APPENDIX D

Exhibit PHI-21

Direct Testimony of

Anthony J. Kamerick

Exhibit No. PHI-21

UNITED STATES OF AMERICA

BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

Pepco Holdings, Inc.,	)	
Potomac Electric Power Company,	)	Docket No. ER08-___-000
Delmarva Power & Light Company, and	)	
Atlantic City Electric Company	)	
	)	

DIRECT TESTIMONY OF ANTHONY J. KAMERICK

August 18, 2008

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DIRECT TESTIMONY OF ANTHONY J. KAMERICK

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Anthony J. Kamerick and my business address is 701 Ninth Street, N.W., Washington, DC 20068.

Q. IN WHAT CAPACITY ARE YOU EMPLOYED?

A. I am Vice President and Treasurer of Pepco Holdings, Inc. (PHI). A statement of my educational history and qualifications is attached to this testimony as Exhibit PHI-22. As Vice President and Treasurer, I am the corporate officer with primary responsibility for conducting PHI's financing program. I am responsible for PHI's relationship with the financial community generally and am the primary contact with the credit rating agencies. I also have responsibility for PHI's Regulatory Affairs division.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to explain why PHI, on behalf of its utility subsidiaries, Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (Delmarva) and Atlantic City Electric Company (ACE), is requesting that the Commission grant certain incentive-based rate treatments for the construction of the $1

billion Mid Atlantic Power Pathway (MAPP) project, a 230-mile transmission line originating in Virginia and terminating in southern New Jersey. The three incentives we are requesting are among those outlined by Congress in Section 219 of the Federal Power Act and approved by the Commission in Order No. 679 for the purpose of encouraging investments such as MAPP.

PHI is requesting the following incentives be incorporated into the existing approved formula of each utility:

- An incentive ROE adder of 150 basis points on the companies' existing 11.3% ROE, resulting in a total ROE of 12.8% for the MAPP project. The incentive ROE is well within the zone of reasonableness as demonstrated by Dr. Avera; and
- 100% of prudently incurred Construction Work in Progress (CWIP) in rate base; and
- Recovery of prudently incurred costs in case of abandonment for reasons beyond the companies' control.

These incentives are being requested as an integrated package and reflect the considerable financial, regulatory, and construction risks of the MAPP project These risks are described in detail in my testimony, Dr. Avera's testimony, and in Mr. Gausman's testimony.

My testimony will describe the financial and regulatory risks that PHI and the utility affiliates face. It will also demonstrate that the package of incentives we are requesting is tailored specifically for this project, and that each incentive is needed to help offset the significant risks and financial stress that construction of project will place

on the companies' financial positions, credit metrics, and financing abilities. In sum, it will demonstrate that all three incentives are needed to enable PHI to finance the MAPP project. This demonstration will show that the investment required for the MAPP project is very significant relative to PHI's current investment in transmission assets and overall asset base, which is particularly important considering today's credit market conditions generally, PHI's credit metrics specifically and the challenge in maintaining adequate credit metrics.

I will address how an incentive ROE of 12.8% and 100% CWIP recovery will help to offset partially the financial stress that construction of the MAPP project will place on the companies' financial positions, credit metrics and financing abilities. The size, complexity and risk inherent in the MAPP project are significantly larger than any other transmission project we have ever undertaken, and it is vitally important that the companies continue to be able to access capital markets on reasonable terms. My testimony concludes with a demonstration of the nexus between the companies' proposed investment in the MAPP project and the requested incentives.

The requested rate treatments are directly related to the nature, size, and scope of the MAPP Project and are necessary to finance the project. PHI's requests in this docket are wholly in line with Congressional and Commission policy encouraging transmission investment for projects, such as MAPP, that have the purpose of "benefiting consumers by ensuring reliability and/or reducing the cost of delivered power by reducing transmission congestion."[1] Chairman Kelliher, observed in testimony before the Committee on Energy and Natural Resources of the United States Senate on July 31,

[1] 16 U.S.C. § 824s.

2008, "the United States is just coming out of a long period of sustained underinvestment in the power grid. . . .Transmission investment was still lagging behind demand growth . . . [prompting Congress] to require the Commission . . . to establish incentive-based rate treatments for transmission."[2] My testimony will show that these incentives are necessary to spur large, multi-state transmission "highway" projects such as MAPP that, when completed, will provide the nation with "the robust transmission grid" it needs.[3] The simple fact is that "incentive rates, bounded by the 'zone of reasonableness' governed by the Federal Power Act" make possible MAPP and backbone projects like it that dramatically improve the transmission grids.[4]

Q. PLEASE DISCUSS THE LEVEL OF FINANCIAL COMMITMENT REQUIRED FOR THE MAPP PROJECT.

A. The MAPP project will require a substantial financial commitment of $1 billion, and is by no means a routine transmission project for the PHI Companies. This new line will extend 230 miles from Possum Point, Virginia, across the Potomac River and through Southern Maryland, pass under the Chesapeake Bay, cross the Delmarva Peninsula to Indian River, Delaware, and proceed north to Salem in New Jersey. The MAPP project is the largest project undertaken by the companies in their separate and combined histories, and as Mr. Gausman's testimony addresses in detail, the project faces significant engineering, environmental, technical and construction challenges. Mr. Gausman

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[2] Testimony of the Honorable Joseph T. Kelliher, Chairman, Federal Energy Regulatory Commission before the Committee on Energy and Natural Resources, United States Senate, July 31, 2008 ("Chairman's 2008 Senate Testimony on Transmission") at pp. 13-14.

