

David E. Ralph
General Counsel



bgeSM

AN EXELON COMPANY

BGE Legal Department
2 Center Plaza, 14th Floor
110 West Fayette Street
Baltimore, Maryland 21201

667-313-3430
443-213-3206 Fax

david.ralph@bge.com

November 30, 2023

Via Electronic Filing

Andrew S. Johnston, Executive Secretary
Public Service Commission of Maryland
William Donald Schaefer Tower, 16th Floor
6 St. Paul Street
Baltimore, Maryland 21202-6806

**Re: Case No. 9692
Baltimore Gas and Electric Company's Response to Order No. 90915**

Dear Mr. Johnston:

While Baltimore Gas and Electric Company ("BGE" or the "Company") strongly disagrees with the Commission's recent order to require the public disclosure of a confidential and privileged BGE internal accounting analysis memo, the Company will comply with the Commission's mandate to release the memo outside of the MYP proceeding. Attached to this letter is a full, un-redacted copy of the accounting memo, with the exception of the author and recipient.¹ As stated by BGE previously, this memo merely provides support for BGE's position regarding benefits to our customers.

Far from seeking to "hide" information, BGE strongly favors transparent exchanges of information between parties and the Commission. As the Commission knows, the confidential accounting memo at issue was voluntarily provided *by BGE* to the Commission and to all parties to this case, including to the Office of People's Counsel ("OPC"), months ago. BGE provided the memo as evidence supporting the fact that the amended conduit agreement between BGE and Baltimore City will save BGE customers \$57 million over the next three years, while allowing BGE to *increase* the investments to improve Baltimore City's conduit system. Moreover, in public hearings, BGE's witnesses were made available for multiple days of cross-examination on the issues raised in the memo.

¹ The internal accounting memo *is* itself the confidential commercial information. In Maryland there is a statute mandating that "[c]lient communications to accountants are privileged." *Sears, Roebuck & Co. v. Gussin*, 350 Md. 552, 562 (1998). The purpose of Maryland's "accountant-client privilege is to encourage free and open communication between the accountant and the client." *Id.* Nothing in the law limits the privilege to communications by externally employed accountants. Rather, it applies to any accounting communications and advice by a licensed accountant or their employees to the client that employs them (in this case, the Company). *See*, CJP 9-110(b)(1) and (2).

There is nothing nefarious or controversial in the memo. The memo is a routine professional accounting analysis that any responsible company undertakes to ensure it is properly accounting for costs under Generally Accepted Accounting Principles. The memo addresses how BGE should account for the money paid to Baltimore City and the \$120 million of capital commitments made by BGE in Baltimore City's conduit system. The Company's accountants determined, and BGE's independent auditor (PricewaterhouseCoopers) confirmed, it is appropriate to capitalize the investments because, while BGE does not own the conduit system, BGE has been granted perpetual access to rights of way by the State of Maryland to distribute electricity in the City. Because of BGE's perpetual access rights, BGE's customers will benefit from these modernization investments over the life of the assets, as opposed to over the life of the agreement term. Pursuant to general accounting principles, investments of this type should be recovered over the life of the assets.

BGE notes that OPC had every opportunity *during this case* to use this accounting memo in its advocacy with the Commission, and even quoted the memo in its post-hearing brief. Not even OPC's *own* accounting expert challenged the conclusions in the memo. After failing to dispute the merits of the analysis in the memo with its own accounting expert, and only after the case was already closed, OPC then turned to the media where it made statements suggesting that the Company acted improperly by objecting to the public disclosure of a confidential internal memo. Conveniently, OPC failed to acknowledge that the memo had been provided to OPC and to the Commission *with their understanding and with their agreement that the memo would be used only for the MYP proceeding and would remain confidential.*²

It is normal practice for public utilities to provide confidential information to the Commission, its Staff, and OPC with their understanding that it will only be used for Commission proceedings. BGE's opposition to OPC's request to make the confidential accounting memo public was based on a core principle that has previously governed Commission proceedings. In fact, the core principle is codified into the Public Utilities Article by *requiring* the Commissioners, Staff, and OPC to refrain from divulging confidential information learned during the course of Commission proceedings. *See* PUA § 2-309. In the past, the Commission routinely issued orders in rate cases that relied on confidential utility information without later mandating that such underlying confidential information be made publicly available. Going forward, all parties must now consider whether confidential information provided will later become subject to public disclosure.

