

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. PA18-3-000
November 21, 2019

Exelon Corporation
Attention: Thomas S. O'Neill
Senior Vice President and General Counsel
10 S. Dearborn St., 48th Floor
Chicago, IL 60603

Dear Mr. O'Neill:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Exelon Corporation (Exelon) and its public utility subsidiaries (collectively, the Companies).¹ The audit covered the period from January 1, 2013 through March 26, 2019.

2. The audit evaluated whether the Companies complied with the conditions established in the Commission's November 20, 2014 order authorizing the merger of Exelon and Pepco Holdings, Inc.² The audit also evaluated the Companies' compliance with: (1) the tariff requirements governing their FERC jurisdictional rates; (2) accounting regulations in 18 C.F.R. Part 101; and (3) financial reporting regulations in 18 C.F.R. Part 141, focusing primarily on the transactions and costs associated with the merger. The enclosed audit report contains 4 findings and 17 recommendations that require Exelon to take corrective action.

3. On November 5, 2019, you notified DAA that Exelon accepts all 4 findings and 17 recommendations in the draft audit report and will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

¹ This includes Pepco Holdings, Inc. and its public utility subsidiaries prior to the merger transaction.

² Order Authorizing Proposed Merger, *Exelon Corp.*, 149 FERC ¶ 61,148 (2014).

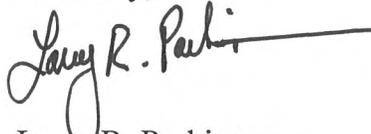
4. Exelon should submit its implementation plan to comply with the recommendations within 30 days of this letter order. Exelon should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. Exelon may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of noncompliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,

A handwritten signature in black ink that reads "Larry R. Parkinson". The signature is written in a cursive style with a long horizontal line extending to the right.

Larry R. Parkinson
Director
Office of Enforcement

Enclosure



Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

**Audit of Exelon Corporation's
Compliance with:**

- Conditions established in the Commission's November 20, 2014 Merger Order;
- Tariff requirements governing Exelon's FERC jurisdictional rates;
- Accounting regulations in 18 C.F.R. Part 101; and
- Financial reporting regulations in 18 C.F.R. Part 141.

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed an audit of Exelon Corporation (Exelon) and its public utility subsidiaries (collectively, the Companies). The audit evaluated whether the Companies complied with the conditions established in the Commission's November 20, 2014 order authorizing the merger of Exelon and Pepco Holdings, Inc. (PHI). The audit also evaluated the Companies' compliance with: (1) the tariff requirements governing Exelon's public utilities' rates; (2) accounting regulations in 18 C.F.R. Part 101; and (3) financial reporting regulations in 18 C.F.R. Part 141, focusing primarily on the transactions and costs associated with the merger. The audit covered the period from January 1, 2013 through March 26, 2019.

B. Exelon Corporation

Exelon is a public utility holding company that is headquartered in Chicago, Illinois and Washington, DC. Exelon is the parent company of six public utilities and two service companies.¹ Through its public utility subsidiaries, Exelon distributes electricity and natural gas to approximately 10 million customers in Delaware, Illinois, Maryland, New Jersey, Pennsylvania, and the District of Columbia. In addition, through Exelon Generation Company, LLC, Exelon has a diverse portfolio of electric generation capacity which includes nuclear, natural gas, hydroelectric, wind, solar, landfill gas, and oil energy and engages, through its customer-facing business, Constellation, in power marketing and sales of electric power and natural gas to its wholesale and retail customers.

¹ The six public utility companies are PECO Energy Company (PECO), Baltimore Gas and Electric Company (BG&E), Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (DPL), Atlantic City Electric Company (ACE), and Commonwealth Edison Company (ComEd).

The two services companies are PHI Service Company (PHISCO) and Exelon Business Services Company, LLC (EBSC).

C. Summary of Compliance Findings

Below is a summary of audit staff's compliance findings. Audit staff identified four areas of noncompliance. Section IV discusses in detail the noncompliance findings in the following areas:

- *Merger-Related Regulatory Assets* – BG&E improperly included the amortization of merger-related regulatory assets approved by a retail regulator in wholesale transmission formula rates. As a result, BG&E overstated its wholesale transmission revenue requirements and overbilled its wholesale customers by approximately \$1.4 million.
- *Transmission Formula Rate Allocators* – Exelon's public utilities improperly included merger-related costs in their transmission formula rate allocators when they computed wholesale transmission revenue requirements. As a result, Exelon's public utilities overstated their wholesale transmission revenue requirements, which led to overbilling wholesale transmission customers by approximately \$333,056.
- *Merger Commitment Costs* – Exelon's public utilities improperly included merger commitment costs for the Exelon and PHI merger in their transmission revenue requirements. As a result, Exelon's public utilities overstated their transmission revenue requirements, which led to overbilling wholesale transmission customers.
- *Amortization of Retail Regulatory Asset* – Exelon's public utilities improperly recorded the amortization of certain regulatory assets and improperly included the amortization of the regulatory assets in their wholesale transmission formula rates without Commission approval to recover such amounts. As a result, Exelon's public utilities overstated their wholesale transmission revenue requirements and overbilled their wholesale customers.

D. Summary of Recommendations and Corrective Actions Taken

Below is a summary of audit staff's recommendations to remedy the findings in this report. Detailed recommendations are in Section IV. Audit staff recommends that Exelon and its public utilities:

Merger-Related Regulatory Assets

1. Establish, update, and implement policies and procedures to ensure BG&E accurately excludes merger-related costs, including regulatory assets created

due to the merger, not approved by the Commission from wholesale transmission formula rates, as required by the hold harmless provisions in the 2012 and 2014 Merger Orders and the 2015 Audit Report recommendations accepted by BG&E.

2. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds that include the amount of inappropriate merger-related regulatory asset amortizations included in wholesale transmission formula rates and the refunds resulting from inclusion of the amortizations in wholesale formula rates, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
3. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
4. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

Transmission Formula Rate Allocators

5. Establish, update, and implement policies and procedures to ensure Exelon's public utilities exclude merger costs from their transmission formula rate allocators when computing their annual transmission revenue requirements as required by the hold harmless provisions in the 2014 Merger Order.
6. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds and the amount of improper recoveries that resulted from including merger costs in the transmission formula rate allocators for computing transmission revenue requirements during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
8. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

Merger Commitment Costs

9. Establish, update, and implement policies and procedures to ensure Exelon's public utilities exclude costs to implement merger commitments made to federal and state regulators from their transmission revenue requirements, as required by the hold harmless provisions in the 2014 Merger Order.
10. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds and the amount of improper recoveries that resulted from including merger commitment costs in the transmission revenue requirements during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
11. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
12. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

Amortization of Retail Regulatory Assets

13. Revise procedures for computing wholesale transmission formula rate billings to wholesale customers to exclude amortization of regulatory assets that have not been approved by the Commission.
14. Provide training to staff on the revised regulatory assets accounting and rate development methods. Also, develop a training program that supports the provision of periodic training in this area, as needed.
15. Submit a refund analysis to DAA, within 60 days of receiving the final audit report from DAA, that explains and details: (1) calculation of refunds that include the amount of inappropriate regulatory asset amortizations included in wholesale formula rates and the refunds resulting from inclusion of the amortizations in wholesale formula rates during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
16. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

17. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of Commission regulations.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that Exelon submit for audit staff review the following:

- A plan for implementing the audit recommendations within 30 days after the final audit report is issued in this docket;
- Quarterly reports to DAA describing Exelon's progress in completing each corrective action recommended in the final audit report. Exelon should make these nonpublic quarterly filings no later than 30 days after the end of each calendar quarter, beginning with the first quarter after submission of the implementation plan, and continuing until Exelon completes all recommended corrective actions.
- Copies of written policies and procedures developed in response to the recommendations in the final audit report. The documents should be submitted for audit staff's review in the first quarterly filing following their completion.