[3] Chairman's 2008 Senate Testimony on Transmission at p.18

[4] *See* Chairman's 2008 Senate Testimony on Transmission at pp. 14-15.

describes the use of advanced technology, and the risk that entails. The project will require various regulatory approvals in three states and the Commonwealth of Virginia, and as Mr. Gausman states, it is imperative that PHI balance and coordinate siting, permitting, environmental, and construction schedules, and with its three major construction partners—Dominion Virginia Power, Baltimore Gas and Electric, and Public Service Electric & Gas--to bring this project to successful completion.

To put the size of this commitment in perspective, the total net asset base of PHI's three utilities as of December 31, 2007, as shown in the FERC Form No.1s, totals $9.7 billion (Pepco = $4.6 billion, Delmarva = $2.4 billion and ACE = $2.7 billion). Thus, this project alone represents more than 10% of the assets of the combined three utilities. When the costs of this project are added to the companies' already significant construction commitments over the next five years, the total commitment is $5 billion, which is more than 50% of PHI's $9.7 billion asset base. Construction commitments of this size are very difficult to finance, particularly in turbulent financial markets such as we have today. Furthermore, over the four-year period 2010-2013, $1.7 billion in debt must be refinanced by PHI, putting additional stress on the company's financing plans.

Given the magnitude of the companies' MAPP construction budget, incentives to build backbone RTEP projects are necessary and appropriate. As the Commission noted in Order 479, P 91

> Public utilities making investments in transmission infrastructure have made clear, both in their applications for new projects and in their comments on this Rule, that the ROE incentives encourage investment. We expect that an incentive ROE will make transmission projects more attractive, and therefore more likely, when transmission projects must compete for capital in vertically integrated utilities as well as in transmission and delivery utilities.

Q. WHAT CRITERIA DID PHI USE IN DEVELOPING ITS INTEGRATED PACKAGE OF INCENTIVES, ESPECIALLY THE INCENTIVE ROE.

A. PHI considered a number of factors in developing its incentive request for the MAPP project. By any standard, the size and scope of the project represent a substantial financial commitment. Furthermore, MAPP is not the only RTEP construction obligation that the companies have committed to undertake. The PJM Board has approved more than $500 million in additional RTEP baseline upgrades that are the construction obligation of Pepco, Delmarva, or ACE. All of these projects are scheduled for in-service between 2009 and 2013, and construction has begun on most.

For the five-year period 2008-2012, the companies are committed to a transmission construction program of approximately $300 million/year.[5] For the period 2001-2007, the companies' PJM RTEP obligation averaged $60 million/year. MAPP construction expenditures will average $180 million/year over the 2008-2012 period, tripling the companies' historic average annual transmission construction expenditures. MAPP alone makes up 60% of the companies' projected transmission capital expenditures, and will virtually double the transmission rate base of $942 million as shown in the companies' recent transmission rate updates. [6]

PHI evaluated its cash flow needs during the MAPP capital expenditure program. The company also evaluated projects of similar size, scope, and risk. PHI's request is a

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[5] See PJM 2007 Baseline RTEP Assessment dated March 2008, available at http://www.pjm.com/planning/rtep-baseline-reports/downloads/2007-rtep-baseline-assessment.pdf.

[6] *Compare* Chairman's 2008 Senate Testimony on Transmission at p. 15, referring to projects approved for favorable rate treatment pursuant to FPA Section 219 and Order No. 679: "Often, the amount of new investment almost equals the transmission owner's existing investment in transmission facilities. Specifically, in a number of cases, the new investment is as much as 80 percent of existing investment."

balanced package of incentives that will enable the Company to access the capital markets on fair and equitable terms.

The 150-basis-point incentive ROE adder, which would increase our base ROE—for this project only—to 12.8%, is appropriate under the circumstances. As Dr. Avera points out, using the traditional RTO Proxy Group approved for PHI's use in prior requests or an Alternative Proxy Group, a 12.8% incentive ROE is less than 100 basis points above the midpoints, and well below [approximately 300 basis points] the high ends of the zones of reasonableness.

Q. PLEASE DESCRIBE PHI'S FINANCING PLANS FOR THE MAPP PROJECT.

A. PHI's initial projections of construction expenditures for the MAPP project totaled $1.05 billion. This estimate is subject to modification as siting, environmental, and construction/engineering issues are fully developed and addressed. PHI will use a combination of internal and external sources to fund MAPP. The largest source of funding will be from external sources and will include corporate debt or other similar securities of the individual utilities, as well as issuances of common equity of PHI. Proceeds of PHI equity issuances will be contributed to the utilities in order for them to maintain investment grade, balanced capital structures. There will be several public sales of debt for each of the utilities and several PHI equity issuances over the construction period. Equity issuances dilute the holdings of current shareholders and the dilution is made worse if the Company's earnings do not increase.

