BEFORE THE
PUBLIC SERVICE COMMISSION OF MARYLAND

Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy	CASE NO. 9820

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June 17, 2026

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INTRODUCTION

Pepco asks the Commission to approve a substantial distribution rate increase at a time when customers are already facing significant energy bill burdens. The Commission should reject Pepco's request to the extent it is based on overstated return assumptions, unsupported forecasts, premature accounting changes, imprudent or previously disallowed capital costs, excessive O&M expenses, and proposed regulatory mechanisms that would shift ordinary business risks from shareholders to customers.

OPC does not contend that Pepco is entitled to no increase. Rather, OPC's recommended revenue requirement reflects the rate increase supported by the evidentiary record. OPC witness David Garrett recommends a return on equity and capital structure that more closely reflect Pepco's low-risk regulated utility business and real-world investor expectations. OPC witness Dustin Madsen recommends adjustments to remove costs that Pepco has not shown are prudent, reasonable, known and measurable, or legally recoverable. Together, those recommendations produce a just and reasonable revenue requirement that allows Pepco a fair opportunity to recover its reasonable costs and earn a reasonable return, while protecting customers from costs Pepco has not justified.

Across the major disputed issues, Pepco asks customers to pay costs, or assume risks, before the company has made the showing the Commission's ratemaking standards require. Pepco seeks to increase customer rates based on forecasted plant additions that were not complete before the hearing date. It asks customers to pay now for a net operating loss carryforward accounting change the IRS has not yet required and may never require. It seeks full recovery of the White Flint Substation despite failing to

perform the alternatives analysis and cost-benefit review the Commission previously found lacking. It seeks recovery of $1.4 million in rate case expenses driven by a fully forecasted test year proposal that Pepco later withdrew. It asks for regulatory asset treatment for broad categories of future costs, including minor storm costs and new legislative, regulatory, or policy requirements, without meaningful limits. And it seeks to eliminate seasonal residential rates even though its own study does not show that doing so is supported by cost causation.

The Commission should not require customers to pay for costs that are unsupported, premature, excessive, imprudent, or contrary to law. Nor should the Commission approve mechanisms that weaken Pepco's incentive to manage costs within the rates already approved. Yet Pepco's filing repeatedly asks the Commission to do just that. For the reasons set forth below, the Commission should adopt OPC's recommended return on equity, capital structure, rate base adjustments, O&M adjustments, revenue requirement, and rate design recommendations.

ARGUMENT

I. Pepco's cost of capital should be based on real-world investor expectations and not provide an excess wealth transfer from ratepayers to Pepco's shareholders.

The distribution rate increase Pepco seeks is driven in large part by Pepco's swelling capital spending, and the unreasonably high return sought by Pepco on that capital spending, specifically the return on equity ("ROE"). While ROE is a key driver of Pepco's requested rate increase, it also is a key lever and opportunity for the Commission

to help address the ongoing utility bill crisis and provide some measure of rate relief for ratepayers. It is critical that the Commission closely and carefully examine the ROE it allows in this case and not merely fall back into familiar patterns based on awarded ROEs from the past or from other state Commissions. The Commission's task is not to preserve past authorized ROE levels for their own sake, but to set a return that is supported by the record in this case and consistent with the constitutional standards established in *Hope* and *Bluefield*.

Put simply, the awarded ROEs typically granted by utility regulatory commissions—let alone the ROE Pepco is requesting—are far higher than objective return estimates made by expert investment firms *for the entire stock market*,[1] far higher than what is required under the *Hope* and *Bluefield* standards, and far higher than the reasonable estimates made by Mr. Garrett, resulting in a substantial wealth transfer from ordinary ratepayers to corporate shareholders.[2] Instead, the Commission should award Pepco an ROE of 7.7 percent, as recommended by OPC witness David Garrett.[3] Combined with Mr. Garrett's recommended capital structure of 43 percent equity and 57 percent debt, Mr. Garrett's recommendations result in an overall rate of return of 6.22 percent, as shown in Figure 2 of his direct testimony, reproduced below.[4]

[1] OPC Ex. 31 (Direct Testimony of David J. Garrett) ("Garrett Direct") at 5:4-6:7.
[2] OPC Ex. 31 (Garrett Direct) at 10-12.
[3] OPC Ex. 31 (Garrett Direct) Figure 1 at 4.
[4] OPC Ex. 31 (Garrett Direct) Figure 2 at 8.

Capital Component	Proposed Ratio	Cost Rate	Weighted Cost
Long-Term Debt	57.0%	5.10%	2.91%
Common Equity	43.0%	7.70%	3.31%
Total	100.0%		6.22%

Mr. Garrett recommends a more appropriate, realistic ROE that meets the *Hope* and *Bluefield* standard of setting an ROE that is comparable to the returns expected from investments of *similar risk*. Moreover, his recommendation would provide ratepayers with some measure of rate relief, and treat them fairly, rather than requiring them to pay a return that exceeds what investors reasonably require for a low-risk regulated utility.

A. The Commission should adopt Mr. Garrett's recommended ROE of 7.7 percent, as it most closely aligns with the *Hope* and *Bluefield* standards.

Hope and *Bluefield* require the Commission to set an ROE that is (1) sufficient to assure confidence in a company's financial integrity; (2) adequate to maintain and support a company's credit and to attract capital; and perhaps most importantly, (3) comparable to returns investors expect to earn on other investments of similar risk.[5] Mr. Garrett's recommended ROE of 7.7 percent satisfies this standard. Pepco's financial integrity is and would remain strong under Mr. Garrett's ROE recommendation, particularly considering Pepco has reaped significant profits in recent years. Even Pepco does not dispute that it would be able to attract sufficient capital at Mr. Garrett's

[5] *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944); *Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923).

recommended ROE. And Mr. Garrett's recommendation is logically closest to providing a return comparable to other investments of similar risk, as it is closer to the returns on the entire stock market anticipated by the world's biggest investment firms—which is far higher than the returns required for extremely low-risk utilities. In other words, the record does not support treating Pepco as if investors require a return above the expected return for the broader stock market when Pepco's regulated utility business is materially less risky than the market as a whole.

1. Mr. Garrett's recommended ROE of 7.7 percent is more than sufficient to assure confidence in Pepco's financial integrity.

As shown in Exelon's 2025 10K, Pepco has recorded rapidly increasing yearly net income—or profit—of $306 million in 2023, $390 million in 2024, and $401 million in 2025.[6] Pepco's burgeoning profit levels show that Pepco is not only financially secure, but extremely profitable. A reduction to Pepco's ROE does not remotely jeopardize Pepco's financial health. Indeed, even with Mr. Garrett's ROE recommendation, OPC's overall revenue requirement recommendation still results in a slight increase to Pepco's rates and therefore affords Pepco a reasonable opportunity to recover its costs and earn a fair return. Pepco's recent financial performance confirms that the Commission need not authorize an inflated ROE to preserve the company's financial integrity.

[6] OPC Ex. 2.

2. Pepco will be able to attract capital at a 7.7 percent ROE.

Utility companies and their experts frequently claim or insinuate that any reduction in ROE will result in the utility being unable to raise capital. But this has never been shown to be true, and would not realistically ever occur.[7] Indeed, Duke Energy grew into the third largest utility in the U.S. with ROEs below 8 percent for over a decade.[8] Rather, what could be affected is the cost of debt, rather than the utility's ability to attract capital.

However, as Mr. Garrett states, what matters to ratepayers is the total overall weighted average cost of capital; that is, the weighted average cost of capital ("WACC"), the combined cost of both debt and equity.[9] That is the cost that ratepayers actually pay. And even if a reduction in ROE were to lead to a credit rating downgrade and a slightly higher cost of debt, which is not a guarantee, ratepayers would still benefit overall, because lowering the ROE to 7.7 percent would outweigh any slight increase in the cost of debt.[10] The Commission should therefore focus on whether Pepco's overall return is sufficient to maintain financial integrity and attract capital, not on whether shareholders receive the highest ROE Pepco can argue for.

[7] *See* Tr. 1219-1220 (Garrett, May 1, 2026).
[8] MEA Exhibit 6 (Direct Testimony of Steven Kihm) at 30:1-5.
[9] *See* Tr. 1221-1223 (Garrett, May 1, 2026).
[10] OPC Exhibit 33 (Garrett Surrebuttal) at 20:6-22:14.

3. Mr. Garrett's recommended ROE of 7.7 percent more accurately reflects the return required by investors of very low-risk companies like Pepco.

Mr. Garrett's recommended ROE of 7.7 percent is logically closer to the true return investors actually require of an extremely low-risk utility company like Pepco. While it is a slight departure from the norm, that does not make it wrong. The Commission should not be tied down to the actions of other commissions or its own past actions, but instead look affirmatively at what the correct decision is this case. And in this case, Mr. Garrett's recommendation is the closest to the true ROE investors would expect from Pepco.

As Mr. Garrett testified, several prominent asset management companies projected returns for the entire stock market of 5.9 percent, 6.7 percent, and 7.7 percent,[11] far below the typical ROEs awarded by Commissions, but more in line with Mr. Garrett's recommendation. Moreover, these estimates are for the *entire* stock market, whereas Pepco, as a utility, would be one of the least risky companies in the market,[12] and thus investors would expect to earn a far lower return from Pepco than from the entire market generally. While Mr. Garrett did not solely rely on these estimates, incorporating the principle of gradualism in his recommendation,[13] they provide a clear indication that Mr. Garrett's overall recommendation more accurately reflects the return investors would actually require from Pepco. Put simply, an investor would not reasonably expect a return

[11] OPC Exhibit 31 (Garrett Direct) at 5:4-6:7; OPC Exhibit 32.
[12] Tr. 1209-1210 (Garrett, May 1, 2026).
[13] OPC Exhibit 31 (Garrett Direct) at 6:4-17.

of 9.5 or 10.5 percent from a low-risk utility while expecting the entire market to return only 6-7 percent.

In developing his cost of equity recommendation, Mr. Garrett utilized multiple financial models, the results of which are summarized in Figure 1 of his direct testimony, reproduced below:[14]

Model	Cost of Equity
Double Leverage ROE (Parent WACC)	5.7%
CAPM (at Proxy Debt Ratio)	8.2%
Hamada CAPM (at Company-Proposed Debt Ratio)	7.7%
DCF Model (Sustainable Growth)	7.3%
Model Average	**7.2%**
Recommended ROE	**7.7%**

The average of Mr. Garrett's models was 7.2 percent, strongly indicating that Pepco's market-based ROE is notably lower than the typical authorized ROE adopted by regulatory commissions,[15] but Mr. Garrett's recommendation of 7.7 percent also incorporates the concept of gradualism.[16] Mr. Garrett did not simply ask the Commission to adopt the lowest model result or mechanically apply market-return estimates. He recommended an ROE above the average of his model results to account for regulatory

[14] OPC Exhibit 31 (Garrett Direct) at 4.
[15] OPC Exhibit 31 (Garrett Direct) at 4:6-4:10.
[16] OPC Exhibit 31 (Garrett Direct) at 4:7-8.

judgment and a measured transition from prior authorized ROE levels.

In totality, both Mr. Garrett's models and the expected returns from prominent investment firms all indicate that Pepco's true ROE is far below the usual 9.5 percent ROE awarded by regulatory commissions. The Commission, standing in place of market competition, must set the ROE near the utility's market cost of equity.[17] Setting an ROE above this, and above Mr. Garrett's 7.7 percent recommendation, would result in an excess transfer of wealth from ratepayers to company shareholders.[18] In a time where many residential ratepayers are already struggling to manage high utility bills, the Commission should respond by using its considerable ratemaking discretion, avoid old habits, and adopt an ROE that shifts the balance back toward ratepayers. The record supports Mr. Garrett's recommendation because it satisfies the *Hope* and *Bluefield* requirements while avoiding an unnecessary premium that customers, not shareholders, would have to fund.

B. Pepco's proposed capital structure is equity-heavy, benefiting Pepco's shareholders at the expense of its customers.

Pepco proposes a capital structure of 49 percent debt, and 51 percent equity.[19] Pepco proposes a capital structure with a higher common equity ratio and therefore less financial risk than the average of Pepco's own proxy group, which averaged 57 percent debt, 43 percent equity.[20] Because a higher equity ratio increases the amount of higher-cost equity included in rates, Pepco's proposed capital structure would increase customer

[17] OPC Exhibit 31 (Garrett Direct) at 13:5-12.
[18] OPC Exhibit 31 (Garrett Direct) at 13:9-17.
[19] OPC Exhibit 31 (Garrett Direct) at 68:13.
[20] OPC Exhibit 31 (Garrett Direct) at 68:12.

costs even before the Commission determines the appropriate ROE.

Because equity is more expensive than debt, as the equity ratio increases, the utility's WACC, revenue requirements, and rates increase, and thus utilities have no incentive to minimize WACC, or operate with a capital structure that minimizes WACC.[21] Due to regulation and the essential services utilities provide, a utility has less business risk than an unregulated company and can thus reasonably carry more debt in its capital structure than most unregulated companies.[22] As such, Mr. Garrett recommends, for ratemaking purposes, adopting a capital structure of 57 percent debt and 43 percent equity for Pepco to match the average equity ratio of Mr. McKenzie's own proxy group,[23] and to align with the results of the Capital Asset Pricing Model (CAPM).[24] The Commission should adopt that recommendation. It better reflects Pepco's actual regulated risk profile, prevents customers from paying for an unnecessarily equity-rich capital structure, and produces an overall rate of return that is fair to both Pepco and its customers.