While BGE disagrees with the decision of the Commission to require a confidential memo to later be made public, BGE releases the memo in compliance with the Commission mandate without redaction which supports BGE's investments to improve the Baltimore City conduit system while lowering the customer bill impacts of those needed investments.

² Just like in nearly every Commission proceeding, OPC signed a Protective Agreement in this case in which the Company and OPC agreed that OPC could use the Company's confidential information for the purposes of use in the case, which OPC did without any complaint.

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Pursuant to the Commission's July 12, 2021, Notice of Waiver and Relaxed Filing Requirements, the Company will not provide paper copies of this filing.

Respectfully Submitted,

David E. Ralph

David E. Ralph

DER/jaw

PUBLIC
COMPANY EXHIBIT
DMV-11

MEMORANDUM**Date:** March 31, 2023**To:** [REDACTED]**From:** [REDACTED], Accounting Manager, Accounting Policy and Research
[REDACTED], Accounting Director, BGE Accounting**Subject:** Baltimore City Conduit Lease**Reference(s):** *Amendment to Settlement Agreement, February 15, 2023***Background:**

BGE is the successor entity to an 1881 franchise that gives BGE the right to install electrical lines in Baltimore City (the "City") in perpetuity. The original franchise had no reference to lease cost, so starting in 1903, the City entered into an agreement with BGE for building and occupancy of conduit at a rate of 7 cents per duct foot per annum. The city and BGE made subsequent agreements in 1931, 1934, 1936, 1939, 1957, 1982, 2004, 2008, 2014, and 2016 to determine the rate that BGE would pay the City for use of the conduit. These agreements have granted BGE with the right to access, occupy, and use the City owned underground municipal conduit system for installation and/or placement of inner ducts, cable, transformers, switchgear, communication lines, and other equipment and materials related to BGE's business. The City has historically charged BGE an annual fiscal year conduit rental fee for its use of the conduit system equal to BGE's pro-rata share, based upon occupied space, of the City's actual costs for maintaining the conduit system.

The last agreement executed in 2016 expired June 30, 2022 and BGE has been accruing an expense and a liability each month equal to the monthly conduit rental fee as calculated per the 2016 agreement. As of January 31, 2023, BGE has accrued \$14 million for its usage of the conduit system since the expiration of the 2016 agreement.

On January 30, 2023, BGE and the City entered into an Amendment to the 2016 Settlement Agreement ("2023 Agreement"). The agreement became effective on February 15, 2023, when the Board of Estimates of Baltimore City approved the contract. Under the 2023 Agreement, BGE is responsible for capital improvements and the City is responsible for maintenance of the conduit system. The 2023 Agreement has the following key terms:

- The initial term is February 15, 2023 through December 31, 2026
- Capital Improvements
 - o BGE is responsible for capital improvements up to \$120 million over the initial term of the 2023 Agreement
 - o Any amounts not expended by BGE must be paid to the City as an additional maintenance payment
 - o BGE and the City shall work in good faith to prioritize and define the scope of work. However, BGE has the authority to decide which projects will be pursued.
 - o All projects undertaken are intended to improve the safety, efficiency and reliability for all users of the conduit system. However, BGE occupies space

- throughout the entire system and therefore any improvements will help improve the safety, efficiency, and reliability of BGE's electric distribution system.
- The City may undertake additional capital improvements in its discretion
 - Maintenance
 - BGE pays the City \$14 million for the period January 1 through December 31, 2023 and \$1.5 million for each of the remaining three years in the agreement
 - The City is responsible for performing maintenance
 - The maintenance to be performed is determined solely by the City, but will consider any reasonable requests by BGE
 - BGE has the ability to perform emergency repairs
 - Renewal Term
 - There is one automatic renewal for an additional three years. BGE and the City have the ability to opt out of the renewal 180 days prior to the expiration of the initial term
 - If renewed, the capital improvements for the three years will be up to \$92 million and the maintenance payment will be \$1.5 million per year
 - BGE is required to pay the rental fee for its usage of the conduit system during July 1, 2022 through December 31, 2022 based on the old rates in the 2016 Settlement Agreement for a total of \$14 million

