Agenda Date: 1/21/15
Agenda Item: 1A

STATE OF NEW JERSEY
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
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Trenton, New Jersey 08625-0350
www.nj.gov/bpu/

AUDITS

IN THE MATTER OF AN AUDIT OF THE AFFILIATED TRANSACTIONS BETWEEN ATLANTIC CITY ELECTRIC COMPANY AND PEPCO HOLDINGS, INC. AND ITS AFFILIATES AND A MANAGEMENT AUDIT OF ATLANTIC CITY ELECTRIC COMPANY PURSUANT TO N.J.S.A. 48:2-16.4, 48:3-49, 48:3-55, 48:3-56, 48:3-58 AND N.J.A.C. 14:3-12.1, 14:4-5 ET SEQ.	)	ORDER OF IMPLEMENTATION DOCKET NO. EA07100794

Party of Record:

Philip J. Passanante, Esq., Associate General Counsel, Pepco Holdings, Inc. / Atlantic City Electric Company

BY THE BOARD:

At its agenda meeting of December 19, 2007, the New Jersey Board of Public Utilities (the "Board" or "BPU") authorized the staff of the Audits Division ("Staff") to initiate an audit of the affiliated transactions between Atlantic City Electric Company ("ACE" or "Company") and Pepco Holdings, Inc. ("PHI") and its affiliates, and a Management Audit of ACE. The Board also authorized Staff to send a Request for Proposals ("RFP") to the five pre-approved management consulting firms under State Term Contract T2482.

Staff conducted an informal RFP review conference at the Board's offices on January 15, 2008, to provide the contracted consulting firms with the opportunity to review the RFP with Staff and representatives of the Company.

In accordance with the RFP, bid proposals were submitted to the Board's Audits Division by February 1, 2008 from Liberty Consulting Group, NorthStar Consulting Group, Overland Consulting, PMC Management Consultants, and Schumaker and Company. The bid proposals were subsequently forwarded to the Evaluation Committee for review and analysis. The Evaluation Committee consisted of staff members from the Division of Audits (2), the Division of Energy (2), and Counsel's Office (1).

At its April 3, 2008 agenda meeting, the Board approved the Committee recommendation of Overland Consulting ("Overland" or "Consultant") to perform the audits at a not-to-exceed cost of $687,825.

This assignment was conducted in two concurrent phases. Phase I concentrated on ACE's compliance with the Electric Discount and Energy Competition Act ("EDECA"), particularly its electric procurement strategies, and the impact of the Company's retail and wholesale transactions with PHI and its affiliates. Phase II included a comprehensive management audit of ACE's major organizational areas other than those identified in Phase I. Phase II also included an examination of executive management and corporate governance, organizational structure, strategic planning, finance, accounting and property records, distribution and operation management, human resources, customer services and external relations, and support services.

Prior to Overland's publication of the Final Audit Report of Overland Consulting in the audit of the affiliated transactions between ACE and PHI and its affiliates and in the management audit of the Company (referred to herein as the "Final Report"), draft versions were provided for review by Staff (including the Divisions of Audits and Energy. A draft version was also provided to ACE for its review and comment on factual discrepancies and the need for any redactions in the Final Report to protect information claimed to be confidential or business sensitive.

On February 1, 2010, Overland submitted its Final Report. The Final Report contained 77 recommendations.

At the BPU's March 3, 2010 Agenda Meeting, Staff recommended that the Board accept Overland's Final Report for filing purposes only; authorize the release of the redacted version of the report to the public for comment, and release the confidential version of the report to appropriate parties, with the execution of a confidentiality agreement if requested by the Company. These actions were adopted by the Board.

The only other interested party in this matter is the Division of Rate Counsel ("Rate Counsel"), filing comments and reply comments.

On April 30, 2010, ACE submitted for filing its comments on the recommendations included in the Final Report. The Company responded to the specific recommendations made by Overland and provided further commentary on various statements made within the audit report. On April 20, 2010, PHI announced the sale of its Conectiv Energy power generation assets to Calpine Corporation. PHI announced that it completed the sale of its Conectiv Energy power generation business to Calpine Corporation on June 30, 2010. This sale impacted a number of the recommendations made by Overland in the Final Report. In its comments, the Company concurred with, or did not object to, the majority of the 77 recommendations contained in the Final Report.

By letter dated April 30, 2010, Rate Counsel submitted for filing its comments on the recommendations included in the Final Report. While not specifically noted in its letter, Rate Counsel's comments applied to audit recommendations 2-2, 3-2, 5-3, 8-10, 8-13, 11-1.

On June 9, 2010, Rate Counsel submitted its Reply comments which reiterated a number of its original comments.

On August 13, 2010, the Company filed its reply comments. These comments specifically addressed and provided what it believed rebutted the items raised by Rate Counsel in its original and reply comments.

Subsequent to the filing of the comments and the reply comments, the Company, on its own initiative, began to implement many of the Final Report recommendations. In addition to its specific implementation efforts, Staff has concluded that approximately 30 percent of the recommendations were addressed in other ways. Fourteen of the recommendations were subsumed within the resolutions of other proceedings before the Board. These included recommendations 5-1, 5-2, 5-3, 6-1, 6-2, 8-10, 14-4, 15-1, 15-2, 15-3, 15-4, 15-5 17-1, and 20-2. The sale of Conectiv Energy resulted in recommendations 4-1, 4-3, and 14-2 no longer being needed as the Company no longer owns generation. Two of the recommendations (3-1 and 3-2) are still open due to the pending merger between PHI and Exelon, and Staff has concluded that 4 others (8-5, 8-12, 14-1, and 24-1) are not needed since the Company's then current practices met the intent of the Overland recommendations. During the period of time that the Company has been implementing the remaining 54 recommendations, ACE held several meetings and participated in numerous discussions with representatives of the Audit Division, and provided the Audit Division with documentation and information regarding the implementation process. Based on the documentation and information provided to the Audit Division, as discussed more fully below, Staff believes that the remaining 54 recommendations have been implemented.

Recommendations Resolved in Other Proceedings

Millennium Account Services

Recommendations 5-1, 5-2 and 5-3 ACE, as part of its 2011 Base Rate Case[1], provided testimony and updated cost-benefit information demonstrating that Millennium Account Services provides a net savings to ACE compared with the cost of ACE providing its own meter reading satisfying these recommendations.

Income Taxes

Recommendations 6-1 and 6-2 Based on the settlement from ACE's 2011 Base Rate Case[2], the Consolidated Tax issue(s) were to be addressed in the Generic Proceeding on Consolidated Tax Adjustments ("CTA"). That proceeding, bearing BPU Docket No EO12121072 has been concluded by the Board Order dated October 22, 2014.[3] This CTA proceeding determined the methodology to be used to calculate the consolidated tax saving adjustment. The Board

[1] Docket No ER11080469, In the Matter of the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for other Appropriate Relief, Testimony of Jay C. Ziminsky, at 28-30, August 5, 2011

[2] Ibid.

[3] Board's Order in EO12121072, In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, Order Modifying the Board's Current Consolidated Tax Adjustment Policy, October 22, 2014

approved methodology from this docket resolves the issues addressed by these two recommendations.

Executive Management and Corporate Governance

Recommendation 8-10 This recommendation, dealing with funding for service quality and reliability projects, was addressed in Phase 2 of the Company's 2009 Base Rate Case[4], along with other reliability related recommendations.

In its April 30, 2010 comments, Rate Counsel fully supported Overland's recommendation that service quality and reliability performance be made a high priority and that ACE adopt and document an improvement that will produce immediate and long term positive results in terms of improved service quality within ACE's service territory.[5]

Power Supply Management

Recommendation 14-4 This recommendation involved an issue regarding the recovery of deferred Non-Utility Generation ("NUG") contract restructuring costs. The recommendation was for ACE to write off all deferred NUG contract restructuring costs on the basis that the costs of abandoned restructuring efforts do not provide any future benefit. The amount of costs deferred was approximately $4.4 million. However, the issue of recovering such costs was fully addressed in ACE's 2009 Base Rate Case[6] where there were compromises on multiple issues in the settlement. In the Order approving the settlement, the Company was allowed to fully recover its deferred costs of $4,360,557 related to the Company's efforts to restructure its Non-Utility Generation purchase power agreements in its Regulatory Asset Recovery Charge.

