsequently adopted by the Act.~~

3. Appendix A to the Service Agreement is hereby deleted in its entirety and replaced with Appendix A attached hereto; and Appendix B to the Service Agreement is hereby deleted in its entirety and replaced with Appendix B attached hereto.

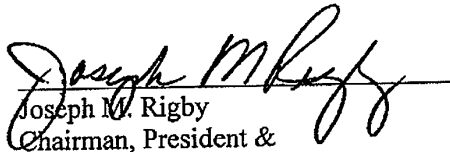
4. Any Service Agreement having a 5-year anniversary date of January 1, 2014 or July 1, 2015 is hereby modified such that its five-year anniversary date shall be deemed to be January 1, 2016, upon which date such Service Agreement will expire unless extended pursuant to Section 3.1 thereof;

5. All of the terms of the Service Agreement that are not expressly modified hereby shall continue in full force and effect. The Service Agreement, as hereby extended and modified, shall apply to any Client Companies that may in the future execute the Service Agreement.

6. This Extension may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. For purposes hereof, a facsimile or .pdf copy of this Extension, including the signature pages hereto, shall be deemed to be an original.

IN WITNESS WHEREOF, the parties hereto have caused this Extension to be executed as of the date and year first above written.

PHI SERVICE COMPANY

By: 
Joseph M. Rigby
Chairman, President &
Chief Executive Officer

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PEPCO HOLDINGS, INC.

By: David M. Velazquez
David M. Velazquez
Executive Vice President

DELMARVA POWER & LIGHT COMPANY

By: David M. Velazquez
David M. Velazquez
President & Chief Executive Officer

ATLANTIC CITY ELECTRIC COMPANY

By: David M. Velazquez
David M. Velazquez
President & Chief Executive Officer

POTOMAC ELECTRIC POWER COMPANY

By: David M. Velazquez
David M. Velazquez
President & Chief Executive Officer

**ATLANTIC CITY ELECTRIC TRANSITION
FUNDING, LLC**

By: David M. Velazquez
David M. Velazquez
Chairman, President &
Chief Executive Officer

CONECTIV SERVICES, INC.

By: David M. Velazquez
David M. Velazquez
Chairman, President, &
Chief Executive Officer

CONECTIV COMMUNICATIONS, INC.

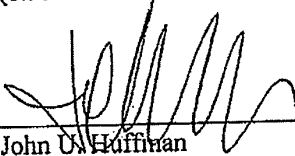
By: David M. Velazquez
David M. Velazquez
Chairman, President, &
Chief Executive Officer

**CONECTIV PROPERTIES AND INVESTMENTS,
INC.**

By: David M. Velazquez
David M. Velazquez
Chairman, President, &
Chief Executive Officer

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PEPCO ENERGY SERVICES, INC.
(on behalf of itself & its subsidiaries)

By: 

John W. Huffman
President, Chief Executive Officer &
Chief Operating Officer


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CONNECTIV, LLC

By: 
Anthony J. Kramerick
Senior Vice President &
Chief Financial Officer

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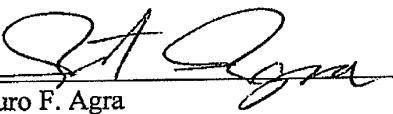
CONECTIV ENERGY SUPPLY, INC.

By: 
Arturo F. Agra
President, Chief Executive Officer &
Chief Financial Officer


**DELAWARE OPERATING SERVICES COMPANY,
LLC**

By: 
Arturo F. Agra
President & Chief Executive Officer

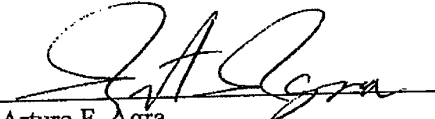
CONECTIV NORTH EAST, LLC

By: 
Arturo F. Agra
President

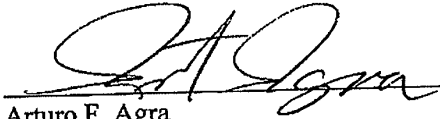
ATLANTIC SOUTHERN PROPERTIES, INC.