II. The Commission should remove certain capital project costs from Pepco's rate base.

A. The Commission should disallow recovery for the White Flint substation.

The Commission should disallow recovery for the White Flint Substation because Pepco has not carried its burden to show that the project's costs were prudently incurred.

[21] OPC Exhibit 31 (Garrett Direct) at 63:16-67:3.
[22] OPC Exhibit 31 (Garrett Direct) at 67:4-18.
[23] OPC Exhibit 31 (Garrett Direct) at 71:10-72:5.
[24] Tr. 1218 (Garrett, May 1, 2026).

This is not a case in which the company merely had to show that a forecast identified a possible future capacity concern. The Commission had already reviewed White Flint in Case No. 9655 and declined to approve cost recovery because it was not sufficiently confident in Pepco's load forecasting, consideration of alternatives, and cost-benefit analysis.[25] The Commission also made clear that, if Pepco chose to move forward with the project, it would have to "thoroughly justify" that decision in a later prudence review.[26] That requirement is central to this issue. Pepco knew what showing the Commission expected, but did not make it.

Pepco did not make that showing here. After the Commission's order, Pepco postponed further construction for about two years and then resumed the project after commissioning Quanta to perform a load forecast for the White Flint area.[27] But a load forecast is not an alternatives analysis. While it may identify a potential planning concern; it does not establish that the company's chosen solution was reasonable, least-cost, or adequately evaluated. Pepco's own witness agreed that the Quanta study was a load forecast study, that a load forecast identifies the issue to be addressed, and that a load study does not review alternatives.[28] Even assuming Pepco reasonably believed Parklawn Substation could face a future overload condition, Pepco still had to show that building the White Flint Substation was a prudent response to that concern.

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[25] Tr. 452:4–16 (Alo, Apr. 28, 2026); Order No. 89868 at 94, *Potomac Electric Power Company's Application for an Electric Multi-Year Rate Plan* (Case No. 9655, June 28, 2021).
[26] Tr. 452:17–23 (Alo, Apr. 28, 2026); Order No. 89868 at 94, *Potomac Electric Power Company's Application for an Electric Multi-Year Rate Plan* (Case No. 9655, June 28, 2021).
[27] Tr. 453:1–15 (Alo, Apr. 28, 2026); Pepco Ex. 12 (Alo Rebuttal) at 16:2–14; OPC Ex. 38 (Fitzhenry Revised Surrebuttal) at 11:9–17.
[28] Tr. 476:10–477:13 (Alo, Apr. 28, 2026).

Pepco did not do so. The record shows that the Quanta study did not consider non-wires alternatives, did not include a cost-benefit analysis, and did not include an hourly constraint analysis.[29] Pepco also admitted that it did not commission any study after Order No. 89868 other than the Quanta study.[30] And while Pepco asserted that it considered energy storage, demand response, targeted energy management tools, distributed energy resources, rebuilding or expanding Parklawn, and taking no action, Pepco did not issue an RFP or conduct a competitive solicitation for any third-party or non-wires alternative.[31] Instead, Pepco relies on generalized statements that alternatives were considered and rejected. That is not enough for a project of this scale, especially after the Commission had already identified the lack of alternatives analysis and cost-benefit support as reasons for denying prior recovery. A general assertion that alternatives were considered cannot substitute for the documented analysis the Commission said was missing.

Nor can Pepco satisfy its prudence burden through public comments submitted in support of White Flint. Through discovery and cross-examination, OPC established that Pepco solicited support from business and community organizations and provided template language for written comments supporting the project.[32] Those comments may reflect Pepco's ability to organize public support for White Flint, but they do not establish that the company reasonably evaluated alternatives, conducted a cost-benefit analysis, or

[29] Tr. 477:7–19 (Alo, Apr. 28, 2026).
[30] Tr. 477:20–478:1 (Alo, Apr. 28, 2026).
[31] Tr. 455:20–456:20 (Alo, Apr. 28, 2026).
[32] Tr. 296:7–297:18 (Perry, Apr. 28, 2026); OPC Exhibits 12 and 13.

selected a least-cost solution. Indeed, the template did not ask commenters to address rate impacts or whether less expensive alternatives could address the reliability concerns Pepco identified.[33] The Commission should give those comments little weight in determining whether Pepco carried its burden to justify full cost recovery for White Flint.

MEA's testimony confirms that Pepco skipped a necessary step in the planning process. Pepco did not have to prove that White Flint was the only possible solution, but it did have to show that it reasonably evaluated the available solutions before asking customers to pay for the project. MEA's analysis shows why Pepco's missing analysis was consequential. Mr. Balakumar explained that a load forecast identifies the problem to be solved, but determining the solution requires a separate alternatives analysis that evaluates whether the constraint can be addressed through traditional infrastructure, non-wires solutions, or some combination of both.[34] He further explained that the record contains no hourly constraint analysis, no quantitative non-wires sizing, and no cost comparison from any analyst using any tool at any point in the project's history.[35] Pepco therefore entered this rate case without a documented alternatives analysis, a quantitative non-wires cost comparison, or a competitive procurement process to identify and consider alternatives.[36]

Pepco's principal answer is that the project must be evaluated based on

[33] Tr. 297:19–298:18 (Perry, Apr. 28, 2026). The record further shows that at least one submitted letter used Pepco's template but did not disclose that Pepco had solicited the letter or provided the template. Tr. 303:16–305:10 (Perry, Apr. 28, 2026); OPC Exhibit 14.
[34] MEA Ex. 8 (Balakumar Surrebuttal) at 17:10–18:6.
[35] MEA Ex. 8 (Balakumar Surrebuttal) at 56:8–23.
[36] MEA Ex. 8 (Balakumar Surrebuttal) at 57:19–27.

information available when the decision was made, not with hindsight.[37] OPC agrees with that standard. But applying that standard does not help Pepco. The defect is not that later events made White Flint look less useful than Pepco expected. The defect is that, at the time Pepco decided to resume construction, it still had not performed the project-specific alternatives and cost-benefit analysis that the Commission had already found lacking. A forecasted need is not a blank check. Once the Commission expressly identified the missing analysis, Pepco could not satisfy its burden merely by producing another forecast and asking the Commission to trust its engineering judgment. The prudence question is not whether Pepco could identify some possible future need. The question is whether Pepco reasonably selected this project, at this scale and cost, after evaluating available alternatives. The record does not show that it did.

The Quanta study itself reinforces why the forecast could not substitute for a prudence showing. Quanta described its work as a forecast of future electric load in the White Flint Study Area.[38] The study modeled nine load-growth scenarios based on uncertainties relating to redevelopment, electric vehicles, and building electrification.[39] It also stated that most expected load growth in the area was due to large load additions from major land-use expansion development projects.[40] As Mr. Fitzhenry explained, however, the Quanta study did not model whether only a portion of the forecasted load

[37] Tr. 393:15–394:11 (Alo, Apr. 28, 2026).
[38] Pepco Ex. 11C (Alo Direct), Confidential Schedule (TOA)-5 at 1. Pepco originally designated Schedule TOA-5 as confidential, but later removed the confidential designation from the schedule in its entirety.
[39] Pepco Ex. 11C (Alo Direct), Confidential Schedule (TOA)-5 at 1, 14.
[40] Pepco Ex. 11C (Alo Direct), Confidential Schedule (TOA)-5 at 18.

would materialize and presented plausible outcomes rather than probabilities.[41] That may be useful forecasting information. It is not proof that White Flint was the reasonable and cost-effective solution.

If the Commission does not disallow White Flint in full, it should adopt OPC's alternative partial disallowance. Mr. Fitzhenry recommended disallowing $44.279 million, or 64.2 percent, of the White Flint Substation core construction costs associated with ITN 74120.[42] That recommendation is based on Pepco's own forecast data showing that the combined Parklawn and White Flint study area is projected to reach only 35.8 percent of available capacity through 2034.[43] On that record, even if the Commission concludes that some additional capacity may have been justified, Pepco has not shown that customers should pay for the full cost of a project whose capacity far exceeds the measurable load need reflected in the current forecast.

That alternative remedy is also supported by the used-and-useful principle. Under that principle, customers should not be required to pay for plant unless the utility has shown that the plant is used and useful in providing service. Mr. Fitzhenry explained that, if 64.2 percent of the combined capacity will remain unused over the next decade, that portion is not useful for serving load and should not be charged to ratepayers.[44] Pepco has not shown that this unused portion of the project is used and useful or should be charged to ratepayers. He further explained that his recommendation is conservative because it

[41] OPC Ex. 38 (Fitzhenry Revised Surrebuttal) at 12:5–13:8; Pepco Ex. 11C (Alo Direct), Confidential Schedule (TOA)-5 at 52.
[42] OPC Ex. 36 (Fitzhenry Revised Direct) at 3:31–4:3; 25:18–26:10.
[43] OPC Ex. 36 (Fitzhenry Revised Direct) at 23:2–5; 25:18–26:10.
[44] OPC Ex. 38 (Fitzhenry Revised Surrebuttal) at 15:10–20.

compares the forecasted load to the combined capacity of Parklawn and White Flint; if the analysis looked only at the incremental capacity added by White Flint, the utilization rate for White Flint would be zero percent.[45]

Pepco criticizes the partial disallowance as a utilization-based adjustment and argues that Mr. Fitzhenry did not identify discrete equipment that should have been removed from the project scope.[46] But that criticism does not solve the ratemaking problem. The Commission is not required to approve the full cost of an oversized project merely because Pepco chose to build the project as an all-or-nothing solution. If the Commission finds that some additional capacity was justified, but that Pepco failed to justify the full scale and cost of White Flint, Mr. Fitzhenry's partial disallowance provides a reasonable and conservative alternative to full disallowance. Pepco should not be rewarded for failing to develop a more targeted or lower-cost solution by forcing customers to pay for the entire project.

The Commission should therefore disallow recovery for White Flint in full. If the Commission concludes that some recovery is warranted, it should adopt OPC's alternative partial disallowance. Either way, the Commission should not allow Pepco to recover the full cost of a major capital project where the company failed to perform the analysis needed to show that the project was the reasonable and cost-effective solution to the identified planning concern.

[45] OPC Ex. 38 (Fitzhenry Revised Surrebuttal) at 16:1–6.
[46] Pepco Ex. 12 (Alo Rebuttal) at 18:14–19:17; 25:4–26:1.

B. The Commission should remove the cost of forecasted plant additions from Pepco's rate base.

Pepco's proposed rate base includes two adjustments for forecasted reliability plant additions that have yet to go into service. RMA 3 reflects the costs of reliability projects forecasted to be placed into service in April 2026 through July 2026.[47] RMA 4 reflects the costs for reliability projects forecasted to be placed into service from August 2026 through July 2027.[48] These two adjustments, based entirely on forecasts, represent a substantial, $50.35 million increase in rate base— $16.77 million RMA 3 and $33.58 million for RMA 4—on which Pepco would earn a return.[49] Pepco customers should not have to pay for investments that Pepco has not proven are used and useful or otherwise known and measurable.

The Commission's standard ratemaking practice is to only consider costs—including plant additions—and revenues incurred during the test year period.[50] This is because the test year revenues may not match the costs of post-test year investments, thereby violating the matching principle.[51] However, given the importance of safety and reliability, the Commission recognizes an exception to its standard practice and allows for

[47] Pepco Ex. 26 (Nelson Direct) at 13:20-23.
[48] *Id.* at 13:23 – 14:3.
[49] Pepco Ex. 29 (Nelson Surrebuttal), Schedule (CN-SR)-1 at 2
[50] Order No. 83085 at 8, *In the Matter of the Application of Delmarva Power and Light Company for an Increase in Its Retail Rates for the Distribution of Electric Energy*, (Case No. 9192, Dec. 30, 2009).
[51] *Id.* ("Adding post-test-year expenses to the rate base, and thus the revenue requirement, feels a little like a heads-I-win-tails-you-lose approach – the revenues (and thus rates) ought normally to match the costs the Company incurs over the course of a year, and the test year should represent a fair snapshot of costs and revenues."); Order No. 84475 at 8, *In the Matter of the Application of the Washington Gas Light Company for Authority to Increase its Existing Rates and Charges and to Revise Its Terms and Conditions for Gas Service* (Case No. 9267, Nov. 14, 2011)

the inclusion of certain post-test year reliability plant additions.[52] This exception applies to "actual, prudently incurred costs for non-revenue producing safety and reliability investments that are completed before the hearing date and are known and measurable."[53]

Pepco's proposed RMA 3 and RMA 4 fail to satisfy the Commission's standard for several reasons. *First*, the vast majority of plant additions reflected in RMA 3 and 4 are not complete and serving customers. RMA 3 includes plant additions forecasted for May 2026 through July 2026; RMA 4 includes plant additions forecasted from August 2026 through July 2027. Considering the evidentiary hearing concluded on May 1, 2026, it is unlikely that any of these projects have been placed into service.