The success of PHI's financing plan rests on its ability to attract sufficient external investors, who will compare a potential investment in PHI to investments in other utilities and competing investment alternatives. Investors expect a satisfactory

return on their investment in transmission, commensurate with returns granted to similar projects and risks. The competition for funds in the industry today is very intense, as all utilities are engaged in building and replacing infrastructure. Notably, the Commission has stated that transmission incentives are "appropriate to encourage proactive behavior." Order 679, P 94.

Q. PLEASE DESCRIBE IN GENERAL THE FINANCIAL AND REGULATORY RISKS AND CHALLENGES OF THE MAPP PROJECT.

A. Financial Risks. In order to finance these expenditures on reasonable terms, investors will require sufficient assurances of cost recovery and a reasonable rate of return on their investment. In addition, the credit rating agencies have expressed concerns over the magnitude of capital expenditures the companies are undertaking, which they have stated will put stress on current ratings. Maintaining solid financial metrics and stable cash flow over the construction period and the life of the project is essential to maintaining the financial integrity of PHI, preventing deterioration in credit ratings and allowing PHI to finance the project on reasonable terms.

Indeed, as Moody's noted in its July 2008 report entitled "U.S. Investor-Owned Electric Utilities: Six-Month Industry Update," a utility's credit rating is large affected by its ability to manage cash flow:

> The manner in which utilities manage these increasing cash outflows and the success they have in attaining regulatory relief will be a major factor in assessing credit ratings over the longer-term horizon.

Regulatory risks. In today's climate of rising commodity and construction costs and increasing concern over the benefits of competition in electricity markets, regulators at all levels are challenged even more than is usual to reach a balance between free markets

and regulation. These risks directly affect the PHI Companies' ability to raise capital. Thus, the ability to raise capital under these conditions will be facilitated by an ROE adder and ratemaking treatment that recognizes the regulatory and political challenges PHI will face in bringing new transmission projects to completion, particularly one of the size and complexity of MAPP.

MAINTAINING STRONG FINANCIAL METRICS

Q. PLEASE DISCUSS THE CURRENT CREDIT RATINGS OF PHI.

A. PHI's current senior unsecured debt rating from Standard & Poor's Rating Service (S&P) is BBB- and its senior unsecured debt rating from Moody's Investor Service (Moody's) is Baa3. Both of these ratings are at the very bottom of the "Investment Grade" rating scale of each of these rating agencies. Indeed, when Moody's downgraded the senior unsecured debt ratings of PHI from Baa2 to Baa3 in July 2006, it expressed concern over "the significant decline in the supportiveness of the regulatory environments."[7] Should PHI suffer a downgrade of only one notch, it would place the Company's senior unsecured debt rating into the "Non-Investment Grade" or "junk bond" category. Non-Investment Grade credit ratings are generally characterized as having significantly more speculative qualities for the investor the lower in the scale the rating is. As a result, Non-Investment Grade ratings bear higher costs for the issuing company, and in unfavorable credit market conditions, the higher cost can be very significant. Even more important, companies with Non-Investment Grade ratings have less access to capital and, during unfavorable credit market periods, they can be effectively shut out of the capital markets – a very

[7] Moody's Global Credit Research, July 11, 2006.

unacceptable event for a capital intensive company. In addition, a Non-Investment Grade credit rating prevents the issuer from participating in the short term Commercial Paper market, which is typically a very inexpensive source of short term borrowing. Moody's, in a credit opinion of PHI, stated:

> Through the twelve months ended March 31, 2008, PHIs cash flow to total debt coverage was approximately 15.8%. While this level of coverage is higher than its 5-year historical average of 12%, it should be noted that a sustainable level of metrics comes during a time of a rather significant consolidated capital program. Moody's views the expected coverage levels to be on the lower end of the Baa3-rating scale.[8]

Q. WHAT ARE THE CREDIT RATINGS OF PHI'S UTILITY SUBSIDIARIES?

A. PHI's utility credit ratings are shown in the table below:

	Moody's			Standard & Poor's	
	Senior Unsecured	Secured		Senior Unsecured	Secured
Pepco	Baa2	Baa1		BBB-	BBB+
Delmarva	Baa2	Baa1		BBB	A-
Atlantic City	Baa1	A3		BBB-	A-

On July 3, 2008, Moody's changed the rating outlook of Atlantic City Electric from stable to negative. In its report, Moody's stated:

> The change in rating outlook to negative from stable reflects Moody's concern that the future financial performance of the company over the medium term will likely be lower than previously expected. We expect the company to face significant challenges in maintaining its key credit metrics at historic levels due to continued increases in operating expenses .... along with a stepped-up capital spending program.[9]

[8] Moody's Investors Service Global Research Credit Opinion: Pepco Holdings, Inc., 14 JUL 2008

[9] Moody's Investors Service Global Credit Research Rating Action: Atlantic City Electric, 3 JUL 2008

Moreover, a downgrading by S&P would lower the senior unsecured ratings of Pepco and Atlantic City to Non-Investment Grade.