Accounting Issues:

1. *Does the 2023 Agreement meet the definition of a lease?*
2. *If the 2023 Agreement meets the definition of a lease, what is the lease classification?*
3. *How should the right-of-use asset and lease liability be measured?*
 - a) *Should the renewal terms in the 2023 Agreement be included in the lease measurement calculation?*
 - b) *What payments in the 2023 Agreement are considered fixed payments?*
4. *What expenditures related to the capital improvements commitment qualify as capital improvements?*
5. *How should expenditures be accounted for that aren't considered a capital improvement?*

Conclusion/Basis for Conclusion:

1. *Does the 2023 Agreement meet the definition of a lease?*

Per ASC 842-10-15-3, a contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration...

Does the 2023 Agreement depend upon the use of an identified asset?

Per ASC 842-10-5-9, an asset typically is identified by being explicitly specified in a contract. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the customer.

The conduit system is stated in the contract, but BGE only occupies approximately 75% – 80% of the conduit system and the specifics of BGE’s portion of the conduit system is not specified in the contract. However, BGE’s portion is an implicitly identified asset since it is physically distinct from the rest of the conduit system and BGE would have no need to access the other portions of the conduit system. BGE’s portion is considered physically distinct as nothing else can be placed in or near that portion of the conduit occupied by BGE’s equipment and physical access to BGE’s portion of the conduit is not allowed without BGE’s permission. Additionally, due to the unique nature of the conduit system, the City does not have the ability to substitute a different asset to fulfill the requirements of the contract. Based on these facts, the 2023 Agreement contains an implicitly identified asset.

Per ASC 842-10-15-4, *to determine whether a contract conveys the right to control the use of an identified asset (see paragraphs 842-10-15-17 through 15-26) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:*

- a) *The right to obtain substantially all of the economic benefits from use of the identified asset (see paragraphs 842-10-15-17 through 15-19)*
- b) *The right to direct the use of the identified asset (see paragraphs 842-10-15-20 through 15-26).*

If the customer in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

Condition A - The right to obtain substantially all of the economic benefits

BGE receives 100% of the economic benefits from BGE’s portion of the conduit system. As such, Condition A is met.

Condition B - The right to direct the use of the identified asset

BGE controls physical access to and the right to direct the use of the portion of the conduit system containing BGE’s equipment per the 2023 Agreement and the perpetual right of way granted by the State of Maryland. As such, Condition B is met.

Conclusion:

As noted above, the 2023 Agreement contains an identified asset and BGE has the right to obtain substantially all of the economic benefits and the right to direct the use of the identified asset. Additionally, the lessor does not have substitution rights and BGE did not design the asset in a way a way that predetermines how and for what purpose the asset will be used throughout the period of use (ASC 842-10-15-26). Based on these facts, the 2023 Agreement meets the definition of a lease.

2. *If the 2023 Agreement meets the definition of a lease, what is the lease classification?*

Per ASC 842-10-25-2, if any of the following criteria are met, the lease is classified as a finance lease:

- a) *The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.*

Condition Not Met – There is no transfer of ownership of the conduit system at the end of the contract term.

- b) *The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.*

Condition Not Met – There is no option to purchase the conduit system.

- c) *The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion shall not be used for purposes of classifying the lease.*

Condition Not Met – The lease term is for only four years (see further discussion in Issue 3a below). The economic life of the conduit system is indefinite. For as long as customers are expected to have a need to consume power from the electricity grid in the City and other parts of BGE's service territory, BGE expects that the conduit system will be maintained. Barring a catastrophic event, we are highly confident that the economic life of the conduit is long enough that the lease term is well below 75%.

- d) *The present value of the sum of the lease payments and any residual value guaranteed by the lessee that is not already reflected in the lease payments in accordance with paragraph 842-10-30-5(f) equals or exceeds substantially all of the fair value of the underlying asset.*

Condition Not Met – As noted in Condition C above, the lease term is for only four years and the economic life of the conduit system is indefinite and the City will continue to maintain it. Barring a catastrophic event, we are highly confident that the present value of the lease payments does not equal or exceed substantially all (90%) of the fair value of the conduit system.