Second, even if some of the plant additions included in RMA 3 went into service between April 1, 2026 and May 1, 2026, no evidence identifies those specific plant additions let alone establishes their prudency. While Pepco witness Alo provides multiple schedules identifying the projects reflected in RMAs 3 and 4, the schedules do not contain information detailing project in-service dates.[54] Pepco witness Leming's schedules identify forecasted plant additions for 2026, but does not provide anticipated in-service dates for any listed project.[55] Absent any evidence establishing that Pepco's

[52] Order No. 87884 at 35, *In the Matter of the Application of Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9418, Nov. 15, 2016).
[53] Order No. 90847 at 12–13 (quoting Proposed Order at 26), *The Potomac Edison Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy* (Case No. 9695, Oct. 18, 2023); Order No. 88432 at 18, *In the Matter of the Application of Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9443, Oct. 20, 2017).
[54] *See* Pepco Ex. 11 (Alo Direct Part II), Schedule (TOA)-1; Pepco Ex.12 (Alo Rebuttal), Schedule (TOA-R)-1.
[55] Pepco Ex. 6 (Leming Rebuttal Part II), Schedule (RTL-II-R)-3) at 3.

projects are or will be complete, the Commission lacks the record evidence necessary to approve recovery for the project costs reflected in RMA 3.

Third, RMAs 3 and 4 do not reflect known and measurable expenses. When asked whether the forecasted plant closings reflected in RMAs 3 and 4 are "known and measurable," Pepco witness Nelson stated that "they're known that at some point there will be plant additions related to those projects. From a measurable standpoint, we've included the best estimate that we have as far as the projected in-service dates of these projects."[56] Forecasted costs based on the company's "best estimate" or "best guess" are hardly known and measurable.[57] Pepco further proposes to true up any variances between amounts projected for RMA 3 and 4 and the actual amounts to ensure that "customers pay only for plant that goes into service."[58] Known and measurable expenses, however, do not require any true up. Pepco's offer to true up RMAs 3 and 4 at a later date effectively concedes that the company does not know what reliability plant—and the corresponding costs—will be placed into service post-hearing.

Finally, the Commission has repeatedly rejected prior Pepco efforts to seek recovery of forecasted, post-test hearing reliability plant adjustments. For instance, in Case No. 9418—which Pepco witness Nelson cites in his rebuttal testimony *in support* of RMAs 3 and 4,[59] the Commission rejected two adjustments reflecting post-hearing reliability plant additions for failing to meet the known and measurable standard.[60] In

[56] Hearing Transcript ("Tr.") at 697:15-22 (Leming, April 29, 2026).
[57] *Id.* at 697:20, 698:12–13.
[58] Pepco Ex. 28 (Nelson Rebuttal) at 25:10-18.
[59] *Id.* at 25:19-21, n. 8 (citing Order No. 87884).
[60] Order No. 87884 at 36.

fact, in each of Pepco's five recent litigated historic test year cases, the Commission rejected proposed adjustments for post-hearing reliability plant additions.[61] Pepco gives no compelling reason why the Commission should depart from its prior consistent practice of excluding forecasted post-test year adjustments.

Until plant is placed into service, the full costs and the date that plant will be serving customers are unknown. RMAs 3 and 4 reflect projects not yet in service, fails to meet the Commission's known and measurable standard, and should be rejected.

C. Certain distribution overhead replacement expenditures should be disallowed.

Pepco's Distribution Overhead Planned P30/P40 replacement program (ITN 77205) is a corrective maintenance program that addresses non-emergency deficiencies in Pepco's overhead distribution system.[62] As Pepco witness Alo explains, the program focuses on replacing aging equipment that is "approaching end of life or no longer meet[ing] safety or clearance standards."[63] P30 refers to replacements recommended within one year, and P40 refers to replacements recommended within one to five years.[64]

Pepco's 2024 spending on distribution overhead planned P30/P40 replacement program far exceeded the spending planned for other years. In 2024, Pepco recorded $2.92 million in overhead planned P30/P40 expenditures.[65] For 2025 and 2026, however,

[61] Case No. 9602 (Proposed Order at 35) (affirmed and adopted by Order No. 89227); Case No. 9443 (Order No. 88432 at 23); Case No. 9418 (Order No. 87884 at 36), Case No. 9336 (Order No. 86441 at 21–22); Case No. 9311 (Order No. 85724 at 14–15).
[62] OPC Ex. 36 (Fitzhenry Revised Direct) at 25:8-10.
[63] Pepco Ex. 12 (Alo Rebuttal) at 103:2-5.
[64] OPC Ex. 36 (Fitzhenry Revised Direct) at 25:13-16.
[65] *Id*. at 25:18-20.

Pepco projected expenditures of $547,000 and $571,000 respectively.[66] As noted in OPC witness Fitzhenry's testimony, Pepco's 2024 expenditures exceeded its budget by $1.76 million or by 265 percent.[67] That level of variance required a meaningful prudence showing. Pepco did not provide one.

Pepco provides little explanation for the prudence of its higher spending levels. The company attributes the variance to "additional unexpected failures than planned."[68] But, beyond generally pointing to scope variability and stating that "higher spending levels should be viewed in the context of system performance and asset condition realities," the company does not provide any evidence identifying the specific work performed and why the cost of that work exceeded the company's budgeted amounts.[69] To the extent prudency is evaluated based on a "management-judgment assessment,"[70] there is little evidence detailing the management-judgment that Pepco exercised and how it resulted in significant spending above budgeted amounts.

Even if one were to accept that field conditions alone justified the significant cost increases for overhead P30/P40 replacements, no data supports that position. Pepco responses to discovery showed that many of the pole and crossarm types replaced were similar to work performed in previous years, and that the company completed 214 *fewer* crossarm replacements in 2024 compared to the previous year.[71] The record therefore

[66] *Id.* at 25:20-21.
[67] *Id.* at 26:6-7, Exhibit CTF-1 at 3 (Pepco response to OPC DR 5-1, Attachment).
[68] Pepco Ex. 11 (Alo Direct Part I), Schedule (TOA)-1 at 22.
[69] Pepco Ex. 12 (Alo Rebuttal) at 104:15 – 105:21.
[70] *Id.* at 104:10-14.
[71] OPC Ex. 38 (Fitzhenry Revised Surrebuttal) at 17:2–13, Exhibit CTF-2 at 13.

does not connect the higher spending to a corresponding increase in the amount or type of replacement work performed.

Cursory explanations with minimal supporting evidence are insufficient to satisfy the burden of proof.[72] As the Commission explained in Order No. 91396,

> prudency requires a demonstration by the utility that projects were appropriately selected, that they provided value to ratepayers, that good management judgment was exercised in the selection of the materials and methods used to execute the projects, and that the costs—by comparison with alternatives—were justified.[73]

Here, Pepco presents no substantive evidence in response to the prudency concerns OPC raised about Pepco's spending. No record evidence details the specific need for any of the P30/P40 replacements, the individual cost of those replacements, and that the replacements were prudently performed. Narrative explanation about the "context" in which to consider system performance spending and the general approach taken to proactive overhead repairs is not a substitute for objective data.

Pepco falls well short of satisfying its burden of proof. The record is insufficient to confirm the prudency of the excessive P30/P40 expenditures that occurred during the test

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[72] *See* Order No. 92264 at 14, *Potomac Electric Power Company's Application for an Electric Multi-Year Plan* (Case No. 9655, March 31, 2026) ("The Commission expects utilities to manage their operations and spending within the limits the Commission approved and that the lack of a specific variance test should not be considered free rein to exceed budgets. Hence, the burden is on Pepco to explain why its actual expenditures far exceeded its budgets as authorized by the Commission in its initial MRP."); *e.g., id.* at 30 (denying recovery for circuit breaker replacements due to lack of specific evidence demonstrating need to replace still functioning equipment); *e.g.,* Order No. 92106 at 39–40, *Application of Baltimore Gas and Electric Company for an Electric and Gas Multi-Year Plan* (Case No. 9645, Dec. 22, 2025) (denying recovery for 13kV Overhead Distribution Automation Reclosers because BGE did "not address specifically how the $3.8 million variance in 2023 provided value to ratepayers" and "made no demonstration beyond the assertion of increased reliability benefit to ratepayers would justify its overspend").

[73] Order No. 91396 at 3–4, *Baltimore Gas and Electric Company's Application for an Electric and Gas Multi-Year Plan* (Case No. 9645, Nov. 1, 2024).

year period. Unless and until Pepco can proffer such evidence, the costs of such investments should be removed from customer rates. The Commission should adopt OPC's adjustment.

D. Rates approved in this proceeding should not include cost recovery for the capital projects disallowed in the final reconciliation of Case No. 9655.

On March 31, 2026, the Commission issued Order No. 92264 on the final reconciliation of Pepco's multi-year rate plan. Among other things, the order reviewed the prudency of capital expenditures incurred in Rate Year 3 of Pepco's MRP. For three projects—Wheaton Substation Transformer #3, Circuit Breaker Replacement, and certain installations of Tree Wire/Spacer Cable—the Commission found the company's expenditures were imprudent and disallowed recovery of costs associated with those projects. Collectively, the net book value of these three projects totals $15.41 million.[74] In discovery, Pepco confirmed that the costs of those disallowed projects are reflected in the TTYCF rate base.[75] Yet, despite cost recovery being disallowed, Pepco did not prepare a ratemaking adjustment to remove those costs from the TTYCF revenue requirement.

The costs of Pepco's projects the Commission found imprudent in Order No. 92264 should be removed from rate base. A finding of imprudence is a legal bar to cost recovery for utility capital expenditures, irrespective of whether it results in infrastructure that is used and useful.[76] Pepco presented no evidence in this proceeding establishing the

[74] OPC Ex. 42 (Madsen Revised Surrebuttal), Exhibit DMM-SR-4 at 15 (OPC DR 32-1, Attachment 1).
[75] *Id.*, Exhibit DMM-SR-4 at 12 (OPC DR 32-1(a).
[76] *Baltimore Gas & Electric Co. v. Public Service Com.*, 305 Md. 145, 165 (1986) (noting that "the general principle of utility regulation that costs incurred by a utility company as a result of managerial imprudence cannot be recovered from the company's customers); *Columbia Gas of Md. v. PSC of Md.*,

prudency of the expenditures disallowed in Order No. 92264.[77] Nor did Pepco seek rehearing or note an appeal of the Commission's imprudence findings.[78] As OPC witness Madsen notes, "it would be improper for customers to continue paying costs relating to projects the Commission did not find prudent and expressly disallowed from recovery."[79] Mr. Madsen's adjustment to RMA 1 reflects the removal of the costs disallowed in Order No. 92264.[80] The Commission should accept Mr. Madsen's adjustment and ensure that Pepco cannot recover costs the Commission expressly deemed imprudent.

III. Pepco's changed accounting treatment for net operating loss carryforwards should be removed from rates.

Pepco's proposed rate base includes a significant adjustment due to a change in the regulatory accounting treatment for tax net operating loss carryforwards ("NOLCs"). This adjustment is premature—Pepco is awaiting an Internal Revenue Service ("IRS") ruling on whether the accounting change is necessary—and costly to customers. IRS procedures allow the Commission to remove the adjustment from rates, without risking any penalty to Pepco, until the IRS determines whether Pepco must change how it accounts for NOLCs. The Commission therefore does not need to choose between protecting customers and protecting Pepco from normalization risk. It can do both by excluding the

224 Md. App. 575, 585 (2015) (stating that, to recover costs of an asset, the utility "must prove that the asset is 'used and useful' and that the . . . costs were incurred prudently").
[77] OPC Ex. 42 (Madsen Revised Surrebuttal) at 5:8-9.
[78] Pepco is still able to seek recovery of the disallowed expenses in a future rate case "subject to a showing that such costs are used and useful and prudently incurred." Order No. 92421 at 4–5, *Potomac Electric Power Company's Application for an Electric Multi-Year Plan* (Case No. 9655, May 29, 2026).
[79] OPC Ex. 42 (Madsen Revised Surrebuttal) at 5:9-12.
[80] *Id.*, Exhibit DMM-SR-1 (Revised) at 4.

adjustment now, while making rates subject to later adjustment if the IRS ultimately determines that Pepco's proposed accounting change is required.