Q. IF CORPORATE BORROWINGS ARE ISSUED DIRECTLY OUT OF THE INDIVIDUAL UTILITIES, WHY IS THE CREDIT RATING OF PHI OF CONCERN?

A. A downgrading of PHI's utilities as a result of credit rating agencies' concern over the magnitude of the construction budget commitments would not only cause the customers of the utilities to pay more for electric service due to the higher cost of capital, it could cause a downgrading of the holding company to "junk" status. Such an event would not give PHI the incentive to undertake such commitments in the future. Moreover, since the projects will be financed with equity issued by PHI, the parent, a downgrading of PHI's debt to below investment grade will very likely have a negative effect on the price of its common stock, making such financings more expensive and costing our customers more in the long run.

Q. EXPLAIN THE RISK TO PHI'S COVERAGE RATIOS AND OTHER FINANCIAL METRICS.

A. Continuing and growing substantial outlays of cash could weaken PHI's credit rating over the near- and mid-term. It is essential that the companies maintain their current credit ratings during this significant capital expenditure program. Standard & Poor's noted:

> During a large capital spending period such as the one currently under way in the transmission sector, timely and efficient rate recovery bolsters companies' credit quality because greater internally generated cash flow during construction results in lower liquidity needs and reduced external financing.
> .....

Therefore, Standard & Poor's considers the healthy ROEs authorized by the FERC to be supportive of credit quality.[10]

MITIGATING FINANCIAL RISK

Q. DISCUSS THE IMPORTANCE OF AN INCENTIVE ROE IN SUPPORTING PHI'S EFFORTS TO RAISE CAPITAL.

A. The traditional, base ROE that applies to all the Companies' embedded rate based facilities as a result of the approved formula rate, while reasonable and appropriate for existing assets, does not provide us with the level of financial assistance and encouragement to commit to the major new management, personnel and capital expenditures necessary to bring a substantive $1 billion project to fruition in a time of unsettled financial markets, uncertain regulatory climate and complex, multi-utility construction scenarios. The base ROE alone will not provide the necessary return and regulatory commitment to support a billion dollar capital attraction program, to assuage investor and regulatory concerns about project success, and to recognize that these projects require the highest level of corporate commitment and priority. The incentive ROE requested will allow us to achieve these important objectives.

Q. DESCRIBE CWIP IN RATE BASE AND HOW IT WILL PRESERVE ADEQUATE CASH FLOW AND ATTRACT FINANCING.

A. With 100% CWIP recovery, the companies will receive a current return on construction expenditures, thus mitigating the cash drain during the MAPP construction program. Under the AFUDC method, the companies would recover construction expenditures and interest after the project goes into service. Given that the MAPP project is not expected

[10] Standard & Poors, Key Rating Factors For U.S. Electric Transmission Companies, Nov. 10, 2005.

to go into service until 2013, it is important that the company receive a current return on MAPP construction expenditures to alleviate some of the financing pressure. The additional cash flow that 100% CWIP in rate base would produce during this substantial construction expenditure period, in turn, will help the companies maintain their credit metrics and financial profile.

CWIP recovery during the MAPP construction period would provide the companies with an additional $125 million in cash flow, substantially strengthening their ability to raise capital, improving cash flow, and reducing interest expense. The table below demonstrates the positive cash flow benefits.

Cash Flow During the MAPP Construction Period*

Dollars in thousands

	Traditional (AFUDC)	CWIP Recovery	Difference
2008	$0	$1,913	$1,913
2009	$0	$16,075	$16,075
2010	$0	$44,955	$44,955
2011	$21,450	$83,241	$61,791
2012	$127,655	$128,173	$518
		Total	$125,251

* Difference between the return, income tax, and depreciation components of the revenue requirement.

The Commission in its Order on Petition for Declaratory Order of Public Service Electric & Gas Company and PPL Electric Utilities in EL08-23, issued April 22, 2008, recognized the benefits of CWIP recovery to enhance a company's cash flow during construction:

> 42. Consistent with Order No. 679, we find that authorizing 100 percent of CWIP treatment for Petitioners would enhance their cash flow, reduce interest expense, assist Petitioners with financing, and improve Petitioners' coverage ratios used by rating agencies to determine credit quality by replacing non-cash AFUDC with cash earnings.
>
> This, in turn, will reduce the risk of a down grade in Petitioners' debt ratings. Considering the relative size of Petitioners' $900 million - $1 billion investment in the Susquehanna Line, we find that authorization of the CWIP incentive is appropriate.