By: 
Arturo F. Agra
President

ATLANTIC GENERATION, INC.
(on behalf of itself & its subsidiaries)


By: 
Arturo F. Agra
President

CONECTIV SOLUTIONS LLC

By: 
Arturo F. Agra
President

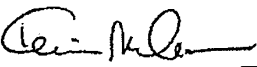
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ATE INVESTMENT, INC.

By: 

Kevin M. McGowan
President & Chief Financial Officer

**POTOMAC CAPITAL INVESTMENT
CORPORATION**
(on behalf of itself & its subsidiaries)

By: 

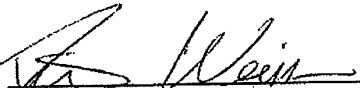
Kevin M. McGowan
President & Chief Executive Officer

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CONNECTIV THERMAL SYSTEMS, INC.

By: 
David N. Weiss
President

ATLANTIC JERSEY THERMAL SYSTEMS, INC.


By: 
David N. Weiss
President

ATS OPERATING SERVICES, INC.

By: 
David N. Weiss
President

THERMAL ENERGY LIMITED PARTNERSHIP I

By: Atlantic Jersey Thermal Systems, Inc
its General Partner

By: 
David N. Weiss
President

Appendix A
Page 1 of 11

This appendix describes (i) the Policies and Procedures (see pages 7-11) to be used to accumulate costs of Service Company services and (ii) the methodologies used to assign or allocate such costs to Client Companies. Definitions of the ratios are provided in Appendix B. The Service Company may provide to associate Client Companies the following services, which may be used by the Client Company:

I. Executive Management

- a. The Executive Management function includes officers of Pepco Holdings, Inc. and PHI Service Company that advise and assist Client Companies on corporate matters such as operations, the issuance of securities, proposals for capital expenditures, budgets, financing, acquisition and disposition of properties, expansion of business, rate structures, public relationships and other corporate matters. The Executive Management function includes the services of the Chairman, CEO, Corporate Secretary, Senior VP and CFO, Senior VP and General Counsel, Controller, Treasurer, Chief Risk Officer, Senior VP External Affairs, President and CEO, Pepco Energy Services, supporting staff and other members of the senior management team as deemed appropriate and not covered in one of the functions below.
- b. To the extent possible, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Two Factor Ratio.

II. Procurement and Administrative Services

- a. The Procurement and Administrative Services functions provide security, including asset protection and investigative services; storeroom procurement and materials management; vehicle resource management, including company vehicle maintenance; mail, records retention management and reprographic services; general services, including strategic sourcing, supplier diversity, supply chain, management and other office services; building services, including facilities management and building maintenance; conference center usage; and real estate services, including right-of-way.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the following ratios:
 1. security - Labor \$ Ratio
 2. storeroom procurement and materials management - Materials Stock Issued Ratio
 3. vehicle resource management - Vehicle \$ Ratio
 4. general services - Two Factor Ratio
 5. building services (facilities cost) - Square Footage Ratio (*)
 6. real estate services - Real Estate Investment Ratio
 7. conference center usage – Employee Ratio (**)
 8. mail, records retention management and reprographic services – Employees by Building Ratio

Appendix A
Page 2 of 11

* - The costs associated with unoccupied space in buildings owned or leased by PHI Service Company will be allocated based on the Service Company Bill Ratio.

** - The Conference Center is used by employees of PHI Service Company as well as employees of other PHI affiliates. The portion of the costs related to usage by PHI Service Company employees will be allocated based on the Service Company Bill Ratio.

III. Financial Services and Corporate Expenses

a. The Financial Services and Corporate Expense function includes financial services such as accounts payable ; payroll accounting services; asset and project accounting services; other financial services, including corporate and strategic planning, budgeting, treasury and finance, risk management, cash management, financing, funded plans administration, investor relations, shareholder services, financial and tax accounting services, regulatory affairs and Sarbanes Oxley compliance oversight; salary accruals; and other corporate expenses, including interest and general fees.

b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the following ratios:

2. accounts payable - Transactions Processed Ratio
3. payroll accounting services – Employees Paid Ratio (*)
4. asset and project accounting services - Gross Property, Plant & Equipment Ratio
5. all other financial services - Two Factor Ratio
6. salary accruals – Two Factor Ratio
7. other corporate expenses – Service Company Bill Ratio

* - The portion of costs associated with payroll accounting services provided for employees of PHI Service Company will be allocated based on the Service Company Bill Ratio.