A. Pepco's changed accounting practice increases rate base with no corresponding benefit to customers.

A tax net operating loss occurs when a company's allowable tax deductions exceed its taxable income for a given tax year.[81] A NOLC refers to a utility's decision to apply a claimed tax net operating loss to reduce taxable income in a future tax year.[82] Companies that are members of a consolidated group of affiliated utilities—such as Pepco is to Exelon—use tax net operating losses to reduce the taxable income of other affiliates and, ultimately, the parent company's overall tax liability.[83] When a subsidiary's tax loss is used to reduce another affiliate's tax liability, the subsidiary is paid cash by the affiliate using the tax loss.[84] Under Pepco's prior accounting practice, the receipt of the cash reimbursement would result in the net operating loss being removed from Pepco's books for ratemaking purposes.[85] However, under Pepco's new accounting practice, tax net operating losses used by another affiliate—and for which Pepco received compensation—remain on Pepco's books for ratemaking purposes.[86]

The proper regulatory accounting of NOLCs is essential for compliance with the IRS's normalization rules. "Normalization" refers to the process by which the near-term

[81] Pepco Ex. 5 (Leming Direct Part II) at 10:14-15.
[82] OPC Ex. 40 (Madsen Revised Direct) at 25:14-15; Pepco Ex. 5 (Leming Direct Part II) at 10:15-16.
[83] OPC Ex. 40 (Madsen Revised Direct) at 25:18-20; Pepco Ex. 5 (Leming Direct (Part II)) at 10:17 – 11:2.
[84] Pepco Ex. 5 (Leming Direct Part II) at 11:3-7
[85] *Id.* at 11:3-22.
[86] Tr. 208:22 – 209:10 (Leming, April 23, 2026).

benefit to utilities from accelerated depreciation is passed on to customers over an asset's remaining useful life.[87] A utility receives the tax benefit of accelerated depreciation early in the asset's life.[88] However, IRS rules require the tax benefits to be passed through to customers over the asset's lifespan.[89] To comply with this requirement, tax liabilities relating to accelerated depreciation are reflected in the balance of accumulated deferred income taxes ("ADIT").[90] ADIT is considered "cost free capital" and is deducted from rate base.[91] Accordingly, all else being equal, a lower ADIT balance results in a higher rate base; and a higher ADIT balance results in a lower rate base.[92]

Ultimately, Pepco's change in accounting treatment for NOLCs results in a significant reduction to the company's ADIT balance and income tax regulatory liability and, ultimately, a $51.1 million increase in the TTYCF rate base.[93] Customers would therefore pay higher rates now based on an accounting change the IRS has not yet required Pepco to make.

B. Pepco is not at risk of a normalization violation if the Commission excludes the accounting change from rates, subject to future adjustment.

Pepco claims that if these changes are not made, it will risk being found to have violated the IRS's normalization rules. The penalty for a normalization rule violation is the loss of the ability to claim accelerated depreciation; a severe impact that OPC does

[87] OPC Ex. 40 (Madsen Revised Direct) at 25:7-9.
[88] Pepco Ex. 5 (Leming Direct (Part II)) at 9:21.
[89] 26 U.S.C. § 168(i)(9) (the "normalization rules").
[90] OPC Ex. 40 (Madsen Revised Direct) at 25:9-11.
[91] *Id.* at 25:11-12.
[92] *Id.* at 25:12-13.
[93] *Id.*, Exhibit DMM-3 at 14 (Pepco Response to OPC DR 6-40(e)).

not take lightly. However, as explained below, Pepco's accounting changes are premature and not required by law. Critically, the IRS's Safe Harbor for Inadvertent Normalization Violations ensures that there is little risk that Pepco will be found to have violated the normalization rules so long as rates excluding the accounting changes are subject to future adjustment based on the outcome of the IRS's review of Pepco's accounting change. Because that safe harbor is available, Pepco has not justified charging customers immediately for a $51.1 million rate base increase based only on the company's prediction of how the IRS will rule.

1. Pepco's reliance on PLRs for other companies is misplaced.

Pointing to a "series of [private letter rulings ("PLRS")] requested by another taxpayer," Pepco witnesses Leming and O'Donnell each assert that because Pepco's situation is "identical to the fact pattern described in the PLRs," the company believes its treatment of NOLCs is inconsistent with the IRS's normalization rules.[94] As such, the company claims it is "required" to revise its accounting methodology at the "next available opportunity."[95]

Pepco overstates the extent to which it can rely on the PLRs referenced by witnesses Leming and O'Donnell. As set forth in IRS Revenue Procedure 2016-1, a PLR is "a written determination issued to a taxpayer . . . in response to the taxpayer's written inquiry. . . A letter ruling interprets the tax laws and *applies them to the taxpayer's*

[94] Pepco Ex. 5 (Leming Direct Part II) at 9:3-13; Pepco Ex. 41 (O'Donnell Rebuttal) at 43:6-17.
[95] Pepco Ex. 5 (Leming Direct Part II) at 9:9-13; Pepco Ex. 41 (O'Donnell Rebuttal) at 43:13-17.

specific set of facts."[96] Accordingly, because PLRs are specific to the circumstances and facts set forth by the taxpayer requesting the ruling, "a taxpayer may not rely on an advance ruling issued to another taxpayer."[97]

The only PLR ruling on which Pepco can rely is one requested by Pepco itself. Though Pepco did request a PLR specific to its facts and circumstances, the IRS has yet to issue a ruling.[98] By claiming that an "instructive" ruling "requires" the company to change its accounting practices, Pepco is relying on the outcome of another taxpayer's PLR, which is prohibited. That is not a sufficient basis to increase customer rates.

Even if Pepco could rely on another taxpayer's PLRs, the company provides no explanation as to why the other taxpayer's circumstances are "identical" to those of the taxpayer that requested the initial PLR. Neither witness Leming nor witness O'Donnell identify the taxpayers that received the PLR and the jurisdiction in which they operate, explain the taxpayer's circumstances that prompted the request for a PLR, or show how that taxpayer's circumstances are "identical" to Pepco's. A conclusory statement in testimony—without supporting explanation—is an insufficient basis to determine that Pepco's circumstances are "identical" and that Pepco's proposed accounting change is absolutely necessary.

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[96] Revenue Procedure 2016-1 § 2.01 (emphasis added); *see* 26 C.F.R. § 601.201(a)(2) ("A ruling is a written statement issued to a taxpayer or his authorized representative by the National Office *which interprets and applies the tax laws to a specific set of facts*.") (emphasis added).
[97] 26 U.S.C. §6110(k)(3) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent."); 26 C.F.R. § 601.201(l) ("A taxpayer may not rely on an advance ruling issued to another taxpayer."); Revenue Procedure 2016-1 § 11.02 ("A taxpayer may not rely on a letter ruling issued to another taxpayer.").
[98] Tr. 270:16-19 (Leming, April 28, 2026); Tr. 907:17-23 (O'Donnell, April 30, 2026); *see* OPC Ex. 27 (Pepco response to OPC DR 26-13(a)).

Moreover, given Pepco's pending PLR request, whether Pepco's prior accounting practice for NOLCs is inconsistent has not been determined. The requirement under Revenue Procedure 2017-47 to correct an accounting practice is triggered by the identification of an "inconsistent practice or procedure."[99] The purpose of Pepco's request for a private letter ruling is to determine whether Pepco's prior accounting of NOLCs is inconsistent with IRS rules. Unless and until such a ruling is issued, there is no inconsistent practice or procedure that Pepco is "required" to correct. Given the pending PLR request, Pepco's own belief that its prior accounting practice is inconsistent with the normalization rules is not determinative of whether the company is required to change its practices. The Commission should reject Pepco's efforts to convert regulatory uncertainty into a present ratemaking entitlement.

2. The IRS's safe harbor for normalization violations mitigates Pepco's risk of removing the proposed adjustment.

Pepco's witnesses assert that, if the Commission rejects the company's accounting change for NOLCs, the company will be in violation of the IRS normalization rules. Revenue Procedure 2017-47 (the "IRS Safe Harbor") establishes certain protections from penalty for inadvertent or unintentional uses of practices or procedures that are inconsistent with the IRS's normalization rules.[100] So long as a taxpayer commits to correcting an inconsistent practice or procedure at the "next available opportunity," the taxpayer will not be penalized for violating the normalization rules.[101] Pepco witnesses

[99] OPC Ex. 29 (Rev. Proc. 2017-47 § 5.01).
[100] *Id.* (Rev. Proc. 2017-47 § 1).
[101] *Id.* (Rev. Proc. 2017-47 § 5.01).

Leming and O'Donnell each claim that, under IRS guidance, this proceeding is the "next available opportunity."[102] But Pepco's reading of the IRS Safe Harbor is myopic and not appropriate for Pepco's current situation.

The Safe Harbor's definition of "next available opportunity" changes based on whether the taxpayer has a pending rate case before its regulator or whether the taxpayer still has a pending PLR request at the conclusion of a pending rate case.[103] For a taxpayer with a pending rate case, "next available opportunity" means the current proceeding unless the taxpayer is precluded by its regulator or applicable law from initiating a change to correct the inconsistent practice or procedure.[104] This appears to be the definition of "next available opportunity" that Pepco's witnesses rely on. However, the applicability of this definition depends, in part, on the IRS determining that Pepco's prior practice is inconsistent. As noted above, Pepco has not received any such ruling from the IRS.

What Pepco's witnesses do not address, however, is the IRS Safe Harbor's definition of "next available opportunity" for taxpayers with a PLR still pending at the conclusion of the rate proceeding. In that circumstance, the safe harbor applies so long as the taxpayer's regulator "establishes or approves rates subject to adjustment from the effective date of the unadjusted rates in order to conform to the [IRS's] ruling."[105] As OPC witness Madsen explains, based on this provision "the Commission could set rates

[102] Pepco Ex. 5 (Leming Direct Part II) at 9:9-13; Pepco Ex. 41 (O'Donnell Rebuttal) at 43:13-17.
[103] OPC Ex. 29 (Rev. Proc. 2017-47 § 4.07).
[104] *Id.* (Rev. Proc. 2017-47 § 4.01(2)).
[105] *Id.* (Rev. Proc. 2017-47 § 4.07(3)).

that exclude Pepco's requested NOLC adjustment that are subject to adjustment based on the outcome of Pepco's pending PLR letter request. In such a circumstance, the company would fall under the protection of the Safe Harbor and not be at any risk of a normalization violation."[106] This is a practical solution that protects Pepco from a potential normalization violation without forcing customers to pay based on a ruling the IRS has yet to issue.

Rather than forcing customers to pay for a regulatory accounting change the IRS has yet to rule on, the Commission can set rates that exclude Pepco's NOLC accounting change and defer consideration of the NOLC issue until after the IRS rules on Pepco's PLR request. Mr. Madsen recommended the Commission "require Pepco to track any incremental costs associated with Pepco's proposed accounting change" which the company would be allowed to recover at a later date if the IRS determines that Pepco's accounting change was required to correct an inconsistent practice.[107] This is the practical answer to Pepco's concern. The Commission can protect Pepco from a normalization violation if the IRS later agrees that the company's prior practice was inconsistent, without basing a decision to charge customers now on a ruling the IRS has not issued.[108]

It is not uncommon for the Commission to set rates conditional on future adjustment.[109] For instance, in Case No. 9418, Pepco claimed that a Commission-ordered

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[106] OPC Ex. 40 (Madsen Revised Direct) at 29:10-14.
[107] OPC Ex. 42 (Madsen Revised Surrebuttal) at 22:16 – 23:3.
[108] *Id.* at 23:4-6 (noting that "[s]uch action aligns with the Safe Harbor provision and ensures that customers are not charged in advance for accounting changes that have yet to be required by the IRS").
[109] *E.g.,* Order No. 88236, *In the Matter of the Application of the Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9418, June 2, 2017); *but see* Order No. 85724 at 15–28, *In the Matter of the Application of Potomac Electric Power Company for*

change to the company's accounting practices for tax settlements may violate the IRS's normalization rules.[110] Though the Commission affirmed its decision, it directed Pepco to request a PLR from the IRS to definitively resolve the issue. Upon Pepco's request, the Commission clarified that its decision on the issue was not a final order and that the rates would be subject to adjustment in a Phase II proceeding pending the outcome of the PLR request.[111] When the IRS ruling confirmed that Commission-ordered accounting treatment violated the normalization rules, the Commission approved recovery of a regulatory asset reflecting the incremental costs caused by the accounting change.[112]

That same approach is available here. Just as Pepco itself recommended in Case No. 9418, the Commission could defer a final ruling on this issue until Pepco receives a PLR determination from the IRS about the inclusion of the NOLC. If the IRS confirms Pepco's accounting change is required, the Commission could allow recovery of any related incremental costs as a regulatory asset. This course of action protects customers from paying additional costs *now* based on what Pepco believes may happen in the future. The Commission should remove the NOLC adjustment from Pepco's TTYCF revenue requirement, subject to a Phase II proceeding adjustment and true-up pending the

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an Increase in its Retail Rates for the Distribution of Electric Energy (Case No. 9311, July 12, 2013). In Case No. 9311, Pepco had not sought a PLR regarding the NOLC issue. *Id.* at 28. Though the record lacked "a definitive analysis of the NOLC and associated tax implications," the Commission "erred on the side of caution" and accepted Pepco's ratemaking adjustments subject to Pepco requesting a PLR from the IRS. *Id.* If Pepco failed to support its position with a PLR within three years, the Commission would adjust Pepco's authorized rates to remove the revenue impact of the NOLC. *Id*

[110] Order No. 88236 at 1–2.

[111] *Id.* at 6.

[112] Order No. 88884 at 5, *In the Matter of the Application of the Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9418, Oct. 24, 2018).

outcome of the IRS's decision on Pepco's requested PLR.

IV. The Commission should reject Pepco's unprecedented proposed regulatory asset for yet-to-be identified storm and regulatory expenses.

Pepco's TTYCF includes an extraordinary proposal: the creation of a regulatory asset specific to potential "exogenous costs" the company would identify in the future. Pepco defines "exogenous costs" as "costs that are externally driven, largely outside of [the company's] control and volatile and unpredictable in nature."[113] Under the company's proposal, costs related to minor storm expense, pension expense, and new legislative, regulatory, or policy changes incurred outside of a rate case would be eligible for inclusion in a regulatory asset and reviewed for prudence and inclusion in rates during a subsequent rate case.[114] Costs included for regulatory asset treatment would be eligible to earn a rate of return, despite such costs being largely operational in nature.