II. Background

A. Exelon Corporation and Pepco Holdings, Inc. Merger

On April 29, 2014, Exelon and PHI entered into a merger agreement whereby Exelon acquired PHI in an all-cash transaction at a purchase price of \$27.25 for each outstanding share of PHI's common stock. On May 30, 2014, Exelon and PHI, together with their respective public utilities filed a merger application in Docket No. EC14-96-000 requesting Commission approval of the merger.

On November 20, 2014, the Commission issued an order approving the Exelon and PHI merger application (2014 Merger Order).² The merger also required approval from several state agencies³ since the PHI businesses to be acquired operated in those jurisdictions. The merger was consummated on March 23, 2016, after all approvals from federal and state regulatory agencies were obtained. Under the terms of the merger agreement, PHI became an indirect wholly owned subsidiary of Exelon. PHI's public utilities⁴ were placed under Exelon Energy Delivery Company, LLC along with Exelon's other public utilities.⁵ PHI's unregulated subsidiaries were placed in separate branches of the Exelon holding company structure. Following the merger, PHI was renamed Pepco Holdings LLC.

As part of the Commission's approval of the merger, Exelon agreed to merger conditions that required Exelon, among others things, to: (1) hold transmission customers harmless from all merger-related costs, including transaction costs incurred to consummate the merger and transition costs incurred to achieve merger synergies, for a period of five years; (2) submit informational filings with the Commission; and (3) protect transmission customers from cross-subsidization.

² Order Authorizing Proposed Merger, *Exelon Corp.*, 149 FERC ¶ 61,148 (2014) (2014 Merger Order).

³ The following state agencies approved the merger: Virginia State Corporation Commission - October 7, 2014; New Jersey Board of Public Utilities - March 6, 2015; Maryland Public Service Commission - May 15, 2015; Delaware Public Service Commission - June 2, 2015; and District of Columbia Public Service Commission - March 23, 2016.

⁴ PHI public utilities prior to the merger were Pepco, DPL, and ACE.

⁵ Exelon public utilities prior to the merger were PECO, BG&E, and ComEd.

B. Accounting and Financial Reporting for Merger Costs

Exelon paid approximately \$7.14 billion for the acquisition of PHI, which was recorded in Exelon's books. In addition to the total purchase price, between 2014 and 2017, Exelon and its subsidiaries incurred approximately \$1.14 billion in other merger-related costs. The \$1.14 billion is comprised of transaction costs of \$309 million and transition costs of \$832 million. The transaction costs included, among other things, internal labor and third-party costs for legal, consulting, and professional services to consummate the merger. The transition costs included integration, internal labor, and other operational costs incurred to achieve merger synergies.

To comply with the Commission's hold harmless provision and accounting requirements, Exelon implemented procedures which led to the creation of project codes and cost centers in its accounting system to track and accumulate merger costs separately from normal operational costs. These projects codes and cost centers were created to separately track transaction and transition costs. The transaction costs were recorded in the books both of Exelon and of PHI. The transition costs were recorded in Exelon and its subsidiaries' books. The public utilities recorded the transition costs in several FERC accounts that are included in their respective transmission formula rates. The merger costs recorded in FERC accounts that were inputs to the transmission formula rates were excluded from wholesale transmission rates billed to wholesale customers except for those merger costs identified in the findings and recommendations section of the audit report.

C. Transmission Formula Rate

Exelon's six public utilities are transmission owners in PJM and therefore operate their transmission assets under PJM's direction pursuant to PJM's Open Access Transmission Tariff (OATT). The six public utilities recover their costs of owning, operating, and maintaining their respective transmission systems using the transmission formula rates approved by the Commission, each of which is included in Attachment H of PJM's OATT.⁶ The transmission formula rates were designed to provide a reasonable opportunity to recover (1) the costs and expenses associated with providing transmission service, and (2) a reasonable return on transmission investments. The development of transmission revenue requirements in the transmission formula rates for wholesale

⁶ See ACE's transmission formula rate, PJM Tariff, Attachment H-1A; BGE's transmission formula rate, PJM Tariff, Attachment H-2A; ComEd's transmission formula rate, PJM Tariff, Attachment H-13A; DPL's transmission formula rate, PJM Tariff, Attachment H-3D; PECO's transmission formula rate, PJM Tariff, Attachment H-7A; and Pepco's transmission formula rate, PJM Tariff, Attachment H-9A.

billings relies, to the extent feasible, on costs recorded in each of the public utilities' Annual Report of Major Electric Utilities, Licensee and Others, FERC Form No. 1 (FERC Form No. 1). This means accurate accounting of costs and transmission investments in the FERC Form No. 1 is important for the development of the transmission revenue requirements and the related billings to wholesale transmission customers.

III. Introduction

A. Objectives

The audit evaluated whether the Companies complied with the conditions established in the 2014 Merger Order. The audit also evaluated the Companies' compliance with: (1) the tariff requirements governing Exelon's public utilities' rates; (2) accounting regulations in 18 C.F.R. Part 101; and (3) financial reporting regulations in 18 C.F.R. Part 141, focusing primarily on the transactions and costs associated with the merger transaction. The audit covered the period from January 1, 2013 through March 26, 2019.

B. Scope and Methodology

Audit staff performed the following to facilitate testing and evaluation of Exelon's compliance with Commission requirements relevant to the audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. This review provided a high-level understanding of Exelon's corporate structure, the services it provides, major events affecting operations and finances, mergers, significant contracts, prior audit issues and other key regulatory and business activities. Examples of materials reviewed include Exelon's annual reports and SEC Form 10-Ks, PHI's Proxy Statement (Schedule 14A), FERC Forms No. 1 and 60, prior FERC audit reports, company-related web sites and other relevant regulatory and media sources.
- *Identified Standards and Audit Criteria* – Identified the regulatory requirements and criteria for evaluating Exelon's compliance with the Commission's merger requirements, including the Commission's November 20, 2014 Merger Order, 2016 Policy Statement on mergers and acquisitions, and accounting and merger-related rules and regulations.
- *Issued Data Requests* – Issued data requests to collect information not commonly available to the public. This information related to internal policies, procedures and controls; business practices; risk management; corporate structure; contractual agreements; financial accounting and reporting activity; corporate compliance; regulatory filings; and other pertinent information. These data were used to test and evaluate compliance with Commission requirements relevant to audit objectives.