Q. HOW WOULD RECEIVING FULL CWIP IN RATE BASE HELP THE COMPANY'S CREDIT RATINGS?

A. Being authorized to recover CWIP in rate base lowers the amount of debt the companies would need to issue for the MAPP project by about $125 million, because the CWIP in rate base treatment provides more positive cash flow during the construction period. As a result, the primary financial metrics that the rating agencies use for their credit analysis do not deteriorate, as they would if CWIP were not included in rate base and AFUDC were accrued instead.

For example, the rating agencies rely heavily on the FFO/Debt ratio (Funds Flow from Operations/Total Debt) in evaluating the ability of companies to meet their financial obligations. For 2007, the PHI utility companies' FFO/Debt ratio calculated by Moody's, based on aggregate data from all three utilities, was 16.1%. If the only project the companies engaged in over the next several years was the MAPP project, then without CWIP in rate base, but including the 150 basis point ROE adder that we have requested, the FFO/Debt ratio for the three utilities would decline steadily from 16.1% in 2007 to 13.5% in 2011. This is because the utilities would be adding debt to the denominator of the FFO/Debt ratio to finance the construction, but only adding incremental cash flow to

the numerator after the various segments are placed in service and higher rates are put in place. However, if we calculate the ratio using CWIP in rate base, the ratio continues to hold up reasonably well, because the annual formula rate update would increase each year adding cash flow to the numerator. Thus, the FFO/Debt ratio remains stable within the range of 16.1% to 15.4%.

Q. WHAT EFFECT WOULD A DECLINE OF THIS AMOUNT IN THE COMPANIES' FFO/DEBT RATIO HAVE?

A. The Moody's benchmark FFO/Debt ratio for Baa utilities with "Moderate" risk, such as the PHI utilities, is a range of 13% to 25%[11]. Thus, if the ratio drops below the 13% level, the companies could face downgrading. Additionally, in a recent publication for Pepco Holdings, S&P stated, "The stable outlook on PHI and its subsidiaries reflects Standard & Poor's expectation for modest improvement of currently weak financial measures. The outlook could be revised to negative if financial measures weaken significantly during the pending construction phase,[12]" indicating that we can not afford for the FFO/Debt ratio to weaken much more before the companies would face a negative credit action.

Q. HAVE YOU PREPARED AN EXHIBIT TO SHOW THIS CALCULATION?

A. Yes. Attached as Exhibit PHI-23 is a table showing the calculation of the FFO/Debt ratio for the three utilities from 2007 to 2011 assuming that the only activity for this period is the MAPP project, in order to demonstrate the effect of this project on the companies' credit metrics. Exhibit PHI-23 shows that the MAPP project alone can have significant

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[11] Moody's Rating Methodology: Global Regulated Electric Utilities, March 2005, p.8.

[12] Standard & Poor's Ratings Direct Research: Pepco Holdings, Inc, August 11, 2008.

adverse effects on the companies' credit ratings. When included with PHI's other construction obligations, the MAPP project adds considerably to the financial burden.

Q. DESCRIBE HOW USE OF CURRENT YEAR ESTIMATED CWIP BALANCE IN RATE BASE HELPS TO SYNCHRONIZE COSTS AND RATES FOR COMPANIES WITH DIFFERENT RATE AND CALENDAR YEARS.

A. Using a forward looking CWIP estimate better matches the timing of incurring costs and recovery in rates and acts in parallel with the companies' current formula, which uses end-of-year plant balances from the Forms 1 and a forward looking, weighted by months in service capex. Reducing the lag further improves the companies' cash flow and decreases interest expense.

Q. EXPLAIN THE BENEFITS OF CWIP IN RATE BASE FOR TRANSMISSION SERVICE CUSTOMERS.

A. With 100% CWIP in rate base, the companies would earn a current return on the balance of construction costs in the CWIP account, rather than accruing these costs and including them in Electric Plant in Service once they go into service, to be depreciated over the life of the asset. Allowing a current return on CWIP results in lower overall construction costs because less financing is required. In turn, this reduces the amount to be charged to customers in the form of depreciation, and provides for a more gradual rate increase.

As the Commission also stated concerning the Susquehanna-Roseland Line in Docket No. EL08-23-000, April 28, 2008 (footnotes omitted):

> 43. We also find that allowing Petitioners to recover 100 percent of CWIP in its rate base will result in better rate stability for customers. As we have explained in prior orders, when certain large-scale transmission projects come on line, there is a risk that consumers may experience "rate shock" if CWIP is not permitted in rate base. By allowing CWIP in rate base, the rate impact of the Susquehanna Line

can be spread over the entire construction period and will help consumers avoid a return on and of capitalized AFUDC.

Q. WHAT ARE THE RATEPAYER BENEFITS OF CWIP RECOVERY OVER THE LIFE OF THE MAPP PROJECT?

A. Alan Heintz, whose prepared direct testimony addresses the ratepayer benefits of CWIP recovery over the life of the project and how the companies will incorporate CWIP into the existing formula, has prepared an exhibit demonstrating that the overall revenue savings over the entire life of the project with 100% CWIP in rate base is $200 million. See Exhibit PHI-30 at 6-7 and Exhibit PHI-35.