Reliability

Recommendations 15-1 through 15-5 All five recommendations from Chapter 15 were resolved in Phase 2 of the Company 2009 Base Rate Case.[7] The recommendations included the following:

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[4] Board's Order in ER09080664, In the Matter of the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for Other Appropriate Relief, and EA07100794, In the Matter of an Audit of the Affiliated Transactions Between Atlantic City Electric Company and PEPCO Holdings, Inc. and its Affiliates Pursuant to N.J.S.A. 48:3-49, 48:3-55, 48:3-56, 48:3-58 and N.J.S.A. 14:4-5 et. seq. and Management Audit of Atlantic City Electric Company Pursuant to N.J.S.A. 48:2-16.4 and N.J.S.A. 14:3-12.1, Order Approving Stipulation, May 16, 2011

[5] Rate Counsel's Comments, letter dated April 30, 2010, at 9.

[6] Board's Order in ER09080664, In the Matter of the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for other Appropriate Relief, Decision and Order Approving Stipulation and Adopting Initial Decision, May 12, 2010

[7] Board's Order in ER09080664, In the Matter of the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for Other Appropriate Relief and EA07100794; In the Matter of an Audit of the Affiliated Transactions Between Atlantic City Electric Company and PEPCO Holdings, Inc. and its Affiliates Pursuant to N.J.S.A. 48:3-49, 48:3-55, 48:3-56, 48:3-58 and N.J.S.A. 14:4-5 ET.Seq. and Management Audit of Atlantic City Electric Company Pursuant to N.J.S.A. 48:2-16.4 and N.J.S.C. 14:3-12.1, Order Approving Stipulation, May 16, 2011

1. **ACE should increase its vegetation management funding.;**
2. **ACE should provide consistent stable funding for reliability initiatives;**
3. **PHI should prepare a comprehensive reliability improvement plan by March 31, 2010;**
4. **ACE should improve the metrics it uses to measure reliability; and**
5. **ACE should include more information in its Annual System Performance Report.**

Specifically, in the 2009 ACE base rate case, the Board approved a stipulation whereby ACE agreed to propose a Reliability Improvement Plan ("RIP") to address concerns affecting service quality. The RIP was to target six areas for improvement and enhanced investment. These areas included the following: Enhanced Vegetation Management, Priority Feeders, Load Growth, Distribution Automation, Feeder Improvements and Substation Improvements. The objective of the RIP for five of the six initiatives was to focus on overall ACE reliability improvement rather than improvements on a district basis. Funds were to be directed at the most prevalent reliability issues within ACE's overall service area rather than spread proportionally across its four operating districts. The RIP did, however, address Cape May, Glassboro, Pleasantville and Winslow Districts It was ACE's goal under the RIP to have a "robust" system with adequate systems and practices in place to assure continued reliable performance for a median range of operating conditions and the ability to respond to events that are in excess of the design of the system. Thus, the RIP in the 2009 Base Rate Case Order provided how the initiatives and improvements would relate to ACE and provided sufficient detail to understanding the improvements in the plan for each of the ACE's four districts as recommended in the Audit.

Moreover, under the Stipulation, the Company also agreed to maintain any improvements it achieves in its System Average Interruption Duration Index ("SAIOI") and System Average Interruption Frequency Index ("SAIFI"). The Company also agreed to more extensive annual reliability improvement reporting requirements to be filed each May 31. ACE agreed to include in its System Reliability Report supplemental metrics and reliability based on information in addition to the specified reliability indices targets for SAIFI and SAIOI. This included reporting of customers experiencing multiple interruptions and momentary average interruption frequency index. All indices will be reported by the Company on a district basis. Additionally, the Company agreed to report on the 20 worst performing circuit feeders. Reporting of worst performing circuits will include a full explanation of contributing factors and proposed corrective actions. Reporting of outage code categories will include the following: Animal Contact, Tree Contact, Transformer Overload, Circuit Overload, Work Error, Equipment Failure, Lightning Contact.

The first report was to be filed no later than May 31 for calendar year 2011, and on each successive May 31 for the preceding calendar year. These reporting requirements included improved metrics for measuring reliability and more information to Board Staff.

Moreover, in the 2011 base rate case, the parties agreed that after the annual filing of the RIP, the parties would conduct quarterly informal consultations to determine whether the RIP is performing as anticipated and discuss additional improvements that can be considered.

Lost and Unaccounted for Energy

Recommendation 17-1 Based on the documentation from ACE's 2011 Base Rate Case[8], ACE has prepared an energy loss study and an update of the fixed loss adjustment factors that are

[8] Docket Number ER11080469, In the Matter of the Petition of Atlantic City Electric Company for

used in retail and wholesale billing to scale meter level loads to the Atlantic System or Atlantic Zone level.

Customer Service

Recommendation 20-2 This recommendation regarding customer down-payments prior to the initiation of a deferred payment agreement was addressed in the Customer Service portion of Phase 2 of the Company's 2009 Base Rate Case.[9]

Recommendations Resolved Through the Sale of Conectiv Energy

Power Supply and Transmission Affiliate Issues

Recommendations 4-1 and 4-3 These recommendations, dealing with joint participation of the utility and the merchant business in PJM activities and the conducting of internal audits on interconnection and station power arrangements with CESI, are no longer needed due to the sale of Conectiv Energy.

Power Supply Management

Recommendation 14-2 ACE has fully divested its generating plants and, accordingly, has fully allocated all of the ACE zone reactive power generator credits to the unregulated generation owners under various agreements, pursuant to Schedule 2 of the PJM OATT. As such, ACE has no additional credits to assign to the NUG contracts.

Recommendations No Longer Applicable

Executive Management and Corporate Governance

Recommendation 8-5 The recommendation regarding modification to the Company's corporate governance guidelines to limit the number of management directors to one is not necessary as PHI has 12 directors (at the time of the report), only one of which is a management director. Additionally, all board independence requirements of the New York Stock Exchange ("NYSE") have been complied with. Finally, the independent directors are in the best position to assess the appropriate number of directors on a facts and circumstances basis within the requirements set by the NYSE. In light of the foregoing, and based on experts on corporate governance indicating that best practice is to have a majority of independent directors (a practice which PHI has shown that it meets), Staff has concluded that this recommendation is not needed.

Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for other Appropriate Relief, Testimony of Elliott P. Tanos, at 8, August 5, 2011

[9] Board's Order in ER09080664, In the Matter of the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for Other Appropriate Relief, and EA07100794, In the Matter of an Audit of the Affiliated Transactions Between Atlantic City Electric Company and PEPCO Holdings, Inc. and its Affiliates Pursuant to N.J.S.A. 48:3-49, 48:3-55, 48:3-56, 48:3-58 and N.J.S.A. 14:4-5 Et. Seq. and Management Audit of Atlantic City Electric Company Pursuant to N.J.S.A. 48:2-16.4 and N.J.S.C. 14:3-12.1, Order Approving Stipulation, May 16, 2011

Recommendation 8-12 The recommendation that the Chief Financial Officer provide written certification each year to the BPU that ACE has not been allocated or directly charged any costs associated with the Executive Incentive Compensation Plan is not required since Executive Incentive Compensation is not currently allowed in rates.

Support Services – Information Technology

Recommendation 24-1 Regarding the formation and use of a Project Management Organization ("PMO") on large scale Information Technology ("IT") projects. Based on the PMO organization chart provided by the Company, Staff has determined that this recommendation is not needed since PHI already uses a PMO structure for all large scale IT projects.

Remaining Recommendations

CHAPTER 2 - OVERVIEW of AFFILIATE RELATIONSHIPS and TRANSACTIONS

Recommendation 2-1 Fully document the pricing basis and space leased by ACE in the lease. Require ACE to approve all changes in the price per square foot and space leased before they are made. Document all changes in lease amendments signed by both parties.