- *Conducted Teleconference Interviews* – Conducted multiple teleconferences with Exelon employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.
- *Conducted Site Visits* – Made four site visits to Exelon’s offices to discuss and observe controls and procedures related to audit objectives. For example, to understand Exelon’s controls and procedures for tracking merger costs, audit staff interviewed accounting and compliance managers and the staff that actually perform such work on a daily basis.
- *Conferred with Commission Subject-Matter Experts* – Conferred with other Commission staff on compliance issues to ensure audit findings were consistent with Commission precedent and policy.
- *Evaluated Internal Controls* – Audit staff evaluated Exelon’s Internal Audit department, i.e., its place in the corporate structure and access to Exelon’s Board of Directors, to assess Internal Audit’s effectiveness and independence. Audit staff also reviewed internal audit reports to identify compliance issues relevant to Commission regulatory oversight authority, and the corrective measures taken to resolve them.

Audit staff evaluated Exelon’s compliance with all relevant requirements related to this audit’s objectives through examining the following:

Compliance with Merger Conditions

- Reviewed the Companies’ merger applications, merger orders, and all other related filings, including customer protests and comments, expert testimony submitted as evidence, and rebuttals;
- Examined the merger transactions and identified the merger conditions applicable to the Exelon and PHI merger;
- Evaluated the actions taken by the Companies to ensure compliance with the conditions imposed by the Commission in the merger order;
- Examined the Companies’ compliance filings to verify compliance with the 2014 Merger Order’s requirements;
- Examined the Companies’ procedures to ensure compliance with hold-harmless commitment and how to account for merger-related costs;

- Reviewed compliance filings to determine whether the Companies sought to recover merger-related costs through wholesale transmission rates; and
- Reviewed supporting documentation of merger-related costs and performed substantive tests of sample data to determine whether the Companies improperly recovered merger-related costs from jurisdictional customers through rates during the audit period.

Compliance with Accounting and Reporting Regulations in the USofA

To evaluate compliance with the Commission's accounting and reporting regulations in the USofA under 18 C.F.R. Parts 101 and 141 for merger-related costs during the audit period, audit staff:

- Reviewed and evaluated the Companies' processes, procedures, and controls to track and account for merger-related costs;
- Interviewed employees that operate the Companies' financial accounting systems to assess the adequacy of accounting and reporting oversight controls related to the merger;
- Reviewed FERC Form No. 1 and Annual Report of Centralized Service Companies, FERC Form No. 60 notes and disclosures related to tracking, accounting, and reporting of merger-related costs;
- Tested selected information reported in the FERC Form No. 1, particularly related to mergers, and compared it to the Companies' books and records to ensure the required information was reported accurately and consistently; and
- Tested a sample of the Companies' required USofA accounts for compliance with the Commission's orders that authorized the mergers as well as with the Companies' internal policies and procedures.

IV. Findings and Recommendations

1. Merger-Related Regulatory Assets

BG&E improperly included the amortization of merger-related regulatory assets approved by a retail regulator in wholesale transmission formula rates. As a result, BG&E overstated its wholesale transmission revenue requirements and overbilled its wholesale customers by approximately \$1.4 million.

Pertinent Guidance

- In the 2014 Merger Order, the Commission accepted the applicants' commitment to hold transmission customers harmless for the merger transaction costs. The 2014 Merger Order states in part:

We accept Applicants' commitment to hold transmission customers harmless for five years from costs related to the Proposed Merger. We interpret Applicants' commitment to apply to all merger-related costs, including costs related to consummating the Proposed Merger and transition costs (both capital and operating) incurred to achieve merger synergies, incurred prior to the consummation of the Proposed Merger or in the five years after merger consummation. Further, we clarify that, if Applicants seek to recover merger-related costs that are the subject of a hold harmless commitment, they must submit a *new* filing under the Federal Power Act (FPA) section 205, and a concurrent informational filing in this docket, in order to do so.⁷

- In the 2012 Merger Order for the merger of Exelon and Constellation, the Commission accepted the applicants' commitment to hold transmission customers harmless for the merger transaction costs. The 2012 Merger Order states in part:

We accept Applicants' commitment to hold transmission customers harmless from costs related to the merger. We interpret Applicants' hold harmless commitment to apply to all transaction-related costs, including costs related to consummating the Proposed Transaction

⁷ 2014 Merger Order, *Exelon Corp.*, 149 FERC ¶ 61,148, at P 105 (footnotes omitted).

and transition costs (both capital and operating) incurred to achieve merger synergies.⁸

Background

In June 2015, DAA issued an audit report to BG&E in Docket No. FA13-13-000. The audit evaluated among other things BG&E's treatment of merger-related costs stemming from the Exelon and Constellation merger in 2012. In the audit report, DAA recommended BG&E establish, implement, and update its policies and procedures to ensure it excluded merger-related costs from its annual formula rate update, as required by the hold harmless provision in the 2012 Merger Order. BGE agreed to comply with the recommendation.

In the current audit, audit staff evaluated Exelon and its public utilities' compliance with DAA's 2015 audit recommendations and the Commission's hold harmless provision in the 2012 and 2014 Merger Orders. Based on discussions with and information obtained from Exelon and its public utilities, on site visits, and data request responses, audit staff discovered that BG&E included \$1,458,287 of merger integration costs in its 2015, 2016, and 2017 transmission revenue requirements. BG&E stated that the merger costs included in wholesale transmission rates were related to retail regulatory assets approved by the MD PSC.⁹

In 2013 and 2016, the Maryland Public Service Commission (MD PSC) approved three regulatory assets for recovery in retail rates related to merger integration costs that stemmed from the Exelon and Constellation, and Exelon and PHI merger transactions. BG&E recorded the deferral of the merger integration costs in Account 182.3. The regulatory assets recorded in Account 182.3 were amortized to various administrative and general expense accounts and included in the wholesale transmission revenue requirement billed to wholesale transmission customers.

Audit staff found that BG&E's recovery of merger-related costs through the amortization of the MD PSC approved merger regulatory assets was contrary to the hold harmless provisions in the Commission's 2012 and 2014 Merger Orders and the 2015 audit report recommendations accepted by BG&E. In the 2012 and 2014 Merger Orders, Exelon and its public utilities committed to holding transmission customers harmless from merger-related costs for a five year period and to only recover merger costs from wholesale customers upon obtaining express Commission pre-approval. Since Exelon

⁸ 2012 Merger Order, *Exelon Corp.*, 138 FERC ¶ 61,167, at P 118 (2012).

⁹ The MD PSC approved three merger-related regulatory assets in Order Nos. 85374, 8606 and 87591 for BG&E.

and BG&E did not obtain Commission approval before recovering the merger regulatory assets in the transmission formula rate, the amounts included in the transmission revenue requirement were improper and led to overstatements of billings to wholesale transmission customers.