IV. Insurance Coverage and Services

a. Insurance Coverage and Services includes coverage for property, general liability, directors and officers, vehicle, and miscellaneous insurance premiums and claims; and insurance and claims administration services.

b. Insurance premiums, claims and the related administrative services that are not direct charged will be allocated as follows:

1. property insurance - Gross Insured Property, Plant & Equipment Ratio
2. general liability insurance - Labor \$ Ratio
3. directors and officers insurance - Two Factor Ratio
4. vehicle insurance – Vehicle \$ Ratio
5. insurance administration services – Two Factor Ratio
6. miscellaneous insurance - Two Factor Ratio

7. claims administration services – Historical Claims Ratio

V. Human Resources

- a. The Human Resources function provides compensation and benefit services; personnel, employment and staffing; diversity, employee/labor relations; skills training and management development; performance improvement; and organizational development.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the following ratios:
 1. cost of benefits - To the extent practicable, each Client Company will be directly charged their cost of employee benefits. Employee benefit costs that cannot be directly charged to Client Companies will be allocated based on the Employee Ratio.
 2. executive compensation services - Two Factor Ratio
 3. all other human resources services - Employee Ratio (*)

* - The portion of costs associated with human resources services provided for employees of PHI Service Company will be allocated based on the Service Company Bill Ratio.

VI. Legal Services

- a. The Legal Services function provides legal counsel related to general corporate issues.
- b. To the extent practicable, services will be directly charged using a standard rate per hour as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Historical Legal Direct Labor Charge Ratio.

Legal services are often provided for other functions within PHI Service Company, such as the review of consolidated financial reports and employee relations, these services will be charged to the appropriate Service Company Cost Center. The Cost Center will be allocated to Client Companies based on the approved ratio for the function billed.

VII. Audit Services

- a. The Internal Audit Services function provides audit services related to general corporate issues.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are

not directly charged will be allocated based on the Two Factor Ratio.

VIII. Customer Services

- a. The Customer Services function includes customer service centers, billing, credit and collections, cash remittance processing, administrative and technical support, quality assurance and training, metering services and systems, customer energy efficiency programs, customer systems, the Special Billing group and other customer related activities. The Special Billing group provides billing of non-energy materials and services.
- b. To the extent practicable, services will be directly charged using a standard rate per hour,
as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the following ratios:
 1. special billing - Special Bills Ratio
 2. all other customer services - Customer Ratio

IX. Utility Marketing Services

- a. The Utility Marketing Services function includes sales; market product and sales planning; market and customer research; direct response marketing; and marketing communication.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Customer Ratio.

X. Information Technology

- a. The Information Technology function provides employee labor, contractors, and other operating support of voice and information technology services which currently include the following; telephone and related items; infrastructure and application systems and support, including desktops, network, SAP and other systems; operating and mainframe systems; storage systems; and other IT support, including technology solutions and information management, applications delivery and support, data administration, security, help desk, consulting, business technology management, support for non-mainframe, non-network systems, miscellaneous infrastructure and applications and general management and administration.
- b. To the extent practicable, service costs will be directly charged to Orders, Projects, or Cost Centers using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers and allocated as follows:

1. telephone and related items – Telephone Ratio
2. infrastructure and application systems and support – End User Ratio
3. mainframe and operating systems – CPU Capacity Ratio
4. storage – Data Storage Ratio
5. other IT Services – Two Factor Ratio

IT services and systems are often provided specifically to other functions within PHI Service Company, such as the Customer Billing System, these services/systems will be charged to the appropriate Service Company Cost Center. The cost center will be allocated to Client Companies based on the approved ratio for the function billed.

XI. External Affairs

- a. The External Affairs function includes; general corporate communications such as , employee communications, general corporate advertising/branding; corporate contributions and governmental affairs which involve developing and maintaining relationships with federal and state government institutions and community officials, including lobbying and other activities.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Two Factor Ratio.