According to the Report and as stated above, the lease and the Cost Allocation Manual ("CAM") currently contain no information other than "fully distributed cost" to describe the rent that ACE pays to Atlantic Southern Properties, Inc. ("ASP") for its use of the Mays Landing building. The rent varies from year to year, as expenses and space usage change. Overland recommends ACE's rent calculation, including the charges per square foot of finished and unfinished space, and the amount of space leased, be fully documented in the ASP/ACE lease. In addition to full documentation in the lease, to the extent lease prices are based on cost, changes in: 1) the cost basis (cost methodology, cost elements or allocation to space categories); 2) the market price basis (including market survey data supporting the market price; or 3) the *amount* of space leased should be approved in advance and incorporated into the lease by way of an amendment, dated and signed by both ASP and ACE. According to Overland, while it will not turn the lease into an arms-length contract, implementing this recommendation will bring ACE into compliance with standard business practice for documenting commercial lease transactions.

Rather than producing a lease amendment every time there is a change in the assignment of square footage at the Mays Landing Complex, this recommendation will be implemented by the filing of the square footage report with the lease agreement. An example of the square footage report has been supplied to Staff. Staff agrees with this method of implementation because the square footage serves as the basis for any required rate base adjustment for lease charges, and the square footage report is updated as needed when square footage assignments are changed due to personnel/department changes. This recommendation should be considered implemented.

Recommendation 2-2 Conduct an annual survey of market prices for finished and unfinished commercial space in market area surrounding Mays Landing. Ensure the price charged to ACE for finished and unfinished space is no more than the lower of fully allocated cost or the market price for equivalent finished and unfinished commercial space in the local market area.

EDECA transfer pricing rules require that ASP's lease to ACE be priced at "no more than fair market value." N.J.A.C. 14:4-3.5(t). According to the Consultant, ACE's Mays Landing lease did not comply with this provision. As a result, we estimate that ACE paid approximately $1.4 million ($460,000 per year for three years) over the market value for space leased at Mays Landing during the audit period. Overland recommends ACE annually obtain, by survey, the necessary market data to determine that its Mays Landing lease price per square foot does not exceed the market price for equivalent finished or unfinished commercial space in the Mays Landing market area. To the extent ACE is charged more than the market price for either finished or unfinished space (i.e., if ACE is charged "fully distributed cost" that exceeds the market price in either space category), ACE should record the excess of cost over market below-the-line so that it is not passed on to ratepayers. The prior audit recommended that the lease be brought into compliance with EDECA's "lower of cost or market" pricing rules. Despite the prior auditor's report notation that a new lease document (which the auditor had not reviewed) was to be executed, compliance with transfer pricing rules was *not* implemented. Therefore, in this audit, we recommend the NJBPU require ACE to provide documented proof of compliance (consisting of the new lease document and annual market survey results).

Rate Counsel agreed with the objective expressed in the auditor's proposed remedy. That is, ratepayers should not have to reimburse ACE for above-market rents that are being paid by ACE to an affiliate.[10]

The Company has agreed that it will obtain an annual survey of market prices for finished and unfinished commercial space in the market area surrounding Mays Landing from a reputable real estate company. Additionally, the Company will make appropriate adjustments for ratemaking purposes so that the above the line price charged to ACE for finished and unfinished space at the Mays Landing Complex is not more than the lower of fully allocated cost or the market price for equivalent finished and unfinished commercial space in the local market area. Based on the information provided in the Company's Base Rate Case filings, Staff recommends that this recommendation should be considered implemented.

CHAPTER 3 - PHI SERVICE COMPANY

Recommendation 3-1 Include detailed definitions of the calculations of allocation factors (Statistical Key Figures, or SKFs) in the Cost Allocation Manual (CAM) – SKFs are the factors used to allocate common service company expenses to subsidiaries.

Current CAM and Service Agreement documentation of allocation factors is limited to general descriptions that apply to groups of allocators. A lack of documentation creates a potential for changes to be made to calculations and a possibility for the manipulation of allocation results. Overland recommends that PHI incorporate definitions of all SKFs (allocation methods) into the CAM. The definitions should include descriptions of the inputs into the SKF and description of the calculations at a level of detail sufficient to permit an independent recalculation of the allocation factor by anyone possessing the proper financial or operational data. Overland further recommends that PHI adopt a procedure to notify the NJBPU of all intended changes in the methods and inputs used to calculate SKFs, including their impact on ACE's allocation percentage (by showing before and after percentage allocations to ACE), before the changes are implemented

[10] Rate Counsel's Comments, letter dated April 30, 2010, at 8.

On April 30, 2014, the pending merger between PHI and Exelon was announced. The merger may change systems and programs currently in place or being contemplated. PHI currently uses SAP as its accounting software; different software will likely be implemented during integration of the proposed merger, if approved. Therefore, Staff does not recommend any changes at this time.

Recommendation 3-2 Develop reports to show: a) how PHISCO's [PHI Service Company] cost centers link with allocation cost pools; and, b) the SKFs (allocation factors) that are applied to cost pools. To facilitate an overall understanding of how service company activities accounted for in individual cost centers are actually allocated to ACE and other subsidiaries, we recommend PHISCO develop the capability to provide:

> a) A report showing which service company cost centers link to each of PHISCO's 400-plus Secondary Cost Elements (cost pools),
> b) A report showing the methods (SKFs and ATPs) applied to each cost pool.

It is Overland's understanding that establishing these relationships is currently a manual process. PHISCO did this for Overland on a sample basis (for 64 cost pools), but it currently has no automated way of documenting the links among cost centers, cost pools and allocation methods for the service company as a whole or on a regular basis. Providing documentation of these links is fundamental to a high level understanding of PHISCO's allocation process.

In its April 30, 2010 comments with regard to Chapter 3 of the Final Report, Rate Counsel stated its belief that PHI Service Company should be mandated to direct bill a fixed percentage of its costs before allocating the remainder of the costs to regulated businesses.[11] Overland did not make a recommendation in support of the Rate Counsel's position, but found that "accounting procedures for pricing directly charged services included in our audit sample were reasonable."[12]

On April 30, 2014, the pending merger between PHI and Exelon was announced. This merger may change systems and programs currently in place or being contemplated. PHI currently uses SAP as its accounting software; different software will likely be implemented during integration of the proposed merger, if approved. Staff is not recommending any changes at this time.

Recommendation 3-3 Identify all PHISCO activities associated directly or indirectly with legislative and political advocacy, corporate sponsorships, and corporate contributions and ensure that the costs of such activities, to the extent charged to ACE, are charged below-the-line.

Overland found that when PHISCO allocated certain government affairs expenses from activities such as advocacy and corporate sponsorships to ACE, they were charged to an above the-line "receiver"; that is, to above-the-line account 923. PHISCO has mechanisms in place to charge these expenses to below-the-line accounts to the extent they are allocated to the utilities. Overland recommends PHISCO conduct a complete review of its government affairs, donations, sponsorships and political and legislative advocacy activities to ensure that the expenses directly or indirectly connected to these activities including at least a share of the

[11] Id. at 4.
[12] Overland's Final Audit Report, February 2010, at 3-10.

compensation paid to the Government Affairs Vice President, be charged to below-the-line "receivers" (accounts) to the extent they are charged or allocated to ACE.

Based on the information provided to Staff by the Company since the completion of the audit regarding reclassification of certain costs in the 2009 Base Rate Case (BPU Docket No ER09080664), update for actuals, and the creation of a below the line Cost Center, the Company has addressed the concerns cited by Overland and this recommendation should be considered implemented. However, the Company should continue to demonstrate in each base rate case filing that the types of costs that are allocated to the cost center account are being charged below the line and thus, are not directly or indirectly charged to ACE or its ratepayers for ratemaking purposes.

CHAPTER 4 - POWER SUPPLY and TRANSMISSION AFFILIATE ISSUES

Recommendation 4-2 ACE should credit a substantial portion of the Connective Energy Supply, Inc. (CESI) retroactive station power billings to the BGS [Basic Generation Service] deferral account.

Based on the billing and deferral information provided by the Company to Staff, between March 2009 and January 2010, a substantial portion of the CESI retroactive station power billings were credited to the BGS deferral through the Company's billing adjustment process, and, as such, Staff recommends that this recommendation be considered implemented.

CHAPTER 8 - EXECUTIVE MANAGEMENT and CORPORATE GOVERNANCE

Recommendation 8-1 If not otherwise previously distributed from the time of their issue, Overland recommends that investor analyst and rating agency reports be released to directors as part of the next package provided by the CEO in advance of Board meetings.