Recommendations

We recommend that Exelon and BG&E:

1. Establish, update, and implement policies and procedures to ensure BG&E accurately excludes merger-related costs, including regulatory assets created due to the merger, not approved by the Commission from wholesale transmission formula rates, as required by the hold harmless provisions in the 2012 and 2014 Merger Orders and the 2015 Audit Report recommendations accepted by BG&E.
2. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds that include the amount of inappropriate merger-related regulatory asset amortizations included in wholesale transmission formula rates and the refunds resulting from inclusion of the amortizations in wholesale formula rates, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
3. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
4. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

Corrective Actions Taken

BG&E refunded the \$1.4 million plus interest to wholesale transmission customers in its 2018 formula rate update filed with the Commission on May 04, 2018. BG&E also updated its policies and procedures for its transmission formula rate update and implemented additional internal controls to mitigate the risk of including merger-related regulatory assets not approved by the Commission in wholesale transmission formula rates and billings to wholesale transmission customers. Therefore, BG&E has fully satisfied Recommendations 1 through 4.

2. Transmission Formula Rate Allocators

Exelon's public utilities improperly included merger-related costs in their transmission formula rate allocators when they computed wholesale transmission revenue requirements. As a result, Exelon's public utilities overstated their wholesale transmission revenue requirements, which led to overbilling wholesale transmission customers by approximately \$333,056.

Pertinent Guidance

- In the 2014 Merger Order, the Commission accepted the applicants' commitment to hold transmission customers harmless for the merger transaction costs. The 2014 Merger Order states in part:

We accept Applicants' commitment to hold transmission customers harmless for five years from costs related to the Proposed Merger. We interpret Applicants' commitment to apply to all merger-related costs, including costs related to consummating the Proposed Merger and transition costs (both capital and operating) incurred to achieve merger synergies, incurred prior to the consummation of the Proposed Merger or in the five years after merger consummation. Further, we clarify that, if Applicants seek to recover merger-related costs that are the subject of a hold harmless commitment, they must submit a *new* filing under FPA section 205, and a concurrent informational filing in this docket, in order to do so.¹⁰

Background

On November 20, 2014, the Commission issued the 2014 Merger Order, which authorized the merger of Exelon, PHI, and their public utility subsidiaries, subject to certain conditions. The Commission conditioned the authorization of the merger on Exelon and PHI holding their transmission customers harmless from costs related to the merger for five years.

Exelon's public utilities recover their costs of providing transmission service through transmission formula rates approved by the Commission and included in the PJM

¹⁰ 2014 Merger Order, *Exelon Corp.*, 149 FERC ¶ 61,148, at P 105 (footnotes omitted).

OATT.¹¹ The transmission formula rate template is populated with data reported in accounts and schedules of each public utility's FERC Form No. 1, and each public utility company's record information. The transmission formula rate template for each public utility is used to compute its annual transmission revenue requirement using costs that are directly traceable to providing transmission services and an allocable portion of costs that are indirectly related to providing transmission service. The allocable portion of costs assigned to providing transmission service is computed using transmission allocators.¹² Transmission allocators are determined using information from each public utility's FERC Form No. 1. This means that merger costs appropriately recorded in FERC Form No. 1 should be excluded from the wholesale transmission revenue requirement in accordance with the hold harmless provision in the merger order.

Audit staff reviewed Exelon's public utilities' allocator computations to determine whether the public utilities excluded merger costs when they computed their transmission allocators. Audit staff determined DPL and ComEd improperly included merger costs when computing their transmission allocators, which resulted in overstatement of their annual transmission revenue requirements and billing to wholesale transmission customers. Per the Commission's 2014 Merger Order, Exelon and PHI were required to hold wholesale transmission customers harmless from merger-related costs; therefore, DPL and ComEd's inclusion of merger costs in computing their transmission allocators and transmission revenue requirements was not in compliance with the Commission's 2014 Merger Order.

Recommendations

We recommend that Exelon and its public utilities:

5. Establish, update, and implement policies and procedures to ensure Exelon's public utilities exclude merger costs from their transmission formula rate

¹¹ See ACE's transmission formula rate, PJM Tariff, Attachment H-1A; BGE's transmission formula rate, PJM Tariff, Attachment H-2A; ComEd's transmission rate formula, PJM Tariff, Attachment H-13A; Delmarva's transmission rate formula, PJM Tariff, Attachment H-3D; PECO's transmission rate formula, PJM Tariff, Attachment H-7A; and Pepco's transmission rate formula, PJM Tariff, Attachment H-9A.

¹² The public utilities' transmission allocators include Gross plant, Net plant, and Wage & Salary allocators. The Gross plant allocator is the ratio of transmission plant divided by total plant. The Net plant allocator is the ratio of net transmission plant divided by net total plant taking into consideration accumulated depreciation and amortization. The Wages and Salary allocator is the ratio of transmission wages/salary over total wages and salary excluding A&G wages and salary.

allocators when computing their annual transmission revenue requirements as required by the hold harmless provisions in the 2014 Merger Order.

6. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds and the amount of improper recoveries that resulted from including merger costs in the transmission formula rate allocators for computing transmission revenue requirements during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
8. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

3. Merger Commitment Costs

Exelon's public utilities improperly included merger commitment costs for the Exelon and PHI merger in their transmission revenue requirements. As a result, Exelon's public utilities overstated their transmission revenue requirements, which led to overbilling wholesale transmission customers.

Pertinent Guidance

- In the 2014 Merger Order, the Commission accepted the applicants' commitment to hold transmission customers harmless for merger transaction costs. The 2014 Merger Order states in part:

We accept Applicants' commitment to hold transmission customers harmless for five years from costs related to the Proposed Merger. We interpret Applicants' commitment to apply to all merger-related costs, including costs related to consummating the Proposed Merger and transition costs (both capital and operating) incurred to achieve merger synergies, incurred prior to the consummation of the Proposed Merger or in the five years after merger consummation. Further, we clarify that, if Applicants seek to recover merger-related costs that are the subject of a hold harmless commitment, they must submit a *new* filing under FPA section 205, and a concurrent informational filing in this docket, in order to do so.¹³

Background

Exelon consummated its merger with PHI on March 23, 2016. To obtain regulatory approvals for the merger transaction, Exelon and PHI made numerous commitments to federal and state regulators, which included providing rate credits to customers, filing specific annual reports, establishing a special purpose entity to hold one hundred percent of the equity interest in PHI, obtaining legal opinions on ring-fencing measures, and holding transmission customers harmless from merger-related costs. From 2016 to 2018, Exelon incurred costs related to its efforts to fulfill the commitments it made to federal and state regulators.

¹³ 2014 Merger Order, *Exelon Corp.*, 149 FERC ¶ 61,148 at P 105 (footnotes omitted).

Audit staff evaluated Exelon's and its public utilities' controls for tracking, accounting, and recovering merger commitment costs to determine whether they complied with the hold harmless provisions in the 2014 Merger Order. Exelon created specific work orders and cost centers to track and accumulate merger-related costs incurred for the Exelon and PHI merger. Audit staff found that some costs incurred to implement the merger commitments were not tracked in merger work orders or cost centers; therefore, they were not accounted for as merger-related costs.

Specifically, Exelon incurred approximately \$1.6 million in costs to implement the merger commitments between 2016 and 2018.¹⁴ Of this amount, Exelon tracked \$1.33 million in merger work orders and cost centers. The remaining \$277,000 were tracked in non-merger-related work orders and cost centers. Merger commitment costs accumulated in the merger work orders and cost centers were excluded from the public utilities' transmission revenue requirements. Merger commitment costs accumulated in the non-merger work orders and cost centers were included in the public utilities' transmission revenue requirements as well as in billings to wholesale transmission customers.