XII. Environmental Services

- a. The Environmental Services function includes oversight of environmental concerns related to air, water, land and waste, as well as compliance with relevant regulations.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Two Factor Ratio.

XIII. Safety Services

- a. The Safety Services function includes reporting and compliance with safety regulations, and oversight of corporate safety awareness programs.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated based on the Two Factor Ratio.

XIV. Regulated Electric and Gas Delivery

- a. The Regulated Electric and Gas Delivery function includes the following electric and gas delivery services: system operations services; meter maintenance and testing; power

Appendix A
Page 6 of 11

procurement and energy planning; and other delivery services, including delivery senior management, asset management, financial analysis, engineering standards, interconnection planning and arrangements, distributions and transmission planning, value added services, engineering services for distribution, substation and transmission, system protection, drafting and construction management, electric maintenance, administrative support, forestry, process improvement, training, performance analysis, benchmarking, and enabling systems.

- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. Services that are not direct charged will be accumulated in Cost Centers. All costs that are not direct charged will be allocated based on the following ratios:

1. system operations services - Kwh Output Ratio*
 2. meter maintenance and testing services - Kwh Output Ratio*
 3. power procurement and energy planning – Kwh Output Ratio
 4. other delivery services - Two Factor Ratio
- * (see Appendix B for gas conversion factor).

XV. Internal Consulting Services

- a. The internal consulting services function will provide consulting in areas such as the alignment of people, processes and technologies with a goal of improving productivity and reducing costs for a business line or shared service department.
- b. To the extent practicable, services will be directly charged using a standard rate per hour, as described in the Policies and Procedures found on pages 7-11 of Appendix A. This may include charges to other Service Company departments when they are a client. Any such charges within the Service Company will be included in those functions billed to Client Companies. Services that are not direct charged will be accumulated in Cost Centers. Costs that are not directly charged will be allocated to Client Companies based on the Two Factor Ratio.

Policies and Procedures

General

Service Company will provide services to Client Companies in accordance with the terms of the Service Agreement.

Service Level Standards

Annually, as part of the corporate budgeting process, a budget will be prepared for the services that will be provided to the Client Companies by each of the shared service providers during the next calendar year. The budgets will include assumptions around direct charging for services. Budgeted costs not directly charged will be allocated on a monthly basis in the budget in accordance with the approved costing methodologies utilized on an actual basis. The budget information is processed in the management information system and is available for review by employees of the Client Companies. The budget targets are set by senior management and the final budget is approved by the Board of Directors. The budget process provides each Client Company with service level standards and sets expectations which can be used during the following year to compare actual Service Company performance against these expectations.

Cost Management

Service Company will maintain a cost management information system that allows it to accumulate costs via cost objects. Cost objects are collection tools and include: Orders, Projects, and Cost Centers. Orders and Projects constitute a work order system for charging costs to specific jobs. These tools collect costs for a limited amount of time and either transfer the dollars to a cost center, if they are an expense, or to an asset and/or balance sheet account for capitalized costs. Cost Centers collect costs at the resource or product level and are the final receiver of expenses collected in Orders as described above. This system supports the philosophy of separating costs by business group and legal entity on a fully costed basis. Service Company will use this system to maintain an accounting system to record all costs of operations.

The cost of work performed by the Service Company will be collected in Orders, Projects and Cost Centers. Time records and expense statements will be used to track resource consumption. Labor related costs collect in cost objects referred to as resource cost centers and are expected to be the most significant costs for the Service Company. To the extent practicable, the Service Company employees shall be required to direct-charge their time to an appropriate cost object through the time reporting system. The following guidelines are provided to ensure accuracy and efficient time keeping by Service Company employees:

1. Time should be entered daily into the appropriate time reporting system. If this is not practical, the employee should prepare manually prepared time records, substantiating later electronic time entry.
2. In no event should time entry be delayed past the end of the pay period.
3. Employees should keep track of time in one-half hour increments.
4. Employee time shall be approved in accordance with the Companies' policies.

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Costs will be charged to Client Company Cost Centers, Orders or Projects as work is performed and costs are incurred. The Controller's Department is responsible to ensure that all of the billing methodologies are consistent with the Service Agreement. The establishment of cost objects within the cost management information system for use by the Service Company will be strictly controlled by the Controller's Department. The Controller's Department will ensure that all cost objects have been authorized by the appropriate Service Company department.