Based on the listing of materials provided to the Board of Directors that was previously provided to Staff, investor analyst and rating agency reports are reviewed and discussed with the Board of Directors and the Finance Committee, and, as such, Staff recommends that this recommendation should be considered implemented.

Recommendation 8-2 The Board may wish to consider revising the minimum level of PHI stock ownership by Board members to be more in line with industry peer policies.

The Company informed Staff of its intention to adopt new share ownership guidelines in December 2011. This new policy required directors to hold shares of Company stock equal to 4 times the cash retainer.[13] As such, this recommendation should be considered implemented.

Recommendation 8-3 The Company does not provide for formal job descriptions applicable to senior management. Overland recommended that this practice be implemented, among other things, to assure documentation of the scope of each officer's responsibilities.

In the fall of 2011, PHI developed position descriptions for PHI executive roles, which was provided to and reviewed by Staff at the Company offices. With the creation of these position descriptions, this recommendation should be considered implemented.

[13] PHI 2014 Proxy Statement at 26.

Recommendation 8-4 Given the increased level of regulatory activity, senior management should consider more frequent interaction with legislators and regulators regarding its strategic and business planning objectives as they relate to a particular state.

Based on the Company comments dated April 30, 2010, the Company has committed that it will be mindful of this recommendation as it determines how best to communicate its strategic and business planning objectives to legislators and regulators.[14] Staff agrees with the Company that measurement of completion of this recommendation is not practical, and therefore it should be considered implemented.

Recommendation 8-6 PHI should utilize the annual Board Retreat as an opportunity for one or two outside speakers to address economic and financial issues likely to materially impact PHI. PHI may also consider having speakers on occasion at the dinners held the evening prior to normal, scheduled meetings.

The Company has provided a listing of outside speakers to Staff which Staff has determined satisfies this recommendation. Therefore, Staff believes that this recommendation has already been implemented.

Recommendation 8-7 When the majority of Board responses to a particular question on the Board Self-Evaluation Questionnaire falls below "1", options for remedial action should be identified and implemented. A formal process should be put in place to track identification of issues or concerns and actions taken.

All self-evaluation results, as well as any related action items are discussed by the Board as a whole or by the appropriate Board committee. The Board and its Committees discuss with management changes that they would like to see implemented and management has implemented the requested changes,[15] Staff finds this recommendation has been implemented.

Recommendation 8-8 While Directors have typically visited the control center in connection with their initial orientation; there have been few opportunities to visit facilities throughout the PHI service area. PHI should consider occasionally holding meetings in locations other than Edison Place.

The Company has provided documentation that the Directors have visited the PHI's control center in Maryland and held the July 2009 (and July 2013) Board meeting in Wilmington, DE which, in both cases, included a tour of Conectiv Energy's and other PHI facilities in the Wilmington area. In July 2010, the Board met in New Jersey, and toured the Mays Landing facility. Staff finds this recommendation has been implemented.

Recommendation 8-9 While the Board is provided opportunities for continuing education, director training should be coordinated on a more formalized basis, with defined expectations of minimum participation levels.

Based on the listing, provided by the Company to Staff, of training courses attended by Board members, Staff believes that this recommendation should be considered implemented.

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[14] ACE's Response, dated April 30, 2010, at 27.
[15] Id. at 28.

Recommendation 8-11 Should PHI corporate credit ratings decline from present levels, the BPU should open a proceeding to consider the implementation of ring-fencing measures to protect ACE from potential adverse effects of its unregulated affiliates.

The Company has agreed that it will advise the Chief Economist of the Board in the event of a drop in PHI credit ratings. The Chief Economist will then advise the Board and pursue whatever action is deemed necessary. This recommendation should be considered implemented.

Recommendation 8-13 Overland recommended the Comp HR Committee reevaluate the weightings it assigns to goals associated with both short-term and long-term executive compensation. In doing so, the Committee should re-design current incentives so that they motivate executives to attain goals associated with customer satisfaction, safety, and reliability while at the same time appropriately penalizing them for poor performance in these same areas. In addition, the Comp HR Committee should consider both the additional costs of developing and tracking numerous performance goals and the potential benefits (e.g. increased motivation) that assigning insignificant weightings to goals will have on executives.

Rate Counsel agrees with this recommendation but believes it does not go far enough. Rate Counsel recommended that the Board direct Overland to examine whether it would be appropriate or feasible to elevate service quality to the same priority level as corporate earnings in setting incentive targets.[16]

Based on information included in the PHI Proxy Statements submitted for review by Staff, the Board of Directors' Compensation/Human Resources Committee regularly evaluates both short- and long-term executive compensation and engages an independent compensation consultant to assist in these evaluations to assure that goals and performance targets are appropriate. Therefore, Staff believes no further action is required and that this recommendation should be considered implemented.

Recommendation 8-14 Overland recommended the Company consider setting a dollar cap on the delegation authority provided to the Chairman of the Audit Committee for eligible products and services offered by the external auditor between regularly scheduled Audit Committee meetings.

The Company provided Staff with its Policy on the Approval of Services Provided by the Independent Auditor ("Policy"). The Policy permits the Chairman of the Audit Committee to approve non-audit services of up to $1.0 million without full committee approval. The Policy further requires the Chairman to report any services so approved to the Audit Committee at its next regularly scheduled meeting. Based on the current policy, this recommendation should be considered implemented.

CHAPTER 9 - STRATEGIC PLANNING

Recommendation 9-1 The Strategic Planning function currently reports to the CFO. This is a key process and a fundamental area of focus for senior management and the Board. As such, this function should report directly to the CEO.

[16] Rate Counsel's Comments, letter dated April 30, 2010, at 10.

A January 2010 survey of the Edison Institute ("EEI") member companies with Strategic Planning departments active on the EEI Strategic Issues Committee showed that those organizations report directly to the CEO only 40% of the time. Most of the Strategic Planning departments, at 48% of the companies, reported directly to the CFO, in the same way that PHI has its departments organized. The remaining departments, at 12%, reported directly to the Chief Operating Officer ("COO"). Although the strategic planning function reports to the CFO, the CEO, the Executive Leadership Team at PHI, and key Power Delivery executives are actively involved in the entire strategic planning process.[17] Based on the material provided to Staff, the Company will maintain its current structure regarding Strategic Planning, but will continue to monitor industry trends with regard to the reporting position for this function. This recommendation should be considered implemented.

Recommendation 9-2 The executive responsible for strategic planning devotes approximately 20-25% of his time to this area. Overland believes that management should consider a further commitment of resource time to the area, given the complexities involved with monitoring and implementation in the current environment.

The Company has informed Staff that it has added a Vice President-Strategic Planning position and provided Staff with a copy of the revised organization chart. This recommendation should be considered implemented.

Recommendation 9-3 PHI has had various degrees of success in the implementation of the "Blueprint for the Future" initiative within its various jurisdictions. Without abandoning its core objectives, the Company should be willing to adapt the various components of its plan to the preferences of each state jurisdiction. With regard to ACE, PHI may need to consider an increased effort by senior management to move its objectives forward.

The Company has discussed and continues to be willing to discuss implementation of aspects of the proposal with interested parties at the BPU, the Governor's Office or other stakeholders, subject to New Jersey ex parte, lobbying, and other requirements of law. Staff agrees with the Company that measurement of this recommendation is not practical and, as such, it should be considered implemented.

CHAPTER 11 - FINANCE

Recommendation 11-1 The ACE equity ratio has declined somewhat in 2008, and should be increased to protect current credit ratings.

In its April 30, 2010 comments, Rate Counsel stated that it believed this recommendation may be unnecessary or dangerous.[18] Rate Counsel went on to say that the recommendation may be unnecessary because ACE is in the final stages of completing a rate increase filing wherein the appropriate capitalization ratios are being established for rate making purposes.[19]

The Company's Common Equity ratio is addressed in every one of the Company's Base Rate Cases and a specific capital structure is adopted by the Board in its order. As such, Staff does not believe that any action needs to be taken on this recommendation at this time.

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[17] Id. at 32
[18] Rate Counsel's Comments, letter dated April 30, 2010, at 10.
[19] Id at 10-11

Recommendation 11-2 PHI should place more emphasis on its strategic and business plans and related financial forecasts in assessing cost recovery requirements. This may require heightened efforts to develop consensus with regulators and legislators.