Audit staff found that the merger commitments were necessary for Exelon and its public utilities to obtain regulatory approval for the merger, and the costs associated with implementing the commitments are merger-related costs. The Commission's 2014 Merger Order required Exelon and its public utilities to hold transmission customers harmless from all merger-related costs. Therefore, all costs associated with implementing the merger commitments should have been excluded from the public utilities' transmission revenue requirements.

The Commission, in the 2014 Merger Order, directed Exelon and its public utilities to make a filing under section 205 of the FPA if the companies sought to recover merger-related costs subject to the hold harmless provisions in the 2014 Merger Order. Exelon and its public utilities did not seek Commission approval to recover any of the merger costs subject to the hold harmless provision. Therefore, inclusion of merger commitment costs in their transmission revenue requirements and billings to wholesale transmission customers was contrary to the 2014 Merger Order and resulted in overstatement of Exelon's public utilities' annual transmission revenue requirements and billings to wholesale transmission customers.

¹⁴ The merger commitment costs included internal labor and third-party costs for legal, consulting, and professional services.

Recommendations

We recommend that Exelon and its public utilities:

9. Establish, update, and implement policies and procedures to ensure Exelon's public utilities exclude costs to implement merger commitments made to federal and state regulators from their transmission revenue requirements, as required by the hold harmless provisions in the 2014 Merger Order.
10. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details: (1) calculation of refunds and the amount of improper recoveries that resulted from including merger commitment costs in the transmission revenue requirements during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
11. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
12. Refund the amounts disclosed in the refund report to wholesale transmission customers, with interest calculated in accordance with section 35.19a of Commission regulations.

4. Amortization of Retail Regulatory Assets

Exelon's public utilities improperly recorded the amortization of certain regulatory assets and improperly included the amortization of the regulatory assets in their wholesale transmission formula rates without Commission approval to recover such amounts. As a result, Exelon's public utilities overstated their wholesale transmission revenue requirements and overbilled their wholesale customers.

Pertinent Guidance

- In Order No. 552, which created Account 182.3 and related accounts for the recording of regulatory assets, the Commission states in relevant part:

As proposed, Account 182.3 would include costs incurred and charged to expense *which have been, or are soon expected to be, authorized for recovery through rates* and which are not specifically provided for in other accounts.¹⁵

- 18 C.F.R. Part 101, Account 182.3, states:
 - A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (See Definition No. 30.)
 - B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.... The amounts recorded in this account are generally to be charged, concurrently with the recovery of the amounts in rates, to the same account that would have been charged if included in income when incurred....
- In *Ameren Corp.*, the Commission states:

¹⁵ Order No. 552, *Revisions to Uniform System of Accounts to Account for Allowances under the Clean Air Act Amendments of 1990 and Regulatory-Created Assets and Liabilities and to Form Nos. 1, 1-F, 2 and 2-A*, 58 Fed. Reg. 17,982, at 18,000 (April 7, 1993), *FERC Statutes and Regulations* ¶ 30,967 (1993) (emphasis added).

The Commission has explained that, “in approving any formula rate, the Commission approves the formula itself, the algebraic equation used to calculate the rates. It does not approve the inputs into the formula or the charges resulting from the application of the inputs to the algebraic equation.”¹⁶

- In *PJM Interconnection, L.L.C. and Virginia Electric and Power Co.*, the Commission held in 2005 that any party desiring to recover claimed costs in a period other than the period in which they would ordinarily be charged must submit a filing with the Commission seeking approval of such recovery:

[W]e [have] provided guidance applicable to any transmission owner seeking to recover a regulatory asset in its rates. We [have] stated, for example, that our accounting rules require “a utility to recognize a regulatory asset where it [the utility] determines it is probable that a cost that would otherwise be charged to expense in one period will be recovered in rates in another.” We [have] also stated that “any party desiring to recover [its claimed costs] in rates other than [in] the period in which they would ordinarily be charged to expense must submit a filing demonstrating that their retail rates in effect applicable to that period [do not or will not permit recovery of those costs in that period] and a rate plan for recovery of them in a different period.”¹⁷

- In *Midwest Independent Transmission System Operator, Inc.*, the Commission stated, in 2004, that the regulatory assets approach includes a filing demonstrating that retail rates will not permit recovery of certain identified costs in the ordinary period, and including a “rate plan for recovery” of such costs in a different period:

With regard to the regulatory asset approach, as the Commission has stated in previous orders, the Commission will continue to apply the existing standard as set forth in 18 C.F.R. Part 101, Account No. 182.3 (2003).

¹⁶ *Ameren Corp.*, 147 FERC ¶ 61,225, at P 27 (2014) (footnotes omitted), *quoting, respectively, American Electric Power Serv. Corp.*, 124 FERC ¶ 61,306, at P 34 (2008); *id.* P 35; and *id.* P 35 & n.51.

¹⁷ *PJM Interconnection, L.L.C. and Virginia Electric and Power Co.*, 110 FERC ¶ 61,234, at P 41 (2005) (footnotes omitted), *quoting, respectively, Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,337, at P 13 (2004); *id.* at P 15.

In general, this standard requires a utility to recognize a regulatory asset where it determines it is probable that a cost that would otherwise be charged to expense in one period will be recovered in rates in another. Accordingly, any party desiring to recover the Schedule 16 and 17 charges [at issue in this proceeding] in rates other than [in] the period in which they would ordinarily be charged to expense must submit a filing demonstrating that their retail rates in effect applicable to that period do not or will not permit recovery of those costs in that period and a rate plan for recovery of them in a different period.¹⁸

Background

Exelon's public utilities provide electric and gas distribution services to customers in multiple state jurisdictions. Due to the ratemaking actions of the state jurisdictions, Exelon's public utilities were approved to defer certain costs as regulatory assets and recover the retail portion of those costs in retail rates. Audit staff reviewed the costs recorded as regulatory assets in the Exelon public utilities' Account 182.3, Other Regulatory Assets, to determine whether the costs were accounted for in accordance with the Commission's accounting regulations.

Audit staff found that Exelon's public utilities recorded several regulatory assets based on ratemaking actions of retail regulators (retail regulatory assets) in Account 182.3. The public utilities also amortized these regulatory assets over the period authorized by the retail regulators. Exelon's public utilities, however, did not seek Commission approval to recover any portion of the retail regulatory assets in their wholesale transmission formula rates. Audit staff found that the amortization of the retail regulatory assets by the Exelon public utilities inappropriately increased their wholesale transmission revenue requirement and wholesale formula rate billings.

A description of the regulatory assets inappropriately included in each of the Exelon public utilities' transmission revenue requirements follows.

¹⁸ *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,337, at PP 14-15 (2004) (footnotes and paragraph number omitted).