Q. WHAT IS THE IMPORTANCE OF RECOVERY OF ABANDONMENT COSTS?

A. The Commission has oft stated that recovery of prudently incurred costs in case of abandonment for reasons beyond a company's control is especially significant for large scale projects with multistate approvals. MAPP is such a project with an estimated budget of $1.05 billion and requiring multiple need, environmental, and siting approvals from three states and the Commonwealth of Virginia. Recovery of abandonment costs will encourage transmission development by reducing the risk of non-recovery of costs.

REGULATORY RISKS

Q. DESCRIBE THE REGULATORY RISKS THAT THE COMPANIES FACE.

A. Faced with rising costs, instability in the nation's housing markets, and increasing concern over the benefits of competition in electricity markets, regulators at all levels are struggling to reach a balance between free markets and regulation. These conditions create risks that directly affect the PHI Companies' ability to raise capital. PHI's ability to raise capital under these conditions will be facilitated by an ROE allowance and

ratemaking adjustments that recognize the challenges faced in bringing new transmission projects to completion.

The past year has been marked by substantial re-evaluation of regional wholesale energy markets by regulators and legislators. Some states are considering forms of "re-regulation" at the retail level. Energy prices, market forces, increased market scrutiny, regulatory initiatives at the federal and state levels, and mandatory reliability standards all have contributed to the current atmosphere of uncertainty, and the financial implications for investors and ratepayers are cause for concern. As Moody's has opined:

> There are several negative key trends that are developing over the near- to intermediate-term horizon that can have a material impact on credit quality. The most important key trends include the following:
>
> - An increasing potential for legislatively mandated revisions, amendments or other modifications to the existing electric market framework. This seems particularly likely in states that have previously enacted legislation that modified their respective electric market frameworks. ...
>
> - An increasing likelihood that utility cash outflows could materially outpace authorized cash inflows — thereby potentially creating an acute deferral/recovery overhang risk.
> - An industry-wide capital investment cycle that appears to be entering a major construction phase where all-in costs—and more importantly, implications to consumer rates—do not appear to be fully vetted, creating the potential for future prudence reviews and write-downs.
>
> - A regionally based capacity market structure where generation suppliers have incentive to maintain increasingly tight reserve margins (thereby increasing profitability associated with capacity payments) and where legacy T&D utilities (especially those with provider of last resort obligation risks) may be forced to pass through steadily increasing purchased power costs — potentially creating a significant recovery lag/deferral risk, depending on the amount of the cost increase.

Moody's Corporate Finance, Industry Outlook, January 2008.

Furthermore, cost recovery is not guaranteed. As Dr. Avera has noted, recovery in rates of the cost of new investment is not guaranteed. Pepco, Delmarva, and ACE are load-serving entities in the PJM footprint. They own no generation, yet they have a statutory obligation to provide Standard Offer Service (SOS) or Basic Generating Service (BGS) service to retail load that has not chosen an alternative supplier. When they purchase generation supply, they also must purchase network transmission service from PJM. In other words, Pepco the LSE does not purchase transmission service directly from Pepco the transmission owner. Rather, Pepco the LSE purchases transmission service from PJM.

Transmission expense is part of the cost of supplying SOS load and the Companies have already seen that when sharp increases in overall SOS costs occur, there are reactions in the political and regulatory environment that put timely cost recovery at risk. In Delaware and Maryland, Pepco and/or Delmarva each had to defer cost recovery for significant periods and were not allowed to earn a return on the deferred balances when the SOS prices increased sharply.

There is risk that the PJM cost allocation for new transmission to beneficiaries outside the constructing transmission owner's zone will not work or the dollars flow as contemplated. Any time that load paying for a project is located in a different zone or state, there is a potential for challenges to the payment obligation.

These risks are magnified with a billion-dollar project such as MAPP. An incentive ROE and ratemaking treatments such as CWIP in rate base help to counter this ongoing risk and thus send the correct message to transmission owners and constructors and the investors who supply the capital to build transmission.

As Moody's noted:

> … Moody's questions the common belief that T&D utilities maintain a materially lower business risk profile than their integrated peers. In our opinion, T&D utilities that maintain an obligation to service consumers may increasingly find themselves facing steep price increases for purchased power and potentially, increased risks for timely recovery of these higher costs when the magnitude of rate increases exceeds ratepayer tolerance. Moody's Corporate Finance, Industry Outlook, January 2008, p. 4

For several years, commissions and the industry have expressed concern that very little transmission infrastructure was being built, even given dire predictions that the grid was on the verge of collapse because it was not built for interregional delivery of bulk power. Congress and FERC itself have struggled with the appropriate and balanced way, in the ratemaking context and with reasonable limitations, to encourage transmission investment.

The mid-Atlantic region has rising electricity needs, limited generation resources, and steadily declining west-to-east transfer capability. The MAPP project—exceptional in size, financial commitment, and potential public benefit--is a direct response to the call to action in one of the nation's two DOE designated National Interest Electric Corridors.