Service Company will use a standard costing system. Resource cost centers collect the actual costs of labor and related costs. As products or services are provided by the Service Company cost centers, the services are directly charged to Orders, Projects or other Cost Centers at standard rates. Standard rates, which are calculated at least annually, are based upon anticipated resource costs and activity levels, e.g. available hours to perform work. Any residual amounts or costs that can not be practicably direct billed remain in the resource cost center to be allocated to Client Companies on an appropriate basis, as defined in the Service Agreement. The amount billed to the Client Company is charged to Client Company Orders, Projects and Client Cost Centers created to collect the costs of the services provided to that company.

The Service Company uses cost allocation methods designed to fully distribute costs. The Service Company will have a tiered approach to billing Client Companies comprised of the following steps:

- A. Direct Assignment: Non-labor costs which benefit specific Client Companies will be directly assigned to the specific Client Companies whenever feasible. Costs which are directly assigned to a Client Company are not costs of the Service Company and therefore are not included in the amounts billed.
- B. Direct Charges:
Labor related services consumed for an Order, Project or activity performed specifically for a Client Cost Center will be directly charged to that cost object at a standard rate per unit of labor. The standard rate includes direct costs such as labor, materials and supplies, and indirect expenses such as overhead costs for benefits and payroll taxes, vehicle costs, occupancy costs, and common IT services necessary for the employee to provide the service.

Certain Service Company costs, such as benefit and payroll administration, common IT services (network, phone, workstations, etc.), and building services consumed by Client Companies will be directly charged at a standard rate per unit of services. These rates are based upon anticipated costs and units of service, including expected occupied space (facilities), users (IT), and employees (benefit and payroll administration).

- C. Indirect Charges:
 - 1. Allocations: Costs accumulated that apply to all Client Companies or to a group of Client Companies, which have not been directly assigned or directly charged as described in A or B, above, will be allocated based on the allocation ratios defined in Appendix B. Allocation ratios will be recalculated by the Service Company at least annually. In some instances allocations related to a specific client company may be charged to that companies' parent company in order to reduce administrative burden. In these cases, the raw data used to calculate the

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ratio to be allocated to the parent company includes the portion of the raw data of the subsidiary company. For example, when calculating the Two Factor ratio for the parent company, the O&M and Gross Property, Plant and Equipment amounts for the subsidiary will be added to the data of the parent company.

Statistical key figures (SKF's) are the specific ratios entered into the Service Company's accounting system. There may be multiple SKF's for one defined ratio depending on the specific Client Companies associated with a particular service allocated using the ratio. For example, there will be one SKF for the Two Factor ratio which allocates internal audit services to all Client Companies and a separate SKF to allocate internal audit services to the three utilities if the audit relates only to the operations of those three companies. The raw data used for the utility companies in each SKF is the same. The only difference is the Client Companies receiving the charges for the services.

2. Service Company Cross Charges:

Certain Service Company overhead costs, such as the cost of benefits, purchasing and storeroom management, and other indirect costs, such as benefit and payroll administrative services, common IT services, and building services are charged to Service Company functions that utilize these services and are included in their standard rate for billing to Client Companies. These costs are charged using standard rates based upon anticipated expenses and units of service, e.g. expected salaries (benefits), square footage, etc. Any difference between the amount charged at the standard rates and the actual costs incurred for the month is charged to Client Companies based on the Service Company Bill Ratio.

In addition, information technology services and support for other Services Company functions caused by, labor strikes, storm contingency coverage, and other special projects, may be cross charged to another Service Company function. These charges are included in the amounts that these functions bill to Client Companies and will be allocated based on the approved allocation ratios defined in Appendix B. These situations require the approval of the Controller's department.

Monitoring

The Controller's Department shall be responsible for reviewing, monitoring, and maintaining the process for the accumulation of Service Company costs charged to Client Companies, either through direct or indirect charges. In connection with the responsibility, the Controller's Department shall:

1. Process the annual budget to allocate shared service costs and Service Company cross-charges to Client Companies.
2. Control the establishment of all cost objects for billing Service Company charges.
3. Analyze the reasonableness of charges in the cost management information system.
4. Review and evaluate the reasonableness of the monthly bill to each Client Company.