ComEd

In 2006, the Illinois Commerce Commission (ICC) approved ComEd's request to recover severance expenses related to the Exelon Way Initiative.¹⁹ The Exelon Way Initiative was a cost reduction measure undertaken in 2003 to integrate and centralize support functions, consolidate and align business units, and standardize and simplify operating processes within Exelon. ComEd incurred \$158 million for severance costs associated with the Exelon Way Initiative. The ICC approved for retail ratemaking purposes recovery of approximately \$141 million²⁰ of the \$158 million of severance costs associated with the Exelon Way Initiative. The amount approved for recovery by the ICC from retail customers was deferred as a regulatory asset and amortized over 7.5 years, consistent with the ICC's approval. In addition to the \$141 million of severance costs approved by the ICC as a regulatory asset, ComEd recorded the remaining \$17 million of severance costs as a regulatory asset and amortized this amount over 7.5 years similar to the amount approved by the ICC. Audit staff found that ComEd did not seek Commission approval to recover portions of the \$17 million of severance cost in its wholesale transmission formula rate during the audit period. Based on ComEd's inclusion of the regulatory assets in wholesale transmission formula rates, the company over recovered approximately \$3.6 million from wholesale transmission customers during the audit period. Since ComEd did not seek approval from the Commission to recover the regulatory asset from wholesale customers, ComEd should have kept this amount in Account 182.3, without amortization, until the costs were approved for rate recovery. Alternatively, ComEd should have recorded the severance costs as an expense in the year the cost was incurred.

Audit staff found that ComEd amortized the entire retail regulatory asset to Account 920, Administrative and General Salaries, and Account 926, Employee Pensions and Benefits. ComEd's wholesale transmission formula rate references Accounts 920 and 926 in the computation of its wholesale transmission revenue requirement. However, because the retail regulatory asset was not approved by the Commission for rate recovery, audit staff believes that ComEd should have excluded such costs from the wholesale revenue requirement. Furthermore, audit staff finds that, while ComEd appropriately excluded \$141 million of the retail regulatory asset from the wholesale transmission

¹⁹ The Exelon Way Initiative was approved by the Illinois Commerce Commission in Docket No. 05-0597 in 2006. The regulatory asset was not approved by the Commission.

²⁰ The amount approved by the ICC for recovery in retail rates was determined by applying the wage and salary allocators to the amortization amount reported for each year during the 7.5 year amortization period.

revenue requirement to prevent double recovery, the remaining retail regulatory asset should not have been amortized to Accounts 920 and 926 because it was never approved by the Commission for rate recovery and amortization. Audit staff found that the retail regulatory asset amortized to Accounts 920 and 926 was not removed from those accounts for purposes of computing billings to wholesale transmission customers. Consequently, retail regulatory asset of approximately \$3.6 million was incorrectly recovered in wholesale transmission rates.

BG&E

In 2003, the MD PSC approved a settlement agreement related to retail standard offer services (SOS).²¹ The settlement provides for the provision of residential SOS and three other types of non-residential SOS to Maryland retail customers to enhance competition in the electric supply market in Maryland. The SOS is an alternative for retail customers to purchasing electric supply from a competitive supplier in Maryland. Based on the settlement, BG&E provided SOS to its Maryland retail customers and incurred incremental cost for providing such services. The incremental cost represented the difference between the cost of providing SOS and the revenues collected for recovery of those costs. BG&E recorded the deferral of the incremental cost of providing SOS to Maryland's retail electric customers in Account 182.3. The regulatory asset recorded in Account 182.3 was authorized for full recovery in retail rates by the MD PSC and amortized to Account 904, Uncollectible Accounts, and Account 921, Office Supplies and Expenses. BG&E's wholesale transmission formula rate references Account 921 in the computation of its wholesale transmission revenue requirement. Audit staff found that the portion of the SOS regulatory asset amortized to Account 921 was not removed from the account for purposes of computing billings to wholesale transmission customers as required by the Commission's regulations. Consequently, the SOS regulatory asset was incorrectly included in wholesale transmission rates.

²¹ The MD PSC approved the retail standard offer services in case number 8908 (MD PSC Order No. 78400). The settlement agreement signatories include Baltimore Gas & Electric, Building Owners and Managers Association of Metropolitan Baltimore, Inc., Choptank Electric Cooperative, Inc., Constellation NewEnergy, Inc., Delmarva Power & Light d/b/a Conectiv Power Delivery, Maryland Energy Administration, Maryland Energy Users Group, Maryland Industrial Group, Maryland Office of People's Counsel, Maryland Public Service Commission Staff, Maryland Retailers Association, Mid-Atlantic Power Supply Association, Mirant Mid-Atlantic, LLC, Pepco Energy Services, Inc., Power Plant Research Program of the Department of Natural Resources, The Potomac Edison Company d/b/a Allegheny Power, Potomac Electric Power Company, Southern Maryland Electric Cooperative, Inc., and Strategic Energy, LLC.

ACE

Between 2011 and 2017, ACE experienced damages to its distribution systems due to major storms (i.e., Hurricane Sandy, Hurricane Irene, and Winter Storm Jonas). The New Jersey Board of Public Utilities approved a retail regulatory asset for recovery in retail rates related to the incremental costs of storm damage incurred by ACE on its distribution systems between 2011 and 2017.²² ACE recorded the deferral of the incremental costs of storm damage in Account 182.3. The regulatory assets recorded in Account 182.3 were approved for full rate recovery in retail rates and amortized to Account 593, Maintenance of Overhead Lines (Major Only); Account 903, Customer Records and Collection Expenses; and Account 408.1, Taxes Other than Income Taxes, Utility Operating Income. ACE's wholesale transmission formula rate references Account 408.1 in the computation of its wholesale transmission revenue requirement. Audit staff found that the portion of the regulatory asset amortized to Account 408.1 was not removed from the account for purposes of computing billings to wholesale transmission customers as required by the Commission's regulations. Consequently, approximately \$33,000 of the regulatory asset was recovered in wholesale transmission rates.

Pepco

In 2014, the MD PSC approved a regulatory asset for recovery in retail rates related to Accenture services costs.²³ The Accenture services costs were for a PHI initiative designed to reduce operating and maintenance expenses through renegotiation of engineering, construction services, and other miscellaneous contracts. Pepco recorded the deferral of the Accenture services costs in Account 182.3. The regulatory asset recorded in Account 182.3 was approved for full recovery in retail rates by the MD PSC and amortized to Account 923, Outside Services Employed. Pepco's wholesale transmission formula rate references Account 923 in the computation of its wholesale transmission revenue requirement. Audit staff found that the regulatory asset amortized to Account 923 was not removed from the account for purposes of computing billings to wholesale transmission customers as required by the Commission's regulations. Consequently, approximately \$40,000 of the Accenture regulatory asset was recovered in wholesale transmission rates.

²² The deferral of major storm costs was approved by the New Jersey Board of Public Utilities in NJ Docket No. ER16030252, and NJ Docket No. ER17030308.

²³ The deferral of the Accenture services costs was approved by the MD PSC in Order number 85724 in 2013. In 2014, in Order no. 86441, the MD PSC approved the recovery of the Accenture services costs deferred in 2013.