Pepco's proposal aims to reduce risks that a utility ordinarily incurs. Historically, utilities bore the risks of incremental cost increases relating to storm expense or regulatory compliance. This is because, under the Commission's standard ratemaking paradigm, extraordinary costs generally are not reflected in a utility's revenue requirement.[115] Because higher operational costs can decrease a utility's earned return,

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[113] Tr. 191:14-18 (Leming, April 27, 2026); Pepco Ex. 5 (Leming Direct Part II) at 3:12-15.
[114] Pepco Ex. 5 (Leming Direct Part II) at 4:19-22, 8:10-12. Pepco also proposes regulatory asset treatment for pension expense. *Id.* at 5:5-10. OPC does not oppose the regulatory asset treatment for certain pension expenses, provided the costs in the regulatory asset are amortized and do not earn a rate of return. *See* OPC Ex. 40 (Madsen Revised Direct) at 19:8-13.
[115] *See, e.g.,* Order No. 83907 at 34, *In the Matter of the Application of Baltimore Gas and Electric Company for Revisions in its Electric and Gas Base Rates* (Case No. 9230, March 9, 2011) (noting that "it is appropriate to normalize costs in a rate case when their extraordinary nature would make it inappropriate to reflect the full amount in a single test year").

utilities have an incentive to ensure that their response to extraordinary or atypical circumstances is cost-effective and well-managed. That incentive is an essential part of cost-of-service regulation.

In practical terms, Pepco asks the Commission to give the company advance permission to defer broad categories of ordinary business costs and then seek recovery of those costs, with a return, from customers in a later proceeding. Pepco's proposal undermines crucial consumer protections, departs from Commission precedent, and should be denied.

A. Pepco's proposed regulatory asset for new legislative, regulatory, or policy requirements lacks any meaningful limits and unduly shifts risks from shareholders to customers.

Pepco asks the Commission to enable the company to earn a return on regulatory compliance costs. As Pepco witness Leming explains "*any* new legislative, regulatory, or other public policy requirement . . . that have an impact on the [c]ompany's cost of service and emerge after the filing and approval of this proceeding" would be eligible for inclusion in a regulatory asset.[116] If any such expenditures were to be recovered over multiple years, the company would seek to include them in rate base.[117]

The primary concern with Pepco's proposal is its breadth. As Pepco witness Leming acknowledged, there are numerous Commission orders issued and new legislation passed each year, all of which could impact or change the company's cost of

[116] Pepco Ex. 5 (Leming Direct Part II) at 6:2-6.
[117] Tr. 193:12-15 (Leming, April 27, 2026).

service and could be eligible for inclusion in a regulatory asset.[118] Pepco has not identified a specific new requirement, a specific cost, a specific threshold, or a specific limiting principle that would prevent ordinary regulatory compliance costs from being shifted to customers through deferred accounting.[119] During the MRP Lessons Learned proceeding, Commissioner Suchman expressly raised concern with the breadth an identical Pepco proposal, describing it as "an exception that could swallow the rule and could involve [the Commission] in a lot of litigation that distracts from what [the Commission] is trying to do . . . ."[120] The breadth of costs potentially eligible for regulatory asset treatment risks burdening customers with compliance costs that are more appropriately borne by shareholders.[121]

In addition to saddling customers with increased costs, Pepco's proposal unduly shifts risks off of shareholders, who can manage such risks, and onto customers, who cannot. Historically, utilities have shouldered the risks that regulatory compliance obligations may increase costs. Asking customers to foot the bill for increased costs directly attributable to regulatory compliance, would upend this longstanding apportionment of risk. Compliance with law and Commission requirements is not an unusual or extraordinary add-on to utility service. It is part of the basic obligation that comes with monopoly service territory and cost-of-service ratemaking.

[118] Tr. 200:20 – 201:10 (Leming, April 27, 2026).
[119] OPC Ex. 40 (Madsen Revised Direct) at 18: 2-5. Pepco witness Leming conceded this fact during the evidentiary hearing. Tr. 202:14 – 203:6 (Leming, April. 27, 2026):
[120] OPC Ex. 8 (Case No 9618, Hr'g Tr. at 65:3-7).
[121] OPC Ex. 42 (Madsen Revised Surrebuttal) at 9:12-14.

B. Prospective regulatory asset treatment for ordinary storm expense costs is unprecedented and improper.

Pepco proposes an extraordinary regulatory treatment for ordinary utility costs. As proposed, "minor storm" costs above or below the "level included in the authorized revenue requirement" would be eligible for inclusion in a regulatory asset.[122] Unlike major storm events, which are defined by COMAR 20.50.01.03B(32), Pepco alone identifies the "minor storm" costs eligible for regulatory asset treatment.[123] Once placed into the regulatory asset, Pepco would seek to include those costs in rate base irrespective of whether the costs are capital or O&M in nature. This proposal departs from well-established limitations regarding the use of regulatory assets and significantly undermines cost-containment incentives. It also creates an asymmetry: customers bear the risk of higher costs, while Pepco would have reduced incentive to manage those costs within the amount already included in rates.

As a general matter, the Commission reserves regulatory asset treatment for extraordinary expenditures that are, generally, non-recurring.[124] Minor storm expenses are neither.[125] While storm activity varies from year to year, such variation is rarely significant enough to warrant special regulatory treatment.[126] Storms are not rare events. They are part of ordinary utility operations.

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[122] Pepco Ex. 5 (Leming Direct Part II) at 4:14-17.
[123] Tr. 192:21 – 193:6 (Leming, April 27, 2026).
[124] *See* Order No. 91048 at 6, *Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy* (Case No. 9702, March 4, 2024).
[125] OPC Ex. 40 (Madsen Revised Direct) at 9:3-5 ("Minor storms are best considered as a standard operational risk that utilities should expect and be prepared to handle.").
[126] *See* OPC Ex. 40 (Madsen Revised Direct), Exhibit DMM-3 at 8 (Pepco response to OPC DR 6-19).

Pepco asks the Commission to normalize a regulatory accounting treatment that the Commission has only previously granted on a case-by-case basis—and rarely, for that matter. The Commission disfavors regulatory asset treatment for minor storm costs.[127] Whether regulatory asset treatment is appropriate is determined on a case-by-case basis *after* the expenditures have been incurred.[128] In short, Pepco seeks the benefit of exceptional accounting treatment, but without first showing exceptional facts.

Moreover, customers are worse off under Pepco's proposal because it undermines crucial cost containment incentives.[129] As OPC witness Madsen explains, Pepco cannot control whether minor storms occur, but Pepco can "control how it responds to a storm."[130] An opportunity to recover any and all budget exceedances for minor storm expenses "shifts cost risks with *how* the company responds . . . away from the company and into its customers."[131] Such an erosion of cost containment incentives does not protect consumers and is antithetical to the public interest.

Pepco provides little actual support for categorically affording regulatory asset treatment to minor storm expense. Pepco witness Nelson claims the company's proposal prevents "immediate rate impacts from volatile, externally driven storm costs, and ensures that customers pay only costs the Commission ultimately determines[] to be

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[127] Order No. 92106 at 26.
[128] *Eg.*, Order No. 92106 at 26 (affording regulatory asset treatment to minor storm expenses "because of the exceptionally high dollar amounts in order to reduce rate shock by spreading costs over a longer period of time."); Order No. 83907 at 34–35 (allowing BGE to amortize "extraordinary level minor storm expenses" relating to a single storm event during the historic test year period because it was appropriate to remove costs from the test year but "unjust" to deny BGE recovery").
[129] OPC Ex. 40 (Madsen Revised Direct) at 8:6-10.
[130] *Id.* at 8:12-13.
[131] *Id.* at 8:13-15.

prudent and reasonable."[132] Yet, under historic test year rates, customers already only pay costs that the Commission deemed prudent and reasonable. Nor is there any possibility of an immediate rate impact resulting from volatile storm costs.[133] Pepco witness Leming further claims that failing to afford "appropriate recovery" of such costs could negatively impact the health of the utility.[134] Yet, Pepco provides no evidence linking the company's inability to receive regulatory asset treatment for minor storm expenditures to changes in the utility's credit metrics. The company's consumer-protection rationale therefore does not withstand scrutiny. The proposal protects Pepco from ordinary operating risk; it does not protect customers from unreasonable rates.

As Mr. Madsen notes, "[d]enying the company's request ensures that the company remains incentivized to address minor storm events prudently and cost-effectively. Approval of Pepco's requested minor storm expense regulatory asset would significantly erode such incentives."[135]At a time when rate affordability concerns are paramount, the Commission must ensure that Pepco has every incentive to act cost-effectively and minimize unnecessary increases to customer rates.

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Pepco asks the Commission to turn the ratemaking paradigm on its head and upend longstanding practices that place regulatory compliance and minor storm expense risks with the party incentivized to cost-effectively manage them—utility shareholders.

[132] Pepco Ex. 28 (Nelson Rebuttal) at 9:20-22.
[133] Tr. 712:13-17 (Nelson, April 29, 2026).
[134] Pepco Ex. 5 (Leming Direct Part II) at 4:3-6.
[135] OPC Ex. 42 (Madsen Revised Surrebuttal) at 10:6-8.

Pepco may seek recovery of actual, prudently incurred costs in a future rate case if those costs satisfy the Commission's standards. What it should not receive is a prospective accounting mechanism that weakens cost-control incentives before any specific cost has even been incurred. The Commission should reject Pepco's proposed regulatory asset treatment for minor storm expenditures and costs to comply with new regulatory requirements.

V. Pepco's requested recovery of rate case expense should be denied.

The Commission should disallow Pepco's requested recovery of its legal expenses associated with prosecuting this proceeding (rate case expenses). Pepco's TTYCF includes an adjustment for recovery of $1.4 million in rate case expense, which the company proposes to amortize over a three-year period.[136] Pepco's requested amount is unreasonable because it is premised on recovery of its litigation expenses to pursue an unnecessarily complex fully forecasted rate case that it later abandoned. Pepco's request is further inflated because it improperly seeks to earn a return on the unamortized balance of an O&M expense item. This aspect of Pepco's request should be denied regardless of whether any portion of its rate case expense is found recoverable. At most, Pepco should be allowed to recover only actual, documented, reasonable costs that were necessary to prosecute the TTYCF case that remains before the Commission.

[136] Pepco Ex. 29 (Nelson Surrebuttal), Schedule (CN-SR)-1 at 15. Pepco's initial filing estimated rate case expense at $1.295 million. Pepco Ex. 26 (Nelson Direct), Schedule (CN)-1 at 14.

A. The Commission should disallow recovery for all of Pepco's rate case expenses associated with this proceeding.

Under the specific facts of this case, the Commission should disallow Pepco's rate case expenses in their entirety. Pepco bears the burden to justify the recovery of these costs and has failed to do so here. Specifically, these rate case expenses were not useful or necessary expenses to the extent they were incurred to support the company's withdrawn FFTY proposal. Rather, they were incurred as part of Pepco's decision to pursue a fully forecasted test year proposal that the company later abandoned. Such expenses should not be recovered, as Pepco was unable or unwilling to isolate these costs from the costs incurred to pursue a rate increase under the Commission's accepted framework.[137] That failure leaves the Commission with no reliable record basis to determine what portion of Pepco's request, if any, reflects reasonable and necessary rate case expense.

Like all expenses, legal costs "must be reasonable in order to be recovered . . . ."[138] While the Commission considers rate case expense recoverable, it applies restrictions such as limiting the recoverable amount to the amount estimated in the company's initial rate case application.[139] The Commission's reasonableness review of rate case expense aims to ensure that the legal costs utilities seek to recover are not excessive. Recovery therefore is not automatic. The company must show that the costs

[137] OPC Ex. 40, Exhibit DMM-3 at 15 (Pepco response to OPC DR 8-3(c)).
[138] Order No. 83516 at 30, *In the Matter of the Application of Potomac Electric Power Company for an Increase in its Retail Rates for the Distribution of Electric Energy* (Case No. 9217, Aug. 6, 2010).
[139] Order No. 86441 at 48, *In the Matter of the Application of the Potomac Electric Power Company for Adjustment to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9336, July 2, 2014) (describing such a cap on rate case expense recovery as "good policy").

were reasonable, necessary, and adequately supported.