Q. DESCRIBE HOW THE INCENTIVES REQUESTED ARE TAILORED TO THE RISKS FACED.

A. PHI's evaluation of the nexus of the incentives requested and the risks and challenges faced considers the magnitude of PHI's investment, the specific risks and challenges inherent in the MAPP project; and the Commission's previous orders granting a number of incentives to other utilities in PJM and elsewhere that have committed to invest in transmission infrastructure.

- An incentive ROE will help ensure that the PHI Companies' credit metrics remain stable, allowing the companies to finance their aggressive, PJM-directed transmission investment program at reasonable cost—a benefit not only to investors, but to ratepayers as well. An incentive adder will also be beneficial in attracting external investors who compare returns on investment in PHI to returns offered by competing utilities and other investment alternatives and their cost recovery mechanisms and returns on equity, and select those investments that produce stable returns.
- 100% CWIP in rate base also will help to ensure that the PHI companies' credit metrics remain stable and that cash flow needs are addressed, thus reducing borrowing needs. CWIP in rate base produces steady and timelier cash flow, which is the single most critical factor in the determination of credit ratings. CWIP in rate base provides more timely cash flow during the critical construction period, the time when cash is most needed. CWIP in rate base also provides the added benefit of reducing depreciation expense, a clear benefit to ratepayers. We are asking the Commission for permission to include CWIP in rate base as a component of our incentives package primarily because we will need the higher, more timely cash flow that it provides in order to help finance MAPP construction costs.
- Recovery of prudently incurred costs in case of abandonment provides certainty of cost recovery to investors and consumers alike during these uncertain times, especially for a large-scale, high-risk project such as MAPP.

Though an incentive ROE and CWIP in rate base provide some similar benefits, both are critically needed and complement one another in achieving the goals we are all seeking, of providing higher, timelier cash flow to help finance the project, and of increasing the rate of return for investors to attract the funds needed in the midst of the intense competition for funds in the market today. The construction time is long—five to six years—and the level of investment significant. As stated earlier, MAPP will effectively double the companies' transmission rate base. CWIP in rate base will not only increase cash flow, but also reduce interest expense and thus help PHI in obtaining financing for MAPP. Furthermore and as noted earlier, investors compare investment opportunities and those with the most attractive returns garner funds more efficiently. It is essential for the companies to be able to compete effectively and on a level playing field in the capital markets.

PHI relied on the framework that Congress and the Commission established with Section 219 of the Federal Power Act and Orders 679, -A, and -B to encourage construction of major interstate transmission projects. The Commission's policy was a major factor in the decision to propose the MAPP project., and we are encouraged by the Commission's positive and stable policy consensus.

In an April 17, 2008, press release announcing approval of two incentive requests, Chairman Kelliher and Commission Spitzer said:

> "These two proposals are exceptional in size, financial commitment and potential benefits for consumers," FERC Chairman Joseph T. Kelliher said. "The actions we take today will help reduce congestion and ensure reliability in two regions of the country with rising electric power needs and limited transmission resources to efficiently deliver the power to customers."

> Commissioner Marc Spitzer agreed. "These orders show we are prepared to exercise the authority Congress granted to FERC in the Energy Policy Act of 2005 to encourage greater investment in the power grid," he said. "Our policies are making a difference – major backbone transmission projects are being proposed and built throughout our nation."

Commissioner Moeller has demonstrated through his support of Orders granting favorable rate treatments for projects similar to the MAPP Project and in public presentations that he wants to encourage transmission infrastructure and that incentives such as the ones we are seeking in this proceeding are appropriate.

Both Commissioners Kelly and Wellinghoff have expressed similar sentiments regarding the PATH project, a long-line, high-voltage, multi-state transmission project similar to the MAPP Project. Incentive rates for what is now the PATH Project originally were approved in separate declaratory orders granted to Allegheny and AEP for their respective portions of the line, and in her concurrence to the order upholding the declaratory order granted to Allegheny, Commissioner Kelly called the Allegheny portion of the line an "excellent transmission project, which will benefit a large proportion of the American public by greatly enhancing reliability and by improving the competitive markets for generation on which the public depends." *Allegheny Energy, Inc.*, 118 FERC ¶ 61,042 at 61,223 (2007). Commissioner Kelly also stated that incentive rates for the project were justified by a number of factors, including the "'length, scope, and multi-state nature' of the proposed project" and the "'enormous' $820 million cost estimate" for the project. *Id.* at 61,224.