DPL

In 2008 and 2011, the Delaware Public Service Commission (DE PSC) and MD PSC approved a regulatory asset for DPL to recover, in its retail rates, costs related to Advance Metering Infrastructure (AMI) and storm damage.²⁴ AMI represented initial costs for the installation of smart meters and early retirement of legacy meters for Delaware distribution customers. Storm damage costs represented the incremental costs for the repair and restoration of DPL's Maryland distribution systems due to a storm in February 2010. DPL recorded the deferral of the AMI and storm damage costs in Account 182.3. The regulatory asset recorded in Account 182.3 for storm damage was approved for full recovery in retail rates and amortized to Account 593, Maintenance of Overhead Lines (Major Only); Account 935, Maintenance of General Plant; and Account 903, Customer Records and Collection Expenses. The regulatory asset recorded in Account 182.3 for AMI was approved for full recovery in retail rates and amortized to Account 923, Outside Services Employed. DPL's wholesale transmission formula rate references Accounts 923 and 935 in the computation of its wholesale transmission revenue requirement. Audit staff found that the regulatory assets amortized to Accounts 923 and 935 were not removed from those accounts for purposes of computing billings to wholesale transmission customers as required by the Commission's regulations. Consequently, approximately \$33,000 of the regulatory asset was recovered in wholesale transmission rates.

Summary

Audit staff determined that the regulatory assets discussed above were not approved by the Commission for recovery in FERC jurisdictional rates. The Commission has stated, in Order No. 552 and subsequent orders, that any party desiring to recover expenses in rates other than in the period in which they would ordinarily be charged to expense must receive approval to recover the deferred cost and approval of the amortization period for recovery.²⁵ Such a required filing is not a mere formality; it is a

²⁴ The deferral of the AMI costs was approved by the DE PSC in Order No. 7420. The deferral of the storm damage costs was approved by the MD PSC in Order No. 84170.

²⁵ See, e.g., *PJM Interconnection, L.L.C. and Virginia Electric and Power Co.*, 110 FERC ¶ 61,234, at P 41 (2005) ("any party desiring to recover" a regulatory asset "must submit a filing demonstrating that their retail rates in effect applicable to that period" will not permit recovery of the costs in the normal period and submit "a rate plan for recovery of them in a different period."); *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,337, at P 15 (2004) ("any party desiring to recover the

necessary step that enables customers and other interested parties, as well as the Commission, to determine whether the proposed recovery treatment warrants a closer review to confirm that it is just and reasonable.²⁶

Schedule 16 and 17 charges in rates other than [in] the period in which they would ordinarily be charged to expense must submit a filing”); *Midwest Independent Transmission System Operator, Inc.*, Order on Petition for Declaratory Order, 102 FERC ¶ 61,279, at ¶ 1 (2003) (“We find that Midwest ISO’s load serving stakeholders may make a rate filing with the Commission clearly demonstrating and supporting that any such costs are currently unrecoverable and so should be treated as a regulatory asset.”) (footnote omitted), *reh’g denied, clarification provided*, 106 FERC ¶ 61,337 (2004); *id.* at ¶ 15 (“Midwest ISO TOs may file pursuant to [FPA] Sections 205 or 206, as appropriate, with the Commission, in the event that they cannot otherwise recover the Schedule 10 costs charged to them, a request for rate recovery of such costs as a regulatory asset.”) (footnote omitted); *id.* (“load serving stakeholders are entitled to the same opportunity to make a rate filing with the Commission clearly demonstrating and supporting that the Schedule 16 and 17 costs are currently unrecoverable and should be treated as a regulatory asset under . . . Account No. 182.3”); *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,192, at P 30 (2003) (“we will permit . . . parties, at their discretion, to make a filing with the Commission clearly demonstrating and supporting that such costs [ISO Cost Adder charges] are indeed currently unrecoverable and should be treated as a regulatory asset under the Commission’s Uniform System of Accounts properly classified in Account No. 182.3, Other Regulatory Assets.”), *reh’g denied, clarification provided*, 104 FERC ¶ 61,012, at P 29 (2003) (“With respect to the Kentucky Commission concern as to the standard to review rate filings for regulatory asset treatment, we clarify that we will continue to apply the existing standard as set forth in 18 C.F.R. Part 101, Account No. 182.3 (2002). Accordingly, any parties requesting regulatory asset treatment will be required to demonstrate that the costs at issue are both unrecoverable in existing rates and that it is probable that such costs will be recoverable in future rates.”), *aff’d sub nom., Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004); Order No. 552, 58 Fed. Reg. at 18,000 (“Account 182.3 would include costs . . . which have been, or are soon expected to be, authorized for recovery through rates”) (emphasis added).

²⁶ See, e.g., *PJM Interconnection, L.L.C. and Virginia Electric and Power Co.*, 110 FERC ¶ 61,234, at P 41 (“any transmission owner seeking to recover a regulatory asset in its rates . . . must submit a filing”); *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶ 61,012, at P 29 (discussing “standard to review rate filings for regulatory asset treatment” and holding “we will continue to apply the existing standard” which is that “any parties requesting regulatory asset treatment will be required to demonstrate that the costs at issue are both unrecoverable in existing rates and that it is probable that such costs will be recoverable in future rates.”).

Although Exelon and its public utilities received approval from retail commissions to recover all or portions of the regulatory assets in retail rates, they did not seek Commission approval before recovering any amounts of the regulatory assets in wholesale transmission rates. Additionally, portions of regulatory assets not authorized for rate recovery by the Commission, a retail regulator, or other regulatory agencies may not be amortized under the Commission's accounting regulations. Therefore, the regulatory assets included in the public utilities' wholesale transmission revenue requirements were improper and led to unauthorized billings to wholesale transmission customers.

Recommendations

We recommend that Exelon and its public utilities:

13. Revise procedures for computing wholesale transmission formula rate billings to wholesale customers to exclude amortization of regulatory assets that have not been approved by the Commission.
14. Provide training to staff on the revised regulatory assets accounting and rate development methods. Also, develop a training program that supports the provision of periodic training in this area, as needed.
15. Submit a refund analysis to DAA, within 60 days of receiving the final audit report from DAA, that explains and details: (1) calculation of refunds that include the amount of inappropriate regulatory asset amortizations included in wholesale formula rates and the refunds resulting from inclusion of the amortizations in wholesale formula rates during the audit period, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.
16. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
17. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of Commission regulations.

Exelon's Response to Draft Audit Report



Thomas O'Neill
Senior Vice President
General Counsel

10 S. Dearborn
Chicago, IL 60603
312 394 7205 Office
312 394 3218 Fax
Thomas.oneill@exeloncorp.com

November 5, 2019

Steven D. Hunt
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 5K-13
Washington, DC 20426

**Re: Exelon Corporation, Docket No. PA18-3-000
Response to Draft Audit Report**

Dear Mr. Hunt:

This letter is in response to the draft audit report ("Draft Report"), dated October 21, 2019, issued by the Federal Energy Regulatory Commission (the "Commission"), Office of Enforcement, Division of Audits and Accounting to Exelon Corporation ("Exelon").