In previous cases, the Commission expressed concerns with significant legal and regulatory expenses incurred by utilities in rate cases.[140] For instance, in Case No. 9217, the Commission scrutinized the costs of Pepco using outside counsel in lieu of in-house counsel. Though the Commission declined to disallow legal expenses given the evidentiary record, it admonished that recovery of legal fees "is not assured in the future, unless cost-justified by Pepco in comparison to staffing the work in-house."[141] Similarly, in Case No. 9299, the Commission scrutinized Baltimore Gas and Electric Company's ("BGE") use of external contractors as testifying witnesses.[142] The Commission found it reasonable for BGE to "obtain a modest amount of external support for rate case preparation," but cautioned BGE "that significant rate case preparation expenses for outside contractors will not necessarily be recoverable, given BGE's level of in-house expertise."[143]

In this case, the Commission should deny Pepco's request to recover rate case expenses. OPC witness Madsen describes the company's filing as "atypically complex" and found that "the scope and complexity of Pepco's application fall[s] well outside what is reasonable to recover from customers."[144] Indeed, unlike a conventional rate case—

[140] *E.g.,* Order No. 85029 at 43–44, *In the Matter of the Application of Delmarva Power & Light Company for Authority to Increase Rates and Charges for Distribution Service* (Case No. 9285, July 20, 2012).
[141] Order No. 83516 at 30.
[142] Order No. 85374, *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustment in its Electric and Gas Base Rates* (Case No. 9299, Feb. 22, 2013).
[143] *Id.* at 13.
[144] OPC Ex. 40 (Madsen Revised Direct) at 22:4-9.

consisting of a single revenue requirement—the company filed four different revenue requirements (three of which supported the FFTY proposal) and two external studies to support Commission review of spending proposed for the FFTY.[145] In sum, the company's initial filing included 14 separate pieces of testimony, prepared and filed by 12 different witnesses, four of which were outside contractors that Pepco retained.[146] In rebuttal the company added two additional witnesses, one of which was also a third party contractor.[147] Clearly, the company devoted significant internal and external resources at significant expense to prepare its rate case. The majority of these resources were directed to support a new proposed ratemaking construct—a fully forecasted future test year—that the Commission did not invite the company to submit and that the company ultimately withdrew. Customers should not be required to pay the costs of developing and litigating that withdrawn proposal.

Pepco was unable to isolate these FFTY-related legal costs from its expenses incurred for the traditional rate case it ultimately pursued. In his direct testimony, Mr. Madsen noted that he would have recommended recovery for the expenses associated with a standard historic test year.[148] However, when asked to quantify costs specific to preparing the FFTY, Pepco simply stated that "the requested analysis has not been performed."[149] The Commission has previously disallowed certain requested rate case

[145] *Id.* at 22:6-7.
[146] Outside contractors include Messrs. Blazunas, Schafer, McKenzie, and Tuladhar. *See* Pepco Ex. 30 and 30C (reflecting rate case costs and outside contractor invoices as of April 23, 2026).
[147] The additional outside contractor Pepco retained is Mr. Tsuchida. *See id.*
[148] OPC Ex. 40 (Madsen Revised Direct) at 22:10-13.
[149] *Id.*, Exhibit DMM-3 at 15 (Pepco response to OPC DR 8-3(c)).

expenses on the basis that documentation for estimates was inadequate.[150] Here Pepco has declined even to estimate—let alone document—the TTYCF-specific costs. Accordingly, given the absence of information detailing the incremental cost of preparing the FFTY, Mr. Madsen recommended full disallowance of rate case expense.[151] That recommendation follows directly from Pepco's failure of proof. The company cannot refuse to segregate unrecoverable or unreasonable costs and then ask customers to pay the entire undifferentiated amount.

Pepco's rate case filing, and commensurate costs, far exceeds the bounds of reasonableness for recovery. Pepco witness Nelson justifies the company's rate case expense by stating that "this proceeding required a more detailed filing because it involved multiple contested issues and new requirements that needed to be fully addressed."[152] But the "contested issues and new requirements" are wholly of the company's own making: Unlike Pepco's previous rate cases, which were based on accepted Commission ratemaking methodologies, the company's application presented a new ratemaking approach that the Commission had never previously authorized—a stated rate based entirely on a single forecasted test year with no opportunity for reconciliation or true up.

Moreover, the company filed its application while awaiting a Commission decision in the MRP Lessons Learned proceeding that would impact the continued use of

[150] Order No. 86441 at 49 (finding "a general invoice with nothing to substantiate this more detailed description of work tasks" insufficient).
[151] OPC Ex. 40 (Madsen Revised Direct) at 22:4-5, 10-15.
[152] Pepco Ex. 28 (Nelson Rebuttal) at 30:7-9.

forecasted test year ratemaking in Maryland.[153] In short, Pepco sought to bypass the Commission's pending review of forecasted test-year ratemaking by presenting a proposal for a *different form* of forecasted test year ratemaking outside of the MRP Lessons Learned proceeding.

Customers should not be forced to compensate Pepco for using this proceeding as a vehicle to propose a new policy—especially one that would shift significant risk from shareholders to customers.[154] If Pepco shareholders want to pursue such policy changes, the company can do so at shareholder expense. The Commission may have given Pepco flexibility to determine the form of the company's next rate case.[155] But such flexibility does not, itself, guarantee recovery for all rate case expenses that Pepco incurs. Again, the touchstone of rate-case expense recovery is reasonableness. Pepco could have filed a reasonable rate case: a historic test year case to adjust its rates during the interim period before the Commission issues a ruling in the MRP Lessons Learned proceeding. Instead, Pepco submitted a highly complex application proposing a new approach to ratemaking that the company eventually withdrew. It is antithetical to the public interest to require customers to pay the costs of that litigation choice. Those costs should remain with

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[153] *See* Case No. 9618, *In the Matter of Alternative Rate Plans or Methodologies to Establish New Base Rates for an Electric Company or a Gas Company*.

[154] *See* OPC Ex. 3 (Exelon Spring 2025 Investor Meeting) at 10 (noting that 92 percent of projected Exelon rate base growth from 2025–2028 "is expected to be recovered through established alternative regulatory mechanisms"); *id.* at 24 ("Rate case activity and investment plan drives path for 5-7% annualized adjusted operating earnings growth, with close to 90% of Exelon's rate base covered by established recovery mechanisms through 2026-2027.").

[155] Order No. 91181 at 30, *Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy* (Case No. 9702, June 10, 2024) ("The form of the Company's next rate case can be any of its choosing, so long as its application is accompanied by the requisite information needed to calculate a historic test year.").

shareholders.

Though complete disallowance of rate case expense is rare, it is justified here. The Commission's role is to ensure that "ratepayer funds are expended *only as necessary* to facilitate efficient and fair rate case proceedings."[156] Pepco's complex rate case application stretches the boundaries of necessity, efficiency, and fairness. The record in this case supports such a finding. To the extent that Pepco did incur expenses that would have been necessary regardless of the type of rate application the company filed, Pepco failed to identify any such expense even when directly asked.

Allowing complete recovery of rate case expense here would send a clear signal to utilities that they bear no risks associated with aggressive and risky litigation tactics because—whether the utility wins, loses, or walks away—the customer must always foot the bill. When recovery of rate case expense is all but guaranteed, utilities are emboldened to pursue litigation strategies that stretch the resources of stakeholders and the Commission to the primary benefit of utility shareholders.[157] Contested case proceedings are, themselves, a form of consumer protection. This consumer protection is undermined when one side—the customer—is guaranteed to ultimately bear the full burden of the utility's participation. The Commission should not adopt a rule in practice under which customers must finance unsuccessful or abandoned utility ratemaking experiments.

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[156] Order No. 88432 at 40, *In the Matter of the Application of Potomac Electric Power Company for Adjustments to Its Retail Rates for the Distribution of Electric Energy* (Case No. 9443, Oct. 20, 2017).
[157] *See* William G. Bolgiano, *Rate Case Expense: A Uniquely Anti-Consumer Form of Litigation Fee Shifting*, 46 Energy L. J. 529, 563–67 (2025).

The Commission should disallow recovery for all of Pepco's expenses related to this rate case. While the most appropriate outcome is complete denial, at the very least the Commission should substantially reduce the amount of rate case expense included in customer rates. Pepco effectively incurred costs to present two rate cases in this proceeding: a traditional test-year rate case and a fully forecasted test-year rate case. Pepco then withdrew the fully forecasted test-year proposal before the Commission could decide it, but still asks customers to pay the costs of developing and litigating that proposal. Any partial recovery should be based on the existing record and should reflect the fact that Pepco's request includes unsupported costs associated with a ratemaking proposal that is no longer before the Commission. In no event should Pepco recover costs attributable to the withdrawn FFTY proposal or any unsupported portion of its request.

B. Pepco should not be permitted to earn a return on any rate case expenses found recoverable.

If the Commission believes some recovery of rate case expense is appropriate, the Commission should accept Staff's recommendation to limit Pepco's recovery to actual expenditures incurred and reject any treatment that would allow Pepco to earn a return, carrying charge, or other profit on rate case expenditures.

The company's adjustment for rate case expense reflects a three-year amortization period. While the amortization of rate case expense is reflected as an adjustment to O&M, the company proposes to place the unamortized balance into a regulatory asset.[158] Pepco witness Nelson notes that the company's adjustment reflects "anticipated rate case

[158] Pepco Ex. 26 (Nelson Direct), Schedule (CN)-1 at 14.

expenses" that would be deferred to a regulatory asset when the Commission issues a final order in this proceeding.[159] To the extent Pepco seeks to include any unamortized balance of rate case expense in rate base, or otherwise earn a return or carrying charge on that balance, the Commission should reject that treatment. In other words, Pepco's proposed rates should not allow the company to earn a return on the unamortized balance of legal and regulatory costs incurred to seek higher rates.[160]

This is directly contrary to Commission policy and basic ratemaking principles. *First*, adjustments to the historic test year "are typically for unusual events that occurred during the actual test year period, or for known and measurable changes that will occur within a given time period after the end of the test year."[161] As Staff witness Rielly explains, any rate case expense recovery should be limited based on actual, documented costs; not forecasts.[162] Pepco's proposal fails that standard because it seeks recovery based on anticipated expenses rather than actual, documented costs.

Second, rate case expenses—whether forecasted or actual—are not the type of costs eligible to earn a rate of return. Generally, Maryland utilities are afforded an opportunity to earn a return "on the fair value of the public service company's *property* used and useful in providing service to the public."[163] Legal expenses are operational in nature; they are not capital expenditures, and are not directly reflected in the value of any

[159] Pepco Ex. 28 (Nelson Rebuttal) at 28:20 – 29:2.
[160] *See* Staff Ex. 6 (Rielly Direct) at 12:5-8.
[161] Order No. 87591 at 98, *In the Matter of the Application of Baltimore Gas and Electric Company for Adjustments to its Electric and Gas Base Rates* (Case No. 9406, June 3, 2016).
[162] Staff Ex. 6 (Rielly Direct) at 12:12-20.
[163] PUA § 4-101(3) (defining "just and reasonable rate") (emphasis added).

specific utility infrastructure serving customers. Moreover, the Commission limits the use of regulatory assets for "extraordinary circumstances generally for non-recurring expenditures on non-capital assets."[164] Rate case expenditures are neither extraordinary, nor non-recurring, especially for utilities with frequent rate case filings—such as Pepco over the last decade. Treating ordinary rate case expense as a return-earning regulatory asset would convert an O&M expense into a profit opportunity without any corresponding customer benefit.

Affording regulatory asset treatment to the unamortized balance of Pepco's rate case expenditures is inappropriate. Therefore, if the Commission allows a portion of Pepco's rate case expenses to be recovered in rates, recovery should be limited to actual expenditures and amortized as an operational expense. The Commission should further clarify that any recoverable rate case expense may not be included in rate base and may not accrue a return, carrying charge, or other profit component. The Commission should reject any return on rate case expense.

[164] Order No. 91048 at 6.

VI. The Commission should adopt OPC's adjustments to Pepco's O&M spending.

Pepco's proposed O&M expense includes costs that are overstated, unsupported, or potentially prohibited from recovery by recently enacted Maryland law. OPC's adjustments better reflect Pepco's actual workforce, reasonable inflation expectations, the company's demonstrated ability to manage corrective maintenance spending without harming reliability, and the statutory limits that will apply during the rate-effective period. The Commission should adopt OPC's O&M adjustments.

A. Pepco's labor costs should reflect actual employee headcount and a reasonable labor escalation rate.

Pepco's TTYCF O&M expense reflects an increase in labor costs based on two factors: (1) a forecast of 1,413 full-time equivalent ("FTE") positions, and (2) a post-test year labor cost escalation of 3 percent.[165] Together, these adjustments increase Pepco's O&M expense by $4.6 million.[166] However, relying on Pepco's forecasted employee headcount likely overstates the number of actual FTE employees. And Pepco has not sufficiently demonstrated that its labor cost escalation rate is reasonable. The Commission should instead base labor expense on actual headcount and a more reasonable escalation rate, as OPC witness Madsen recommends.

1. The Commission should base labor cost escalation on actual employee headcount.

For 2025, Pepco's labor expense budget reflects 1,413 FTEs, based on a full complement of 1,453 and a 2.75 percent vacancy rate.[167] However, Pepco's actual

[165] OPC Ex. 40 (Madsen Revised Direct) at 16:2-13.
[166] Pepco Ex. 28 (Nelson Rebuttal), Schedule (CN-R)-1 at 4.
[167] OPC Ex. 40 (Madsen Revised Direct), at 16:2-4, Exhibit DMM-3 at 6.

headcount (as of November 30, 2025) was 1,355 FTE.[168] Accordingly, OPC witness Madsen recommended basing labor costs on 1,355 FTEs, since that number is the most accurate representation of Pepco's actual workforce and Pepco did not provide any evidence of a realistic ability to close the stated gap in positions.[169] That gap should not be charged to customers as if the positions were filled.