To prepare base rate proceedings, the Company uses its financial forecasts and related business and strategic plans to assess the need for and timing of cost recovery through rate cases and similar filings. Staff agrees that measurement of this recommendation is impractical and, as such, this recommendation should be deemed implemented or not required.

CHAPTER 12 - CASH MANAGEMENT

Recommendation 12-1 Overland recommended the money pool conditions agreed to by ACE in the previous Competitive Service Offerings audit be maintained, and ACE should file any proposed changes to these terms with the BPU and receive approval before implementing them. Both parties should come to an understanding regarding the use of the money pool to settle intercompany transactions.

ACE and the Staff have an agreement[20] regarding using the money pool to settle inter-company transactions, and that ACE will continue to operate and abide by the findings of the Competitive Services Offerings audit by filing quarterly reports to the Staff demonstrating that it is abiding by the Competitive Services Offerings audit. As such, this recommendation should be considered implemented.

CHAPTER 13 - ACCOUNTING and PROPERTY RECORDS

Recommendation 13-1 Overland recommended that the Company take the necessary steps within the next twelve months to satisfactorily address, in all material respects, the finance staffing concerns that have affected the Company for the past five years.

Staff has determined, based on its review of the updated organizational charts provided by the Company to Staff, that by filling the open positions, the Company has addressed the finance staffing concerns cited by Overland and this recommendation should be considered implemented.

Recommendation 13-2 On a spot basis, Overland recommends that Internal Audit confirm both the occurrence of actions asserted to have been taken by management in response to internal audit report recommendations and the effectiveness of those actions to remedy the noted audit findings.

Based on the information provided to Staff from the Company's Internal Audit Manual, Section 6.0 page 1-3, revision no. 5, effective October 31, 2011, Monitoring Open Audit Recommendations, this recommendation has been implemented by the Company taking definitive steps to follow-up on all audit recommendations.

Recommendation 13-3 As part of its formal internal audit report, Overland recommends that Internal Audit summarize its attribute sampling results and quantify in dollar terms the instances of noncompliance and total sample tested.

[20] Response to Discovery OC-1; Audit recommendation No. 31-letter dated September 28, 2006 from Mark C. Beyer, Chief Economist of the BPU, to Jeffery E. Snyder, Assistant Treasurer of ACE.

Based on the information provided to Staff from the Company's Internal Audit Manual, Section 5.0 pages 1-5, revision no 5, effective 31, 2011, Audit Report Process, Staff believes that this recommendation has been implemented by having Internal Audit summarize and quantify in dollars the results when attribute sampling is used during an internal audit and discussed in the audit report. Where appropriate, the audit report will also discuss the interpretation of the results cited.

CHAPTER 14 - POWER SUPPLY MANAGEMENT

Recommendation 14-1 ACE should prepare biennial power supply plans. ACE's power supply costs are impacted by complex interactions between a large number of external factors and strategic alternatives. Those interactions and alternatives should be analyzed on an integrated basis. ACE should prepare biennial power supply plans for its BGS firm requirements load. PHI already prepares extensive power supply plans for Pepco and Delmarva. Much of the technical analysis required for those plans is also applicable to ACE. The incremental effort and cost to prepare an ACE plan should be relatively modest.

Due to the process used by the Board to procure BGS supply, it is unnecessary to perform biennial power supply plans, and therefore, Staff has concluded that implementation of this recommendation should not be required.

Recommendation 14-3 Logan and Chambers CO2 allowance costs should not be passed through to ACE. The increased costs are not recoverable under the Logan or Chambers NUG contracts. The contract capacity prices greatly exceeded market prices for many years. The owners expected the contract to be honored when the capacity prices were extremely high. Those extremely high capacity prices amply compensated the owners for the risk that environmental costs might increase in the future. The owners have already been compensated for that risk and should not be allowed to increase their charges to ACE.

Logan and Chambers CO2 allowance costs were not and should not be passed through to ACE. The purchase prices for energy and capacity are set by the contract terms, which did not include pass-through of CO2 or any other emissions costs, or any other taxes and assessments. Copies of recent bills have been provided to Staff to show that billing is being done per the contacts. As such, this recommendation should be considered implemented.

CHAPTER 16 - EMERGENCY MANAGEMENT - STORM RESPONSE

Recommendation 16-1 ACE should prepare an assessment of its capabilities to respond to a hurricane. ACE has not prepared an assessment since the Witt Report. ACE should prepare an assessment of its capabilities to restore service after a hurricane. The assessment should be distributed to the leaders on ACE's Regional and District Incident Management Teams to facilitate communications about storm response plans, capabilities and roles.

Based on discussions and meetings between Staff and the Company, it was agreed that having ACE participate in storm drills would satisfy the intent of this recommendation. Based on the Exercise Plan for the September 22, 2010 "Bay Blast" exercise provided by the Company to Staff, ACE actively participated in the annual "Storm Drill" conducted by the PHI utilities. As such, this recommendation should be considered implemented[21].

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[21] This Order does not address the recommendations and directives included in the Order dated 1/23/13,

Recommendation 16-2 ACE should complete its Incident Response Plan. ACE's current Incident Management Team (IMT) plan is inadequate. ACE recognized the need for a new plan and issued a draft plan in April 2005. The completion of the new ACE incident response plan has been delayed for far too long. ACE should place a high priority on completing the plan.

Information was previously provided by the Company to Staff, and Staff agrees that the ACE Incident Response Plan was completed in the fourth quarter of 2009, and it is posted on the Company's Emergency Preparedness intranet web page. The entire plan is available on the Company's intranet site and was also available for Staff to review at the Company's Mays Landing or Trenton offices. This recommendation should be considered implemented.

CHAPTER 17 - LOST and UNACCOUNTED for ENERGY

Recommendation 17-2 ACE should develop the capability to reconcile its energy account on a more detailed basis. ACE does not estimate or analyze its energy losses by cause category. ACE only prepares energy account reconciliations at the total system level. Calculating actual loss percentages at a substation and feeder level would allow ACE to identify and analyze facilities with unusually high energy losses. Developing a better understanding of the sources of energy losses will help ACE develop cost effective strategies for reducing losses.

This recommendation is an extension of the work to be performed in Recommendation 17-1, which calls for the Company to prepare an energy loss study to update fixed loss factors. Based on information provided to Staff by the Company, the energy loss study was completed in mid-2011. At that time, the Company determined that, in order to perform a loss study at a more detailed level, Advance Meter Infrastructure ("AMI") data needs to be available to reconcile the loads with loss estimates at the substation or feeder level. In addition, this requires knowledge of the coincident loads at all voltage levels and delivery paths from the end-use up to the Atlantic System level. In making this recommendation, Overland recognized the need for interval metering at load centers and circuits between the zone and the service, and acknowledged the need for AMI interval metering at the services to get coincident load data to calculate the losses. Currently, the Company has no AMI metering in New Jersey and therefore will not have the capability to reconcile loads at more detailed levels in the foreseeable future. As such, Staff agrees that since the Company will not have the data necessary to carry out this recommendation, and recommends that this recommendation should be considered implemented or should be eliminated.

CHAPTER 18 - ONE CALL DAMAGE PREVENTION PROGRAM

Recommendation 18-1 PHI should consider centralizing the management of the locating and mark out function in the service company.

Staff has determined, based on the additional information provided, the Company has conducted an analysis of the centralized approach of managing the underground facilities locating contract, and has concluded that since the PHI utilities have separate service territories in four states each having laws, regulatory oversight open "one-call" dispatch processes, and best practices as they specifically relate to the respective state jurisdiction, there was no benefit to centralized management of the locating and mark-out function. Staff agrees that retaining this function in New Jersey is a critical component of ACE's responsibilities under the New Jersey

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In the Matter of the Board's Review of the Utilities' Response to Hurricane Irene, EO11090543.

underground damage prevention program. Further, ACE should continue its delivery of outreach and education programs to the State's damage prevention stakeholder community. As such, this recommendation should be considered implemented.

CHAPTER 19 - CONSTRUCTION CONTRACT MANAGEMENT - INSPECTION

Recommendation 19-1 PHI should consider replacing some temporary construction management construction representatives (CM-CRs) with permanent CM-CRs. The stated purpose of using the retirees is to supplement the permanent workforce to address peak workload requirements. Ten of the retirees are essentially working for ACE full time. The contracting approach does not result in significant cost savings. Replacing some of the retirees with permanent employees would produce a number of benefits including improving internal controls and facilitating process improvements.