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The Controller's Department shall be responsible for updating all allocations used by the cost management information system. Supporting workpapers will be maintained by the Controller's Department. The Controller's Department will be responsible to ensure that all allocations are proper, accurate, and current. Also, the Controller's Department shall be responsible for ensuring that the allocation methodologies are in accordance with the provisions of the System's cost accounting manual and the Uniform System of Accounts for Centralized Service Companies promulgated by the FERC, if applicable.

Billing

The amounts billed by PHI Service Company will be available monthly through reports accessible within the accounting system. A hard copy of the bill will be available upon request. The Controller's Department shall be responsible for reviewing the monthly bills, as necessary, with the pertinent officers of the Client Companies, or their designees, who are responsible for approval of the bills upon request.

The monthly bills will contain the following information:

1. The Client Company.
2. The cost of each service billed to the Client Company.

The cost management information system will contain detailed information supporting each service charged to a Client Company. Furthermore, each Client Company cost center head and project manager is responsible for validating, in a timely manner, costs charged to their cost center or project, including amounts billed by the Service Company. This validation is a key component of Pepco Holdings, Inc.'s system of internal controls. Using the cost management information system, cost centers are able to drill down on all costs billed to them by the Service Company to determine the specifics of each cost. The Controller's Department will assist Client Company cost center managers, as necessary, to research and validate charges to their cost centers.

When an erroneous charge is discovered, the Controller's Department is responsible for correction of the error in a timely manner.

Dispute Resolution

If there is a dispute between a Client Company and the Service Company concerning the appropriateness of an amount billed to a Client Company, the Controller's Department will meet with the appropriate representatives for the Client Company cost center and the Service Company to resolve the dispute. If the dispute cannot be resolved by the Controller's Department, the issue will be referred to the Chief Financial Officer of Pepco Holdings, Inc. for disposition.

Internal Audit

The Internal Audit Department shall perform an audit of the Service Company billing process every two years. Computer systems, billings, and source documents will be examined to ensure on a test basis that the services provided are authorized, documented, and accurately

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recorded in the accounting records. The audits will include an examination of the Service Company allocation methods and the allocation factors used to ensure that they are in compliance with the methodologies described in the Service Agreement. Also, the audits will evaluate the adequacy of the system of internal controls over the billing process and the reasonableness of each allocation methodology used to distribute costs to the Client Companies.

Definition of Service Company Allocation Methods

<u>Ratio Title</u>	<u>Ratio Description</u>
CPU Capacity Ratio	A ratio the numerator of which is the amount of CPU capacity used for a particular system within a Client Company, the denominator of which is the total amount of CPU capacity used by all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Customer Ratio	A ratio the numerator of which is the number of customers served by a Client Company, the denominator of which is the total number of customers for all the Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Customers designated as both electric and gas, within the same company, will be assigned 50% to gas and 50% to electric for the purposes of this ratio calculation.
Data Storage Ratio	A ratio the numerator of which is the gigabytes of data storage space used for a particular system application, the denominator of which is the total gigabytes of data storage space used for all system applications (or specific system applications receiving the service allocated per this factor, if not all system applications are receiving the service).
Employee Ratio	A ratio the numerator of which is the number of employees of a Client Company, the denominator of which is the total number of employees for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Employees by Building Ratio	A ratio the numerator of which is the number of employees occupying each building receiving the service, the denominator of which is the total number of employees occupying all buildings receiving the service.
Employees Paid Ratio	A ratio the numerator of which is the number of employees paid through the Service Company's payroll system for a Client Company, the denominator of which is the total number of employees paid through the Service Company's payroll system for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).