Pepco's general description of hiring initiatives does not establish that its forecasted headcount is known, measurable, or likely to occur during the rate-effective period. Pepco bases its forecasted FTEs on the success of the company's new hiring tactics to address the difficulties in hiring and retaining entry-level workers.[170] Pepco does not explain, however, the extent to which the number of vacancies are specific to entry-level employees. Improving outreach to entry level trade employees may, eventually, result in fewer skilled worker vacancies. But if the majority of vacancies are not entry-level, an improvement in Pepco's ability to fill entry-level positions will not resolve Pepco's vacancy issues in the near term.

This is not the first time Pepco based a labor cost adjustment on an increase in headcount. In Case No. 9702—Pepco's most recent case—the Commission rejected Pepco's use of forecasted employee headcounts that exceeded actual employee levels.

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[168] *Id.*, Exhibit DMM-3 at 6 (Pepco response to OPC DR 6-8, Attachment 1).
[169] *Id.* at 16:7-9. .[170] Pepco Ex. 41 (O'Donnell Rebuttal) at 29:7-8 ("The Company's forecast staffing levels are supported by talent practices designed to strengthen and sustain its exempt and highly technical workforce."); Pepco Ex. 23 (Williams Rebuttal) at 7:13 – 8:15.
[170] Pepco Ex. 41 (O'Donnell Rebuttal) at 29:7-8 ("The Company's forecast staffing levels are supported by talent practices designed to strengthen and sustain its exempt and highly technical workforce."); Pepco Ex. 23 (Williams Rebuttal) at 7:13 – 8:15.

While the Commission expressed faith in Pepco's intention to fill its open positions, it found that "the evidence did not show that the forecasted increase will take place . . . at the level projected by Pepco."[171] In this case, such evidence is similarly lacking.

Customers should not pay labor costs based on positions Pepco has not shown it will actually fill. In Case No. 9702, Pepco reported 96 fewer employees than its forecasted FTE count as of Q3 2023, including 50 open positions within electric operations.[172] Here, electric operations vacancies account for 42 of the 58 vacant FTEs.[173] That Pepco was only able to fill eight vacant electric operations positions since Q3 2023, even after implementing a new hiring plan, further suggests that Pepco's forecasted headcount is unlikely to be met. High-level discussion of the company's new hiring initiative for entry-level positions does not establish that Pepco is likely to fill the vacant positions. Like in Case No. 9702, the Commission should base Pepco's labor cost on its actual headcount as of Q3 2025, as per OPC witness Madsen's recommendation.

2. Pepco's 3 percent labor cost escalation rate is unreasonable.

Pepco's labor cost adjustment reflects a post-test year cost escalation of 3 percent per year for management and union staff.[174] The management salary increase would be effective as of March 2027.[175] The union staff salary increase is contractually obligated and would be effective on June 1, 2027.[176] These salary increases are additional to several

[171] Order No. 91181 at 35.
[172] Order No. 91181 at 32–33.
[173] OPC Ex. 40 (Madsen Revised Direct), Exhibit DMM-3 at 6 (Pepco response to OPC DR 6-8, Attachment 1).
[174] Pepco Ex. 26 (Nelson Direct) at 22:5-9.
[175] *Id.* at 22:5.
[176] *Id.* at 22.6.

prior salary increases for management and union employees: a 3 percent increase for management employees effective March 1, 2025, a 4 percent increase for bargaining unit employees effective June 1, 2025, and a 3 percent contractually obligated wage increase for union employees effective June 6, 2026.[177]

Pepco notes that the post-test year salary increases are known and measurable. Yet there is not sufficient evidence demonstrating the reasonableness of Pepco's labor cost increases. Pepco did not provide any compensation studies to support the non-contractually obligated wage increases reflected in RMA 20.[178] Beyond declaring its intent to increase management employee wages by three percent, Pepco provides little explanation or justification of why a three percent increase is reasonable or necessary. Known and measurable does not mean automatically recoverable. Pepco still must show that the cost level is reasonable, and the company did not do so.

Moreover, Pepco's labor escalation rate unreasonably exceeds the rate of inflation. OPC witness Madsen explains that "wage increases are intended to provide compensation to employees that allow them to continue to maintain cost-of-living standards, which are directly impacted by inflation."[179] Over the long term, salary increases should trend towards the rate of inflation.[180] Pepco's proposal, however, results in a 9.2 percent increase in salaries.[181] Reducing the management wage increase planned for 2027 to two

[177] Pepco Ex. 26 (Nelson Direct) at 21:9-13.
[178] OPC Ex. 40 (Madsen Revised Direct) at 18:1-7; OPC Ex. 42 (Madsen Revised Surrebuttal) at 18:16 – 17:8.
[179] OPC Ex. 40 (Madsen Revised Direct) at 17:6-9.
[180] *Id.* at 17:9-11.
[181] OPC Ex. 42 (Madsen Revised Surrebuttal) at 29:17-19.

percent, as Mr. Madsen recommends, ultimately results in an overall 5.2 percent increase in salaries and is more in line with actual inflation levels. [182]

In sum, Mr. Madsen's recommendations—to base Pepco's labor expense on Pepco's actual employee headcount and use a two percent post-test year labor escalation rate for management employees—results in a labor cost that is more closely aligned with Pepco's actual costs. The Commission should reject Pepco's overstated labor costs and accept Mr. Madsen's adjustment.

B. Pepco's non-labor O&M expenses should reflect recent, actual inflation rates not historic, anomalous rates.

Pepco further proposes an adjustment to increase non-labor O&M expenses. Pepco's RMA 25 adjusts the test year revenue requirement to reflect a 4.46 percent increase in non-labor O&M expenses.[183] Pepco's adjustment is based on the five-year average Consumer Price Index ("CPI") for the Washington-Arlington-Alexandria DC-VA-MD-WV region for 2020-2025.[184]

Mr. Madsen recommends basing Pepco's non-labor O&M expenses on the 2.5 percent inflation rate projected for Maryland in 2026.[185] As Mr. Madsen notes, the historic inflation rate relied upon by the company is impacted by the historically anomalous inflation experienced in 2021 through 2023.[186] From 2000 to 2025, the average rate of inflation was 2.17 percent, excluding the anomalous periods; including

[182] OPC Ex. 40 (Madsen Revised Direct) at 18:9-11; OPC Ex. 42 (Madsen Revised Surrebuttal) at 30:1-4. Mr. Madsen's adjustment does not alter the contractually obligated salary increases for union employees.
[183] OPC Ex. 40 (Madsen Revised Direct) at 18:14-16.
[184] Pepco Ex. 26 (Nelson Direct) at 24:5-11.
[185] OPC Ex. 40 (Madsen Revised Direct) at 19:9-10.
[186] *Id.* at 19:6-8, Figure 4.

the anomalous periods increases the average inflation rate to 2.57 percent.[187] As of December 2025, the projected inflation rate for Maryland is approximately 3 percent; for the broader United States, inflation trended around 2.5%.[188] Pepco does not dispute the accuracy of these numbers. In fact, Pepco witness Nelson states that the company "does not oppose an alternative CPI bundle, as there are multiple CPI measures that reasonably capture national, state, and local economic conditions and may therefore serve as appropriate indicators of inflationary trends."[189]

Mr. Madsen's recommendation more accurately reflects the rates of inflation the company is likely to experience during the rate effective period. Pepco's five-year average gives undue weight to a recent anomalous inflationary period and is therefore less predictive of O&M cost escalation going forward. The Commission should reject Pepco's proposed 4.46 percent non-labor O&M expense increase and accept Mr. Madsen's adjusted increase of 2.5 percent.

C. The costs of corrective maintenance work deferred in 2024 should not be reflected in O&M expense.

Pepco's proposed revenue requirement reflects increased emergent corrective repairs during the test year period. From 2024 to 2025, Pepco projects O&M costs in electric operations to increase by approximately $7 million.[190] Pepco attributes this increase to, among other things, "anticipated increases in emergent corrective repairs."[191]

[187] *Id.* at 18:19 – 19:4.
[188] *Id.* at 18:19 – 19:2.
[189] Pepco Ex. 28 (Nelson Rebuttal) at 39:14-18.
[190] Pepco Ex. 22 (Williams Direct) at 35:12-13.
[191] *Id.*at 35:13-14.

Pepco also points to actions it took in 2024 to defer planned work in order to align Pepco's O&M expense with the amount set by the Commission in Case No. 9702.[192] In discovery, Pepco identified a $5.6 million decrease in emergent corrective repairs in 2024, relative to Pepco's projections.[193]The company appears to be seeking to recover the costs of the O&M expenditures relating to emergent corrective repairs deferred from 2024.[194]

The Commission should not allow Pepco to convert prior-year deferrals into a new increase in the TTYCF revenue requirement. Including the costs of work deferred from 2024 to 2025 is an attempt for Pepco to recover the costs of O&M work disallowed in Case No. 9702. In that case, the Commission ordered Pepco to reduce its overall O&M spending relating to outside services costs.[195] Since outside service costs primarily consist of billings from affiliate service companies—which Pepco witness O'Donnell claims the company cannot directly change—Pepco reduced deferred corrective maintenance costs as a way to offset the reductions to outside services.[196] In other words, rather than attempting to cut costs as the Commission directed, the company cut costs elsewhere. Now, the company points to those cost reductions as a justification to *increase* its O&M spending. In Order No. 92264, the Commission stated that it "expects utilities to manage their operations and spending within the limits the Commission approved . . .

[192] Pepco Ex. 40 (O'Donnell Direct) at 23:8-12.
[193] OPC Ex. 40 (Madsen Direct), Exhibit DMM-3 at 7 (Pepco response to OPC DR 6-12).
[194] Pepco Ex. 40 (O'Donell Direct) at 26:17-22.
[195] *Id.* at 23:3-6; *see* Order No. 91181 at 40.
[196] Pepco Ex. 40 (O'Donnel Direct) at 25:6-14.

."[197] Pepco should not be awarded an increase in O&M expenditures due to efforts the utility took to operate within the Commission's prior authorized revenue requirement. Otherwise, the Commission's prior O&M reduction would be temporary in name only: Pepco could defer work for one year and then seek to recover the same costs in the next case.

Moreover, there is little evidence suggesting that Pepco's deferred work negatively impacted the safe and reliable service Pepco provides to its customers. There was no obvious decline in Pepco's reliability in 2024 despite Pepco's decision to defer corrective maintenance work.[198] OPC witness Fitzhenry's analysis confirms that Pepco's reliability performance in 2024—when major event days are excluded—was consistent with prior years notwithstanding the deferrals in emergent corrective repairs.[199] Pepco witness Williams notes that the work deferred reflects "prioritization within operational constraints," and that the company did not defer corrective repairs "required to safely restore service or address immediate reliability risks."[200] Pepco's decision to defer $5.6 million of corrective maintenance work without any appreciable reliability impact indicates that the company is capable of effectively operating under a lower O&M budget than what is reflected in the proposed TTYCF and that the company has more discretion over the timing of when such work takes place.[201] That record evidence undercuts Pepco's claim that the proposed increase is necessary to provide safe and reliable service.

[197] Order No. 92264 at 14.
[198] OPC Ex. 40 (Madsen Direct) at 21:6-10, Figure 5.
[199] OPC Ex. 36 (Fitzhenry Revised Direct) at 8, Table CFT-2.
[200] Pepco Ex. 23 (Williams Rebuttal) at 4:6-12.
[201] OPC Ex. 40 (Madsen Revised Direct) at 21:6-13.

Pepco's witnesses do not point to any specific impacts resulting from OPC's recommended adjustment. Instead, the company claims—without support or substantiation—that continued reductions in O&M expense will "constrain Pepco's operational flexibility" and could "ultimately necessitate reductions in labor."[202] In fact, Mr. Madsen's recommended TTYCF revenue requirement represents an increase in O&M (and labor) spending relative to the rates set in Case No. 9702. Pepco therefore has not shown that OPC's adjustment would impair operations, reliability, or staffing.

In sum, Pepco gives little reason why Mr. Madsen's removal of deferred corrective maintenance costs should be rejected. In contrast, Mr. Madsen's testimony shows that, given Pepco's actual reliability performance, the company does not require a significant increase in O&M expenditures to continue providing safe and reliable service. As per Mr. Madsen's recommendation, Pepco's O&M expense for the TTYCF should be adjusted to remove the $5.6 million of corrective maintenance costs deferred from 2024.

D. A Phase II proceeding is required to remove costs prohibited from recovery by the Utility RELIEF Act.

Pepco's TTYCF revenue requirement likely includes costs that recently enacted law now prohibits Pepco from recovering. During the 2026 Legislative Session, the General Assembly passed the Utility RELIEF Act.[203] In relevant part, the Act restricts recovery of supervisor compensation that exceeds 110% of the Chair of the Public Service Commission's maximum annual salary.[204] Salaries and bonuses are expressly

[202] Pepco Ex. 40 (O'Donnell Direct) at 26:10-12.
[203] 2026 Session Laws, Ch. 353.
[204] 2026 Session Laws, Ch. 353 (to be codified at PUA § 4-504(c)(3)). "Supervisor" is defined as meaning an employee "employed in a bona fide executive capacity under the Federal Fair Labor Standards Act," or

included in the definition of compensation, as are certain non-health or medical related benefits.[205] On May 12, 2026, Governor Moore signed the Utility RELIEF Act into law, and on July 1, 2026, the restriction on compensation recovered through rates goes into effect as an amendment to PUA § 4-504. Rates approved in this case will therefore go into effect during a period when those statutory limits apply.