The Company has added two additional permanent construction representatives and has elevated one position to a supervisory role; therefore, this recommendation should be considered implemented.

Recommendation 19-2 A final inspection report should be prepared for contracts exceeding $100,000. A written inspection report should be prepared for larger projects to document compliance with contract requirements and facilitate communications and accountability.

This recommendation has been implemented by ACE requiring the preparation of a final inspection report for all construction projects where contract labor exceeds $100,000. A revised Final Inspection Report was implemented on December 31, 2012, and ACE represents that is being used. Therefore, based on the information provided, this recommendation should be considered implemented.

Recommendation 19-3 The contractor evaluation should be completed for all contracts exceeding $100,000. PHI has a form for evaluating contractor performance. However, the evaluations are only prepared for about ten to twenty percent of ACE's lump-sum bid projects. The contractor evaluation could provide valuable information for future bid evaluations.

This recommendation has been implemented by ACE performing a contractor evaluation for all contracts where contract construction labor exceeds $100,000. Construction Management has been utilizing the PHI corporate network directory file system (shared folder) as a repository for contractor evaluations. The use of this shared folder provides a centralized location for construction contractor evaluations. This information is available and used for future contractor selection and award. Based on the work completed on this recommendation, this recommendation should be considered implemented.

CHAPTER 20 - CUSTOMER SERVICE

Recommendation 20-1 Overland recommended the Company reevaluate the number and weighting of Annual Incentive Plan goals it maintains for its various employee groups. In doing so, the Company should consider both the additional costs of developing and tracking numerous performance goals and diminishing benefits (e.g. lack of motivation) that assigning insignificant weightings to goals will have on employees.

The Company's current Annual Incentive Plan process already includes what Overland's recommendation seems to suggest. Since the Company's Annual Incentive Plan process is a dynamic one with the ability to change the number and weighting of the goals it maintains, especially with respect to the Customer Care organization, no additional activity is needed as a result of the Overland recommendation. As such, the recommendation should be considered implemented.

CHAPTER 21 - HR OVERVIEW, WORK FORCE PLANNING and STAFFING

Recommendation 21-1 PHI should consider implementing an HR service center in 2010. Establishing an HR service center would concentrate administrative and transactional tasks in an organization dedicated to operational efficiency in those areas. The service center would allow the HR Department's other areas to focus on higher value activities. The service center concept recommended by North Highland has considerable merit.

PHI has implemented an online HR Service Center that is focused on several key principles, including: a) giving employees a common portal to access HR information on-line; b) utilizing common technology to manage, track, trend, and measure case management and resolution; c) improving role clarity for process execution between the Centers of Expertise, the HR Business Partners, and the Service Center so that the right resources are directed towards transactional issues and the right resources are driving more strategic decision making with respect to HR issues; and d) implementing metrics to measure the overall performance of the Service Center.[22] Based on the supporting documentation provided to Staff announcing the HR Service Center, this recommendation should be considered implemented.

Recommendation 21-2 PHI should move forward with the HR dashboard business intelligence project. The project will facilitate the extraction and analysis of data enabling better management decisions. The project will increase workforce planning efficiency and reduce the manual processing currently required to prepare the HR metrics dashboard. The implementation cost is relatively modest.

Based on the information provided to Staff (even though the Company had a change in strategy regarding the use of SAP BW), People Strategy and Human Resources ("PS&HR") has established an excel-based HR Dashboard to assist in managing HR processes. This dashboard has been in place since 2009 and incorporates data from various HR systems and processes. As such, this recommendation should be considered implemented.

Recommendation 21-3 PHI should implement a cross-functional job rotation program. PHI does not currently have a cross-functional job rotation program. Those programs have a number of benefits including increased job satisfaction and reduced turnover. North Highland recommended that PHI implement a job rotation program as a career development tool. The program should be integrated with PHI's workforce planning and employee development strategies.

According to the update in the implementation response provided by the Company in April 2014, PHI has continued investigating its readiness for a company-wide cross rotational program. Existing assessment supports the implementation of this recommendation. During the fall of 2009, the Office of Diversity in PS&HR launched the PS&HR Cross Rotational Development Program ("CRDP"), designed to gather data as to needed IT support, logistic demands, and

[22] PHI News – Issue 08-September 2011

developmental opportunities that could successfully be deployed on a larger scale initiative. The PS&HR CRDP pilot included a design of temporary assignments aimed at providing cross training, professional development, competency enhancement, and knowledge sharing opportunities for employees working within the PS&HR department at PHI. Employees who participated gained new knowledge, skills, and professional growth as a result of the rotational assignment. Since 2009, however, PHI and its affiliates have undergone organizational wide restructuring that results in the need for further evaluation of the readiness and timing of an expansion of cross-functional job rotation programs in other areas of the company. As a result of the 2010 Organization Review Process ("ORP"), and the resulting organizational changes from this process, it has been determined that the timing is not right for a company-wide cross rotational program. However, PHI looking at the feasibility of developing a rotation program for accounting, but that is still in the discussion stage. The Power Delivery organization is focusing on the creation of a Leadership Development Program. This program is in the early stages of development and design. Candidates for participation in the program will come from Power Delivery's supervisors and managers. A working committee of Power Delivery executives has been formed to complete the Program design, which is expected by the end of 2014. Staff has determined, based on its review of the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, Staff agrees with the Company that no further action is required to achieve the objectives of this recommendation.

Recommendation 21-4 PHI should develop a centralized employee recognition and rewards program. PHI does not have any centralized programs to recognize and reward individual performance. Employee recognition and reward programs motivate performance and increase job satisfaction. A formal recognition system for rewarding individual performance is an industry best practice. PHI should accelerate its efforts to develop a recognition and rewards policy and program.

The Company provided information to Staff describing the PHI Management Recognition Award Program effective May 1, 2011. The objective of the program is to implement a consistent PHI wide recognition program to reward management employees for significant contributions to the successes of the business that are above and beyond day to day responsibilities. As such, Staff has concluded that this recommendation has been implemented.

CHAPTER 22 - HR PERFORMANCE EVALUATION, COMPENSATION and TRAINING

Recommendation 22-1 PHI should implement mandatory performance evaluation training for supervisors and managers. PHI supervisors are not using the full range of Performance Accountability System (PAS) ratings. PHI's current supervisor training is ineffective. PHI should enhance its training for supervisors and make the training mandatory.

Staff has agreed with the Company that rather than implementing mandatory performance evaluation training for supervisors and managers, the Company (through its ultimate parent, PHI) was to assess its PAS and implement modifications as warranted. Based on the documentation provided to Staff, the Company has implemented substantial changes to the PAS as a result of a review and assessment of the then existing PAS including redefining ratings, reweighting of goals, reweighting core competencies, and simplification of the overall process. As such, this recommendation should be considered implemented.

Recommendation 22-2 PHI should incorporate individual performance into the Annual Incentive Plan ("AIP"). The current linkage between individual performance and AIP payouts is too weak to motivate employees. PHI's ability to recognize individual performance in merit pay increases is limited by the budgeting process. The AIP appears to be the most viable mechanism for differentiating pay based on performance. Individual performance should be given at least a one-third weight in the AIP payout formulas.

The Company (through its ultimate parent company, PHI) has not implemented any changes in the AIP plan to provide for individual goals. At this time, the Company feels that team level goals under the AIP provide the appropriate line of sight, and are supportive of a participative team environment. The Company did implement a recognition and rewards program in 2011 to provide management an additional tool to recognize extraordinary employee performance. (*See* Recommendation 21-4) The Company feels that the current combination of performance management and merit, annual incentives, and recognition awards programs provides the appropriate compensation mix to manage employee performance. Based on the information provided to Staff, the intent of this recommendation has been met and that this recommendation should be considered implemented.

Recommendation 22-3 PHI should evaluate its training organizational model. There are three basic types of training organizational models: decentralized, centralized and federated. The trend in general industry is to move towards the centralized model. PHI currently uses the decentralized model. PHI's decentralized approach lacks enterprise-wide governance and coordination and does not optimize resource utilization. PHI should review industry best practices and evaluate the advantages and disadvantages of using the federated or centralized training organizational models.