Similarly, in his statement dissenting in part from the subsequent FPA Section 205 order granting incentive rates to the PATH Project, Commissioner Wellinghoff, explaining his conclusion that PATH Project qualifies for an incentive ROE adder, stated

that the project "involves multiple entities and jurisdictions and . . . will relieve transmission constraints along a critical corridor." *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188 (2008). Commissioner Wellinghoff stated further that "the PATH project is a non-routine investment worthy of an incentive ROE adder because it will use advanced technologies that will increase efficiency, enhance grid operations and reliability, and result in greater grid flexibility, thus benefiting all users of the grid and ultimate consumers." *Id.*

As I have noted, in determining to proceed with the MAPP Project, we considered as significant the Commission's strong policy in favor of major new transmission projects and the rate treatments, including higher returns on equity, necessary to finance these projects. Influencing our thinking was the fact that the MAPP Project has the characteristics and provides the benefits that the Commission has been calling upon industry to champion.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

UNITED STATES OF AMERICA

BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

Pepco Holdings, Inc.,	)	
Potomac Electric Power Company,	)	**Docket No. ER08-___-000**
Delmarva Power & Light Company and	)	
Atlantic City Electric Company	)	

Washington, District of Columbia

Anthony J. Kamerick, being first duly sworn, deposes and states that he is the affiant referred to in the document entitled "Testimony of Anthony J. Kamerick," and that the statements set forth therein are true and correct to the best of his knowledge, information and belief in this proceeding.

Anthony J. Kamerick

Subscribed and sworn to before me, the undersigned notary public,
this 15th day of August 2008.

Notary Public

My Commission Expires: January 1, 2010

Linda J. Epperly
Notary Public, District of Columbia
My Commission Expires Jan.1, 2010

Exhibit PHI-22

Educational History and Qualifications of

Anthony J. Kamerick

Statement of Educational and Occupational
History and Qualifications

Anthony J. Kamerick
Vice President and Treasurer

Mr. Kamerick graduated from the University of Maryland in 1970, receiving the degree of Bachelor of Science in Accounting. In 1976, he graduated from the George Washington University, receiving the degree of Master of Business Administration with a major in Finance and Investments. He also successfully completed the University of Michigan's Public Utility Executive Program.

Mr. Kamerick was first employed by Potomac Electric Power Company (Pepco) in 1970, and has served in various positions of increasing responsibility, including Manager – Revenue Requirements and Director – Budgets and Financial Planning, prior to being elected Assistant Treasurer of Pepco in 1982 and Assistant Comptroller in 1983. From 1985 through February, 1988 Mr. Kamerick served as Treasurer of Pepco's then-principal subsidiary, Potomac Capital Investment Corporation (PCI), being elected Vice President – Treasurer of PCI in September 1986. In March 1988, he was reassigned to Pepco and was elected Assistant Comptroller, and then elected Comptroller of Pepco in April 1992. In May 1994 Mr. Kamerick was elected Vice President and Treasurer of Pepco. Following Pepco's merger with Conectiv, and the formation of Pepco Holdings, Inc (PHI) as the parent of Pepco and Conectiv in August 2002, Mr. Kamerick was elected to the additional position of Vice President and Treasurer of PHI.

In his current position, Mr. Kamerick is responsible for bank relations, cash management and short and long term financing activities for PHI and its utility subsidiaries, Pepco, Delmarva Power and Light and Atlantic City Electric. He is also

responsible for PHI's investor relations, shareholder services, corporate insurance, and pension investment administration.

In 2005, Mr. Kamerick was also given oversight responsibility for PHI's Regulatory Affairs group, which represents PHI's regulated subsidiary companies' positions on financial matters before its various regulatory bodies. He has testified before the Maryland Public Service Commission, the Public Service Commission of the District of Columbia and the New Jersey Board of Public Utilities. He has also appeared before the Maryland and Delaware legislatures on matters concerning the Company's finances and rates.

He is a member of District of Columbia Chapter of Financial Executives International and is a past President of the Chapter and Board member. He is a member of the National Association of Rate of Return Analysts and the Counsel of Corporate Treasurers. He is a former member of the Edison Electric Institute Accounting Research Committee and the Budget and Financial Forecasting Committee. He serves on the Board of Directors of Montgomery Alliance for Community Giving and has also served on the Board of Directors of the Community Services for Autistic Adults and Children.

Exhibit PHI-23

Cash Flow Analysis

Exhibit PHI-23

PHI Power Delivery

Example of Effect on FFO/Debt Ratio of Alternative Recoveries of Capital Investment
Exclusion of CWIP from Rate Base with AFUDC Accounting Vs. Inclusion of CWIP in Rate Base

	Actual	Proforma			
	2007	2008	2009	2010	2011
	(Thousands of Dollars)				
AFUDC Method:					
FFO *	$ 570,600 [1]	$ 570,600	$ 569,592	$ 563,112	$ 575,616
Total Debt	3,552,377 [1]	3,580,377	3,760,385	4,008,873	4,276,857
FFO / Total Debt	16.1 [1]	15.9	15.1	14.0	13.5
CWIP in Rate Base Method:					
FFO *	$ 570,600 [1]	$ 572,513	$ 585,736	$ 608,717	$ 639,699
Total Debt	3,552,377 [1]	3,578,464	3,742,328	3,945,211	4,149,112
FFO / Total Debt	16.1 [1]	16.0	15.7	15.4	15.4

[1] Moody's Financial Metrics for Potomac Electric Power Company, Delmarva Power & Light and Atlantic City Electric Company (Key Indicator Reports as of 12/31/2007).

* FFO is also referred to as CFO pre-W/C in Moody's Global Regulated Utilities Rating Methodology.