Pepco's TTYCF includes costs that fall under the definition of "compensation" in PUA § 4-504 as of July 1, 2026. For instance, Pepco's TTYCF reflects $15.542 million of annual incentive payment costs.[206] For wages, Pepco's test year includes management base wages totaling $80.51 million.[207] And it is likely that some of this compensation will be paid to employees that meet the definition of "supervisor" set forth in PUA § 4-504. Without an opportunity for the Commission to identify and remove any costs subject to the limitation in PUA § 4-504, any order the Commission approves in this proceeding will likely result in Pepco recovering compensation costs prohibited by Maryland law. The Commission should not approve rates that knowingly risk including costs the General Assembly has barred from recovery.

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an employee of a public service company who is delegated certain authorities over personnel, including hiring, promotion, firing and discipline, assignment of work, and responding to complaints. *Id.* (to be codified at PUA § 4-504(a)(4)).

[205] 2026 Session Laws, Ch. 353 (to be codified at PUA § 4-504(a)(3)). "Compensation" is broadly defined to mean "a form of payment or consideration to or for the benefit of" an employee of a public service company, its parent, or any affiliate "in connection with the employee's work for a public service company." *Id.* (codified at PUA § 4-504(a)(3)).

[206] Pepco Ex. 28 (Nelson Rebuttal), Schedule (CN-R)-1 at 29.

[207] This includes $21.93 million for Pepco employees, $31.57 million for wages charged to Pepco from PHISCO, and $27.01 million for wages charged from the Exelon Business Services Company. Pepco Ex. 28 (Nelson Rebuttal), Schedule (CN-R)-1 at 25.

The current record does not appear sufficient to identify all compensation amounts that must be removed under PUA § 4-504. That is not a reason to ignore the statute. Rather, the Commission should establish a Phase II proceeding limited to identifying and removing the prohibited compensation costs from Pepco's revenue requirement. A limited Phase II would allow the Commission to apply the new statutory restriction accurately without delaying resolution of the remaining issues in this case. The Commission should approve OPC's requested Phase II process to identify any costs included in Pepco's TTYCF revenue requirement that are prohibited from recovery by the Utility RELIEF Act and remove those costs from customer rates.

VII. OPC's proposed revenue requirement is just and reasonable and affords Pepco a fair opportunity to earn a reasonable rate of return.

OPC witness Dustin M. J. Madsen recommends that the Commission approve a revenue requirement increase of $14.825 million.[208] Mr. Madsen's revenue requirement reflects a total rate base of $3.03 billion, operating income of $177.01 million, and an ROE of 7.7 percent. That recommendation is not a denial of cost recovery. It is a rate increase based on evidence-supported adjustments that remove costs Pepco has not shown are prudent, reasonable, known and measurable, or legally recoverable.

Rate Base — The starting point for Mr. Madsen's rate base is Pepco's plant in service balance as of September 30, 2025—net of accumulated depreciation and amortization—including Pepco's adjustments RMA 1 and RMA 2. Mr. Madsen further adjusts Pepco's plant-in-service balance by including identified plant additions in service as of the date of the evidentiary hearings, removing the inclusion of net operating loss carryforwards, removing the costs of imprudent plant additions identified by OPC witness Fitzhenry—the White Flint Substation and certain distribution overhead planned P30/P40 replacements—the costs of capital projects disallowed by the Commission in Order No. 92264, and the impact of Pepco's requested regulatory asset for the unamortized balance of rate case expense. These adjustments ensure that customers are not required to pay a return on costs that are premature, unsupported, imprudent, or already disallowed.

O&M — For the TTYCF, Pepco's proposed operating revenue adjustments reflect

[208] OPC Ex. 42 (Madsen Revised Surrebuttal), Schedule DMM-SR-1 at 1.

increases in labor expense and non-labor O&M. For labor expense, Mr. Madsen proposed adjustments to reflect actual employee headcount and a reasonable, two-percent escalation in management wages. For non-labor O&M, Mr. Madsen recommended an adjustment to reflect a 2.5 percent inflation rate. Mr. Madsen made further adjustments to remove the costs of certain corrective maintenance work that Pepco deferred in 2024 to align Pepco's O&M expense with the Commission's ruling in Order No. 91181. In total, Mr. Madsen's adjustments result in a $13.84 million *decrease* in operating revenues.[209] These adjustments better align Pepco's O&M allowance with actual staffing levels, current inflation expectations, and the company's demonstrated ability to manage operations without the additional costs it seeks here.

* * *

Mr. Madsen's revenue requirement reflects reasonable adjustments to remove imprudent, unsupported, or excessive capital and O&M expenditures and better reflects Pepco's actual cost to serve customers. Coupled with OPC witness Garrett's recommended capital structure—which better reflects Pepco's actual cost of debt and aligns with investors' actual expectations—Mr. Madsen's recommended revenue requirement will result in a "just and reasonable" rate that is better aligned with the public's interest in affordability compared to the rate that Pepco proposes. The Commission should adopt OPC's proposed revenue requirement because it allows Pepco a fair opportunity to recover its reasonable costs and earn a reasonable return, while

[209] *See* Office of Staff Counsel, Revised Post Hearing Revenue Requirement Comparison Chart, ML# 330372 (Case No. 9820, May 21, 2026).

protecting customers from costs that Pepco has not justified.

VIII. Pepco's rate design should retain seasonality, as Pepco has failed to demonstrate that the elimination of seasonality is supported on a cost basis.

Pepco has proposed to begin gradually eliminating seasonally-differentiated volumetric distribution rates for residential customers,[210] which Pepco initially proposed in Case No. 9702. In that case, the Commission declined to approve Pepco's proposal and advised that it intended to eliminate Pepco's seasonally differentiated rate structure in its next rate case. [211] The Commission further instructed the company to provide a cost analysis and customer impact study of the gradual elimination of seasonal rates in its next rate case.[212] That instruction did not relieve Pepco of its burden to show in this case that eliminating seasonality is supported by cost causation and customer impacts.

To comply with the Commission's order, in this case, Pepco presented a seasonality study that provides information about seasonal cost relationships but does not explain how those relationships impact rate design outcomes. Although Pepco agrees that the purpose of the seasonality study is to determine if a cost basis exists to justify the retention or elimination of seasonal rate differentiation for certain customer classes,[213] the company did not explain how the results of the seasonality study would impact rate

[210] Pepco Ex. 35 (Blazunas Direct) at 32:8-11. Pepco has proposed to eliminate seasonality for the following rate schedules R (and its derivative rate schedules R-PIV, PIV, and R-TOU-P), R-TM, GS, T, EV, TN (and Rider SL-TN). *Id*.
[211] Order No. 91181 at 190, *Potomac Electric Power Company's Application for Adjustments to its Retail Rates for the Distribution of Electric Energy* (Case No. 9702, June 10, 2024).
[212] *Id*. at 191.
[213] *See Id*. at 190; Pepco Exhibit 31 (Schafer Direct) at i; Tr. at 862:16-21 (Schafer, Apr. 30, 2026); Tr. 881:20-992:4 (Blazunas, Apr. 30, 2026).

design. Pepco has therefore failed to demonstrate that the elimination of seasonally differentiated rates would better reflect underlying costs than existing seasonal rates. A study that identifies seasonal cost relationships but does not translate those relationships into a supported rate design recommendation does not justify eliminating seasonality.

OPC Witness Whited's analysis found that eliminating seasonally differentiated volumetric distribution rates would reduce the cost-reflectivity of Pepco's rates. As a summer-peaking utility, Pepco's current practice of charging higher rates in the summer aligns with cost-causation principles. Pepco's seasonality study reflects that there are cost differences between the seasons. By adjusting certain demand allocators to reflect the fact that summer peaks are approximately 20 percent higher than winter peaks, the results of Pepco's seasonality study allocate lower costs to the winter than the summer and support the continuation of seasonality in rates for residential customers.[214] Rates should reflect those cost differences to send more accurate price signals to customers and enhance fairness. On this record, eliminating seasonality would move rates away from the cost differences Pepco's own study identifies.

In addition, eliminating seasonality in rates would weaken economic incentives for customers to adopt heat pumps, which are an important technology for achieving Maryland's energy and climate goals. While other incentives are available to support heat pump adoption in the State, eliminating seasonality would increase heat pump operating costs and make them less economically attractive. That outcome would be inconsistent

[214] OPC Exhibit 35 (Whited Surrebuttal) at 9.

with the State's broader electrification policy goals and should not be adopted absent a stronger cost-based justification than Pepco has provided here.

Pepco argues that the company is justified in eliminating seasonally differentiated rates because distribution system costs are generally fixed and because seasonality in rates is a vestige of the company's rate designs prior to unbundling.[215] This conclusion is based on a short-run cost analysis, and ignores the fact that increasing peak demand will increase distribution costs over the long-run. Prices that reflect long-run marginal costs will help customers make better decisions regarding electricity consumption that will help to minimize long-run system costs. For example, if there is substantial headroom to accommodate additional winter load (such as heat pumps), then prices that reflect long-run marginal costs in the form of seasonal differentiation will help encourage greater consumption in the winter and energy conservation in the summer.[216] Pepco Witness Blazunas concedes that, "with respect to economic theory, efficient price signals are conceptually grounded in long-run marginal costs."[217]

Because Pepco's summer peak demand is approximately 20 percent higher than its winter peak, the company has much more capacity to accommodate load growth in the winter than in the summer.[218] Moreover, Pepco is unlikely to transition to a winter peaking utility in the near term. Recent data do not show significant growth in winter peak load.[219] In a 2023 report prepared for the Commission by the Brattle Group, only

[215] Pepco Exhibit 33 (Schafer Rebuttal) at 23:9-14; Pepco Exhibit 38 (Blazunas Rebuttal) at 12:17-20.
[216] OPC Exhibit 35 (Whited Surrebuttal) at 11.
[217] OPC Exhibit 35 (Whited Surrebuttal) Ex. MW-SR-1 at 11.
[218] OPC Exhibit 34 (Whited Direct) at 9.
[219] OPC Exhibit 35 (Whited Surrebuttal) at 14-15.

one of the six scenarios in the study projects that Pepco would become winter-peaking before 2031—and even then only under the highest levels of electrification.[220]

Regardless of the initial reason for Pepco's seasonal rates, the relevant question is whether seasonal rates reflect current differences in costs. The Commission need not eliminate seasonality simply because it signaled an intention to do so in Pepco's prior rate case. Pepco has not shown that eliminating seasonality in rates is justified on a cost basis and its rates should reflect seasonal cost differences to provide customers with economically efficient price signals and enhance fairness. The Commission should therefore reject Pepco's proposal to begin eliminating seasonal differentiation for residential volumetric distribution rates.

In addition, the Commission should adopt Witness Whited's proposal to reclassify the month of October as a winter month, which would redefine the summer season as June through September. Staff recommends that the Commission accept this recommendation[221] and Pepco does not oppose this recommendation,[222] but advised that doing so would constitute an operational change that would take approximately five months to safely implement.[223] Accordingly, the Commission should direct Pepco to implement this change by June 1, 2027.

[220] *Id*. at 14.
[221] Staff Exhibit 20 (Bowser Rebuttal) at 13:8-16.
[222] Pepco Exhibit 39 (Blazunas Surrebuttal) at 2:9.
[223] Tr. at 373:6-364:5 (Vosvick, Apr. 28, 2026).

CONCLUSION

This case does not require the Commission to choose between allowing Pepco to recover its reasonable costs and protecting customers from unjustified rate increases. OPC's recommendations do both. They allow Pepco a fair opportunity to recover the costs it has shown are prudent, reasonable, known and measurable, and legally recoverable, while removing costs that Pepco has not justified.

Pepco's filing asks customers to bear too much risk and pay for too many unsupported costs. It asks customers to pay a return based on an overstated cost of capital; to fund forecasted plant additions not yet shown to be used and useful; to pay now for an accounting change the IRS has not yet required; to absorb the full cost of a major substation project that Pepco did not adequately justify; to reimburse expenses associated with a withdrawn ratemaking proposal; and to accept new regulatory assets that would weaken Pepco's incentive to manage ordinary operating risks. That is not just and reasonable ratemaking.

The Commission should instead adopt OPC's record-supported recommendations. Specifically, the Commission should adopt OPC witness Garrett's recommended 7.7 percent return on equity and capital structure of 43 percent equity and 57 percent debt. The Commission should reject Pepco's proposed regulatory assets for minor storm expenses and new legislative, regulatory, or policy changes; deny recovery of Pepco's rate case expense, or at minimum deny any return on those expenses; adopt OPC's rate base adjustments; adopt OPC's O&M adjustments; establish a Phase II process to remove costs prohibited from recovery by the Utility RELIEF Act; approve OPC's recommended

revenue requirement; and reject Pepco's proposal to eliminate seasonal residential distribution rates.

OPC's proposed revenue requirement is not punitive. It is the result of applying the Commission's ordinary ratemaking standards to the record Pepco presented. The Commission should adopt OPC's recommendations and ensure that customers pay no more than the just and reasonable cost of receiving safe and reliable service.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 17th day of June 2026, the foregoing Initial Brief of the Maryland Office of People's Counsel was e-mailed to all parties of record to this proceeding.

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