The Company conducted an evaluation of its training organization model in 2010 as part of the Organization Review Process ("ORP"), and the Manager of Training was assigned to the HR sub-team, to assist in the evaluating the Training Strategy and Operating Model. As a result of the review project, a number of significant activities took place, including:

- 3 PHI training Full-Time Equivalent reductions in December 2010;
- Realignment of the Training Department to Power Delivery Operations effective January 2011;
- Project Charter drafted in November 2010 to evaluate PHI's Training Strategy and Operating Model (copy provided); and
- Survey of 21 electric utilities' training organizational models that supports PHI's current model.

Based on the information provided to Staff, this recommendation should be considered implemented.

Recommendation 22-4 PHI should accelerate its efforts to standardize operating procedures. Historically, each of PHI's four operating regions wrote and maintained separate operating procedures. PHI has a goal of standardizing the procedures. Standardizing procedures would reduce training costs because the same training courses could be used in all the regions. The resources assigned to the standardization process are currently inadequate.

Staff has determined, based on its review of the additional information provided by the Company, that the Company has and continues to develop and consolidate its operating procedures. This work includes the creation of a working team data base re-alignment of operating procedures that may more effectively and efficiently permit access, segmentation, and review of operating procedures. In addition, all new and revised operating procedures are evaluated, on a case by case basis to determine if the subject may address more than one operating region, and if so the operating procedure is written accordingly so as to cover those regions. A single data base has been developed to contain all of the operating procedures. The data base was developed over a two year period and went on line in January 2013. Currently the data base contains approximately 525 procedures. The Company has provided Staff with sample information from the data base. Based on the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, Staff agrees that this recommendation should be considered implemented.

CHAPTER 23 - HR EMPLOYEE BENEFITS and PRODUCTIVITY ANALYSIS

Recommendation 23-1 PHI should work with its unions to consolidate its medical plans. Consolidating PHI's medical plans would reduce costs and administrative complexity. Pepco's IBEW local agreed to medical plan consolidation in 2004. PHI should work with its ACE and Delmarva IBEW locals to eliminate plans that are not cost effective.

The Company has made medical plan consolidation part of the cycle of union negotiations. The Delmarva and ACE local unions agreed to eliminate two indemnity plans and one HMO plan, leaving only three of the six heritage plans. This recommendation should be considered implemented.

Recommendation 23-2 PHI should consider increasing the monthly contributions paid by pre-Medicare participants in its retiree medical plans. Pre-Medicare participants in PHI's retiree medical plans pay significantly lower contributions than those required by other electric utilities. PHI's contribution requirements are inconsistent with industry practice.

PHI provided to Staff a description of its recent changes to its medical plans. These changes include elimination of retiree medical subsidies for all PHI employees hired after specific dates. These subsidies were eliminated for management in 2005. In the most recent cycle of negotiations, ACE union employees hired on or after July 1, 2011 will be able to participate in the retiree medical plan but without subsidy. Further all retirees, regardless of hire date, now participate in the PHI plans and all heritage plans have been eliminated for retirees. Based on the information provided, Staff has determined that this recommendation should be considered implemented.

Recommendation 23-3 The Operations Department should implement an internal benchmarking program. The Operations Department does not compare productivity in ACE's four districts to productivity in Delmarva and Pepco districts. The large scope of PHI's operations provides a significant opportunity for internal benchmarking. Comparing productivity across the three utilities would facilitate the replication of best practices and the standardization of operating procedures.

According to information provided by the Company, PHI presently does perform benchmarking across the operations organizations, including the results of the annual PA Consulting benchmarking survey which includes many of the dimensions mentioned in the recommendation. As noted elsewhere in the audit report (page 23-30), PHI also tracks on a monthly basis across the operating organization a number of internal metrics related to the cost per order for various types of work, number of orders completed per day, completion times for emergency work, etc. Based on its review of the information provided, Staff has determined that this recommendation should be considered implemented or unnecessary.

CHAPTER 25 - SUPPORT SERVICES – OTHER

Facilities and Real Estate Management

Recommendation 25-1 Facilities Overland recommended the Company implement a program of service level expectations similar to what is used in the Information Technology department to measure and assess Facilities, Security, and Real Estate Management performance.

Staff has determined that based on the additional information provided by the Company in a written response, during implementation process in 2010, Support Services put together its annual Business Plan which was developed in conjunction with Power Delivery. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Facilities. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees.

Additionally, the Services Steering and Strategy Committee have been created which closely models the IT Steering and Strategy Committees currently in place. The purpose of the Services Steering and Strategy Committees is to provide a more formal/structured approach in addressing service levels – matters of cost, quality and speed, along with a place to vet issues/ideas for the upcoming year for Fleet, Facilities, Corporate Security, HR Services and Disbursements and Supply Chain. In 2011 and 2012, Facility Management, in conjunction with the Support Service Organization, developed an Accountability Plan that identified key business initiatives and service level agreements. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Facilities. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees. For Facilities, the metric focuses on Facility availability. These metrics were continued for 2014.

Based on the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, it is Staff's position that this recommendation should be considered implemented.

Recommendation 25-2 Facilities and Real Estate Overland recommended the Company consider updating its benchmarking data on Facilities and Real Estate Management so that relative Company performance can be assessed. Industry-specific or geographically relevant data would be preferred over data that has been obtained in the past.

Staff has determined, based on its review of the additional information provided by the Company in a written response, during the implementation process, that the Company works with related trade organizations in an effort to obtain benchmarking data on Facilities. In 2011, Facilities conducted an industry-specific benchmarking study with the EUBA (Electric Utility Benchmarking Association). Additional benchmarking studies are contemplated, by the Company. Based on the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, it is Staff's position that no further action is required to achieve the objectives of this recommendation.

Supply Chain

Recommendation 25-1 Supply Chain Overland recommended the Company implement a program of service level expectations similar to what is used in the Information Technology department to measure and assess Supply Chain performance.

Staff has determined, based on its review of the additional information provided by the Company in a written response, during the implementation process in 2010, Support Services put together its annual Business Plan which was developed in conjunction with Power Delivery. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Supply Chain. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees. Additionally, a Services Steering and Strategy Committee has been created which closely models the IT Steering and Strategy Committees currently in place. The purpose of the Services Steering and Strategy Committee is to provide a more formal/structured approach in addressing service levels – matters of cost, quality and speed, along with a place to vet issues/ideas for the upcoming year for Fleet, Facilities, Corporate Security, HR Services and Disbursements and Supply Chain.

In 2011 and 2012, Supply Chain, in conjunction with the Support Service Organization, developed an Accountability Plan that identified key business initiatives and service level agreements. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Supply Chain. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees. For Supply Chain, the metric focuses on critical inventory availability, and inventory accuracy level. These metrics were continued for 2014 and are as follows:

•Deliver Supply Chain services at the agreed upon levels

Critical Inventory Availability

Threshold:	95%
Target:	97%
Stretch:	98%

Inventory Accuracy

Threshold:	95%
Target:	96% and no significant SOX deficiencies related to inventory
Stretch:	98% and no SOX deficiencies related to inventory

Based on the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, it is Staff's position that this recommendation should be considered implemented.

Vehicle Resources Management ("VRM")

Recommendation 25-1 VRM Given ACE's significantly higher-than-average cost per vehicle (compared with PHI and the Utilimarc benchmark study average), as heavier duty vehicles (large pickups and bucket trucks) are retired from service, we recommend ACE determine, on a case-by-case basis, whether they can be replaced with smaller, lighter versions of the same vehicle type. A list of retired heavy duty vehicles and their replacements should be maintained and, when it is determined that less costly replacements are not feasible, the reason should be documented. The list should be reviewed annually by the Vehicle Resources Group Manager in conjunction with annual transportation budget to provide a second level of review as to whether smaller, less costly vehicles can be acquired as heavy duty vehicles are retired.

Based on the information provided to Staff, *this recommendation has been implemented* by VRM compiling a list of replacement vehicle candidates each year as part of the overall budget process and reviewing them with ACE Business Partners. As large vehicles (i.e., bucket trucks, derricks, buried distribution trucks, etc.) are identified for replacement, VRM will continue to work with the Business Partners to determine if the vehicle can be replaced with a smaller, lighter version of the same vehicle type. If a suitable replacement is identified that is a smaller, lighter version of the same unit, it will be obtained.