The Draft Report evaluated Exelon and its public utility subsidiaries'¹ compliance, during the period from January 1, 2013 through March 26, 2019, with: (1) conditions established in the Commission's November 20, 2014 order authorizing the merger of Exelon and Pepco Holdings, Inc., (2) tariff requirements governing Exelon's public utilities' rates, (3) accounting regulations in 18 C.F.R. Part 101, and (4) financial reporting regulations in 18 C.F.R. Part 141.

The Draft Report identifies four areas of noncompliance and 17 recommendations to remedy the noncompliance findings. Exelon does not contest the Draft Report and generally agrees to the recommendations and corrective actions contained in the Draft Report in order to bring resolution to the audit. However, as described further in Attachment A, Exelon provides comments on the Draft Report's conclusions on several issues.

¹ Exelon's six public utility subsidiaries are Commonwealth Edison Company ("ComEd"), Baltimore Gas & Electric Company ("BGE"), PECO Energy Company ("PECO"), Atlantic City Electric Company ("ACE"), Delmarva Power & Light Company ("DPL"), and Potomac Electric Power Company ("Pepco").

Exelon takes its compliance obligations seriously and welcomes the opportunity to comment on the Draft Report in accordance with Part 41 of the Commission's regulations.² Exelon also notes the Commission audit staff's time and professionalism throughout the audit with appreciation.

Respectfully submitted,

/s/ Thomas O'Neill
Exelon Corporation
Senior Vice President and General Counsel
10 S. Dearborn St., 48th Floor
Chicago, IL 60603

² 18. C.F.R. 41.1(b).

ATTACHMENT A

Audit Staff Finding:

1. Merger-Related Regulatory Assets

Audit staff confirmed that BGE improperly included the amortization of merger-related regulatory assets approved by a retail regulator in wholesale transmission formula rates.

Exelon Response:

Exelon accepts this finding and the corresponding recommendations 1 through 4. BGE has updated its policies and procedures for its transmission formula rate update and implemented additional internal controls to mitigate the risk of including merger-related regulatory assets not approved by the Commission in wholesale transmission formula rates and billings to wholesale transmission customers. Taking a proactive stance to this issue, and resulting from BGE's identification of the amounts included in the transmission rates, BGE refunded \$1.4 million plus interest to wholesale transmission customers in its 2018 formula rate update filed with the Commission on May 4, 2018. As noted in the Draft Report, BGE has fully satisfied recommendations 1 through 4.³

Audit Staff Finding:

2. Transmission Formula Rate Allocators

Audit staff found that ComEd and DPL improperly included merger costs when computing their transmission allocators, which resulted in overstatement of their annual transmission revenue requirements and billing to wholesale transmission customers.

Exelon Response:

Audit staff concludes that ComEd and DPL improperly included merger costs as a result of computing the transmission allocators. ComEd and DPL do not object to that finding and, as described further below, will undertake the corrective actions to the extent that they have not already done so.⁴ The Exelon public utilities will implement policies to ensure that the merger costs are excluded from their transmission formula rate allocators.

³ Exelon Corp., Docket No. PA18-3-000, Draft Audit Report of Exelon Corp., p. 14 (October 21, 2019).

⁴ ComEd has established policies to ensure that it excludes merger costs from its transmission formula rate allocators and has included the refund amounts in its 2018 transmission formula rate update. ComEd will submit that information to the Commission consistent with the final audit report.

Audit Staff Finding:

3. *Merger Commitment Costs*

Audit staff found that ComEd, BGE, PECO, ACE, DPL, and Pepco improperly included merger commitment costs for the Exelon and Pepco Holdings, Inc. merger in their transmission revenue requirements.

Exelon Response:

Exelon undertook significant efforts to apply the Commission's hold harmless commitments and ensure that transmission customers did not receive costs that resulted from merger costs as defined by the Commission. With respect to the finding that the Exelon utilities improperly included merger commitment costs in the transmission revenue requirement, Exelon accepts this finding and the associated actions. Exelon agrees that certain costs incurred solely to implement merger commitments are appropriately excluded from the formula rates.

Exelon further appreciates the recognition by the audit staff that a distinction is to be made between merger costs incurred solely to fulfill merger commitments and costs that both fulfill merger commitments as well as continuing compliance obligations that existed previously or were incurred prior to, and independent of, the merger. In addition, some costs were incurred post-merger resulting from operations of a newly merged business, and do not constitute merger-related costs for which customers should be held harmless. Accordingly, as audit staff agrees and understands, not all costs associated with the many memorialized merger commitments are 'merger related' costs as described by the Commission or the 2014 Merger Order.

For these reasons, Exelon views as overly broad and therefore potentially inaccurate the Draft Report characterization that "all costs associated with implementing the merger commitments should have been excluded from the public utilities' transmission revenue requirements." Rather, it is only as to those costs that fall within hold harmless category of merger related costs as defined by the Commission for which corrective action has been properly prescribed by this audit, and to which Exelon concurs.

4. *Amortization of Retail Regulatory Asset*

Audit staff found that ComEd, BGE, ACE, DPL, and Pepco improperly recorded the amortization of certain regulatory assets and improperly included the amortization of the regulatory assets in their wholesale transmission formula rates without Commission approval to recover such amounts.

Exelon Response:

The affected Exelon utilities agree to provide refunds associated with the retail regulatory assets as generally described in the Draft Report for the January 1, 2013 through March 26, 2019 period of the audit in order to resolve the issue raised by audit staff. Exelon understands that this will resolve the issues with respect to all of the subject regulatory assets and that no further action will be taken or permitted pertaining to those regulatory assets. Exelon also agrees to the corrective actions noted in the Draft Report concerning the rate treatment of retail regulatory assets, without agreeing or conceding that actions taken were inappropriate or improper.

While not contesting the finding and corrective actions, Exelon respectfully submits that the policy guidance referenced in the Draft Report does not address the specific factual circumstances present regarding the formula rates and protocols of the Exelon utilities, and fails to both establish clear precedent for the result reached by the audit and to demonstrate that the amounts were improperly recorded in any respect. To the contrary, the annual amortizations relating to the regulatory assets identified were properly recorded by each utility in Accounts 920 and 926 and reported on the respective Form 1 in each year. Those accounts are automatically recovered in the Formula Rate of each utility because the Commission-approved formulas for each utility require that A&G expense be based on the amounts reported in the Form 1 and then allocated to transmission using the wages and salaries allocator. Given that the approved formula is the rate on file, the amounts included were proper not only for accounting purposes, but for ratemaking purposes as well. See *Pub. Utils. Comm'n of Cal. v. FERC*, 254 F.3d 250, 254-55 (D.C. Cir. 2001) (explaining that the formula is the rate and that underlying materials that impact the cost levels that will be charged through the rate need not be separately filed).

Moreover, recovery under similar circumstances has been approved and upheld by the Commission. Exelon invites your attention to Opinions 509 and 509-A, which support the conclusion that state-approved regulatory asset amortization amounts accounted for in specific FERC accounts may be flowed through a formula rate, as long as the formula rate specifically references and identifies that account. *La. Pub. Serv. Comm'n v. Entergy Corp.*, Opinion No. 509, 132 FERC ¶ 61,253 (2010), *order on reh'g*, Opinion No. 509-A, 137 FERC ¶ 61,101 (2012).