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End User Ratio	A ratio the numerator of which is the number of users of infrastructure or application systems within a Client Company, the denominator of which is the total number of users of infrastructure or application systems within all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Gross Insured Property Plant & Equipment Ratio	A ratio the numerator of which is the total gross cost of insured property, plant and equipment in a Client Company, the denominator of which is the total gross cost of insured property, plant and equipment for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Property, Plant and Equipment owned by PHI Service Company, which can not be attributed to a building, and consolidation adjustments not recorded on a specific company are excluded. Property which is insured, but not owned by an affiliate, will be included at its insured value.
Gross Property, Plant & Equipment Ratio	A ratio the numerator of which is the total gross cost of property, plant and equipment in a Client Company, the denominator of which is the total gross cost of property, plant and equipment for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Property, Plant and Equipment owned by PHI Service Company and consolidation adjustments not recorded on a specific company are excluded.
Historical Claims Ratio	A ratio the numerator of which is the total claims expense of a Client Company, the denominator of which is the total claims expense for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Historical Legal Direct Labor Charge Ratio	A ratio the numerator of which is the amount of direct legal time charges to a Client Company for a twelve month period, the denominator of which is the total amount of direct legal time charges to all Client Companies using the service (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service) for a twelve month period. Direct time charges to PHI Service Company are excluded.

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Kwh Output Ratio	A ratio the numerator of which is the number of kilowatt hours purchased and generated by a Client Company, the denominator of which is the total number of kilowatt hours purchased and generated by all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Labor \$ Ratio	A ratio the numerator of which is the amount of labor dollars incurred by a Client Company for a twelve month period , the denominator of which is total labor dollars for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service) for a twelve month period. Any labor dollars attributed to PHI Service Company will be excluded.
Materials Stock Issued Ratio	A ratio the numerator of which is the materials stock issuance from a Client Company store room, the denominator of which is the total materials stock issuances from all Client Company store rooms (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
O&M Ratio	A ratio the numerator of which is the total operations and maintenance (O&M) expense of a Client Company for a twelve month period, the denominator of which is the total operations and maintenance expense for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service) for a twelve month period. Any affiliate whose total O&M expense is negative, the O&M of PHI Service Company, and O&M which is caused by consolidation adjustments will be excluded.
Real Estate Investment Ratio	A ratio the numerator of which is the cost of real estate leases and land and buildings owned by a Client Company, the denominator of which is the total cost of real estate leases and land and buildings for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Real Estate owned or leased by PHI Service Company is excluded.

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Service Company Bill Ratio	A ratio the numerator of which is the total amount billed by PHI Service Company to a Client Company for a twelve month period, the denominator of which is the total amount billed by PHI Service Company to all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service) for a twelve month period. Any client companies billed a negative amount for the twelve month period will be excluded from the calculation.
Special Bills Ratio	A ratio the numerator of which is the number of special bills issued for a Client Company, the denominator of which is the total number of special bills issued for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Bills issued on behalf of PHI Service Company are excluded.
Square Footage Ratio	A ratio the numerator of which is the number of total square feet of space occupied by a Client Company, the denominator of which is the total number of square feet of space occupied by all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Telephone Ratio	A ratio the numerator of which is the number of telephone extensions used by a Client Company, the denominator of which is the number of telephone extensions used by all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).
Transactions Processed Ratio	A ratio the numerator of which is the number of transactions processed for a Client Company, the denominator of which is the total number of transactions processed for all Client Companies using the service (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Transactions processed for PHI Service Company are excluded.
Two Factor Ratio	A composite ratio which is comprised of an average of the O&M and Gross Property, Plant and Equipment ratio percentages (described above) for all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service).

Vehicle \$ Ratio

A ratio the numerator of which is the amount of vehicle rate charges in a specific Client Company, the denominator of which is the total amount of vehicle rate charges in all Client Companies (or specific Client Companies receiving the service allocated per this factor, if not all Companies are receiving the service). Rate charges to PHI Service Company are excluded.

Notes:

Where applicable, the following will be utilized to convert gas sales to equivalent electric sales:
0.303048 cubic feet of gas equals 1 kilowatt-hour of electric sales (based on electricity at 3412 Btu/Kwh and natural gas at 1034 Btu/cubic foot).

The historical time period utilized to prepare the allocation ratio may vary to more accurately reflect ongoing operational activities due to the dissolution or acquisition of a Client Company and/or line of business, the wind down of a Client Company and/or line of business or a significant change in projected future operations of a Client Company.