Records Management

Recommendation 25-1 Records Management Overland recommended ACE (and PHI) implement a policy addressing the retention of corporate email. There is currently no policy covering email and, based on potentially conflicting practices and requirements (as discussed below), it does not appear that the generic applicability of corporate records policy is sufficient to provide assurance that records maintained as emails and email attachments will be retained for required periods. The policy should address 1) the types of emails that constitute a corporate record, 2) retention of email correspondence and attachments by employees on their computers, and 3) retention of archived email correspondence and attachments by the IT organization. We do not recommend specific retention periods, or conditions under which emails should be or may be deleted by employees prior to archiving, but both of these should be considered and defined by PHI in developing an email retention policy.

The Company's current Records Retention Policy in Sections 5.1 and 5.3 provided to Staff address electronic mail; therefore, this recommendation is implemented.

Recommendation 25-2 Records Management Overland recommended ACE maintain records of the results of site visits to Nova Records Management. ACE indicated that "periodically, Company representatives will visit the Nova Records facility to ensure ACE documents are adequately stored." ACE stated that it visits Nova "1-2 times per year" but does not maintain any documentation of the visits. Nova appears to be responsible for the care of most, if not all, of ACE's record archive. The findings from the site visits should be documented and maintained. PHI should consider having the findings sent to its internal audit department for their review and recommendations.

The Company has been documenting its practice of conducting two site visits per year to each storage facility to ensure that ACE documents are adequately stored and in compliance with PHI's terms and conditions. Observations from the site visits will be logged on the prescribed form and made available to the Group Manager on request. PHI will conduct periodic audits of the documentation based on appropriate risk assessment. The first audit was conducted in 2011. Based on the information provided to Staff, this recommendation should be considered implemented.

Corporate Security

Recommendation 25-1 Corporate Security Implement a program of service level expectations similar to what is used in the Information Technology department to measure and assess Corporate Security performance. Currently, PHI does not employ operational metrics to assess the performance of the security function. It is Overland's understanding that a system of service level expectations is being implemented beginning in 2010.

Staff has determined, based on its review of the additional information provided by the Company in a written response, during the implementation process in 2010, Support Services put together its annual Business Plan which was developed in conjunction with Power Delivery. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Security. Ultimately, it was agreed that, given the focus on other areas of Support Services, no formal metrics would be developed for Corporate Security in 2010 other than to ensure all NERC physical security work was completed for the year. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees. Additionally, the Services Steering and Strategy Committee has been created which closely models the IT Steering and Strategy Committees currently in place. The purpose of the Services Steering and Strategy Committees is to provide a more formal/structured approach in addressing service levels – matters of cost, quality and speed, along with a place to vet issues/ideas for the upcoming year for Fleet, Facilities, Corporate Security, HR Services and Disbursements, and Supply Chain.

From 2011 onward, Corporate Security, in conjunction with the Support Service Organization, developed an Accountability Plan that identified key business initiatives and service level agreements. As part of the plan, the leaders of Support Services met with key Power Delivery executives to discuss high-level Service Levels/metrics that would indicate a level of performance for Corporate Security. The results of these metrics were shared with Power Delivery on a quarterly basis and were an integral part of performance management for Support Services leaders and employees. For Corporate Security, the metrics were Security Surveys and follow-ups, North American Electric Reliability Council ("NERC") Critical Infrastructure Protection Compliance, and NERC Critical Infrastructure Protection Project completion.

In 2013, Support Services was integrated into Power Delivery. During 2013, the design phase was completed to form a new Support Service Committee that would review policies and procedures and make recommendations to Executive Leadership. This new committee will meet once a quarter in 2014. For 2014, the Corporate Security metrics include: 1) Security Surveys and follow-ups and 2) NERC Critical Infrastructure Protection Compliance.
Based on the work completed on this recommendation, and the recent announcement of a pending merger between PHI and Exelon which may change systems and programs currently in place or being contemplated, Staff believes that this recommendation should be considered implemented.

Recommendation 25-2 Corporate Security Standardize corporate security training across all PHI companies. Provide the corporate training given to Pepco uniformed security personnel to security personnel in ACE territory.

Staff has determined, based on its review of additional information provided by the Company in a written response, during the implementation process, that a PHI-wide contract security guard training program model was developed in 2009. At the time of the audit, there were 15 security officers assigned to PHI sites in New Jersey. Refresher training was provided. The material covered a variety of subjects including Access Control, Customer Service, Medical Emergencies, Patrolling, Facility Alarms, and Safety Awareness. This training is required by the New Jersey State Police as part of the re-licensing process and puts the security function into compliance with New Jersey State regulations. As such, this recommendation should be considered implemented.

Recommendation 25-3 Corporate Security Perform and document the annual review of security policy and procedures as indicated in the Corporate Security Strategy document.

Based on the information previously provided to Staff, reviews of the security policy and procedures have been performed annually since 2008 based on the Corporate Security Strategy. As such, this recommendation should be considered implemented.

Recommendation 25-4 Corporate Security Implement a procedure to follow up on and ensure correction of deficiencies found during substation inspections. Currently, Corporate Security performs substation inspections, documents noted deficiencies (most of which by themselves are minor), and sends inspection reports to the Substation Maintenance organization, where it is assumed corrections will be performed. We recommend a simple follow up procedure be implemented to ensure corrections are made: 1) Corporate Security should hold the inspection report open until 2) Substation Maintenance reports back that it has addressed and corrected the noted deficiencies. This can be done by having someone in Substation Maintenance sign off on the deficiencies when corrected and sending a copy of the signed report back to Corporate Security.

This recommendation was implemented by continued documentation of the substation deficiencies, and a commitment that Corporate Security will document and track action(s) taken to resolve any such deficiencies. Staff has been provided with a copy of the file used by the Security Department to document and track the ACE Security Audit findings and actions taken. Based on the information provided to Staff, this recommendation should be considered implemented.

DISCUSSION AND FINDINGS

As noted above there are seventy-seven recommendations in Overland's Final Report for improvement in the management and operations of ACE. As also noted above, subsequent to the filing of the comments and the reply comments, the Company, on its own initiative, began to implement many of the Final Report recommendations. In addition to its specific implementation efforts, approximately 30 percent of the recommendations were addressed in other ways. Fourteen of the recommendations were subsumed in the resolution of other proceedings before the Board. These included recommendations 5-1, 5-2, 5-3, 6-1, 6-2, 8-10, 14-4, 15-1, 15-2, 15-3, 15-4, 15-5 17-1, and 20-2. The sale of Conectiv Energy resulted in recommendations 4-1, 4-3, and 14-2 no longer being needed as the Company no longer owned generation. Two of the recommendations (3-1 and 3-2) are still open. Staff has recommended that four others (8-5, 8-12, 14-1, and 24-1) are not needed since the Company's then current practices met the intent of the Overland recommendations. During the period of time that the Company has been implementing the remaining 54 recommendations, ACE has held several meetings and participated in numerous discussions with representatives of the Audit Division, and provided the Audit Division with documentation and information regarding the implementation process. Based on the documentation and information provided, Staff believes that the remaining 54 recommendations have been implemented.

After review of the Final Report and the comments of the Company and Rate Counsel and the Staff positions, the Board agrees with Staff's recommendations. Therefore, upon careful review of the Final Report recommendations and the comments received, the Board **HEREBY FINDS** that the Company has implemented the remaining 54 recommendations, as modified above. The Division of Audits shall monitor, evaluate, and modify, as necessary, the implementation of the two remaining open recommendations. The implementation of the recommendations of the Final Report shall not be dispositive of issues raised in any other proceedings before this Board.

DATED: 1\21\15

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ATTEST:

KENNETH J. SHEEHAN
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities

In the Matter of An Audit of the Affiliated Transactions between Atlantic City Electric Company and Pepco Holdings, Inc. and its affiliates and a Management Audit of Atlantic City Electric Company Pursuant to N.J.S.A. 48:2-16.4, 48:3-49, 48:3-55, 48:3-56, 48:3-58 and N.J.A.C. 14:3-12.1, 14:4-5 et seq. – Docket No. EA07100794

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