- e) *The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.*

Condition Not Met – The City will continue to benefit from this asset even after the end of the lease term likely through another agreement with BGE, which implies the City's investment in the conduit system is not being recovered through the 2023 Agreement. It is expected that BGE will indefinitely occupy and control the electric conduit, but the City will still use this asset. It could be argued that the asset is specialized in nature due to the fact that BGE must operate and occupy most of the conduit to distribute electricity. However, if BGE would no longer occupy the conduit system, the City could use the space that BGE had occupied for other uses. Therefore, we view this criteria as not being met.

Conclusion:

As noted above, the 2023 Agreement does not meet any of the finance lease criteria and will be recorded as an operating lease. Furthermore, this arrangement does not meet the spirit of a finance lease because the City did not price the recovery of its investment into the lease payments. A typical finance lease structure recovers the lessor's investment during the term of the lease. In this case, the City and BGE will continue to enter into future agreements with future lease payments, which indicates the City did not fully recover its investment. Even if BGE classified this as a finance lease, the difference between the accounting as an operating lease versus a finance lease would be immaterial because BGE

would elect to record the lease as an operating lease in accordance with ASC 980-842-45. Per ASC 980-842-45-3:

The nature of the expense elements related to a finance lease (amortization of the right-of-use asset and interest on the lease liability) is not changed by the regulator's action; however, the timing of expense recognition related to the lease would be modified to conform to the rate treatment. Thus, amortization of the right-of-use asset shall be modified so that the total of interest on the lease liability and amortization of the right-of-use asset shall equal the lease expense that was allowed for rate-making purposes. For newly completed plants such regulatory treatment could result in a phase-in plan as defined in Subtopic 980-340.

3. *How should the right-of-use asset and lease liability be measured?*
 - a) *Should the renewal terms in the 2023 Agreement be included in the lease measurement calculation?*

ASC 842 Leases requires lessees to record a right-of-use (ROU) asset and a lease liability for all leases at lease commencement. The lease liability is equal to the present value of the remaining lease payments over the lease term. Per ASC 842-10-30-1, the lease term includes the following:

- a. *Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option*
- b. *Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option*
- c. *Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.*

Per the 2023 Agreement, there is no option to terminate the lease, but there is an automatic renewal for three years. However, both BGE and the City have the ability to elect not to renew with notice at least 180 days prior to the end of the original four-year term.

Per Exelon policy, reasonably certain is defined as a 75% likelihood. BGE notes the following:

- BGE is certain that they will continue to use the conduit system indefinitely, however, it may not be under these terms
- The 2023 Agreement includes a new structure in which BGE is directly responsible for the conduit system capital improvements and could be considered a “test case” agreement. As such, there is a good chance that the City may want to change this new structure and not extend the agreement under the current terms.
- There is a possibility that if the City likes this new structure, the City could decide to sell the conduit system to BGE in the future. (Note: For this scenario to be a possibility, it would require another ballot initiative to reverse the rule that currently prohibits the City from selling the conduit system to any counterparty.)

Conclusion:

Based on the above, the renewal term is not reasonably certain of exercise and should be excluded from the lease classification assessment and the measurement of the lease liability and ROU asset.

b) What payments in the 2023 Agreement are considered fixed payments?

As noted above, the lease liability is equal to the present value of the remaining lease payments over the lease term. Per ASC 842-10-30-5, lease payments include fixed payments, including in substance fixed payments. The 2023 Agreement includes a payment of \$14 million in the first year and payments of \$1.5 million for each of the three remaining years of the term for a total of \$18.5 million over the term. These payments are considered fixed payments and are included in the measurement of the lease liability and ROU asset at contract inception.

The 2023 Agreement also requires BGE to make capital improvements to the conduit system for up to \$120 million over the initial term of the 2023 Agreement and any amounts not expended by BGE must be paid to the City as an additional maintenance payment. BGE expects that the majority of the capital improvements commitment would qualify and be capitalized as a fixed asset by BGE (see further discussion in Issues 4 and 5 below). Per PwC's Leases guide, dated January 2023, 3.3.4.1, *payments for lessee assets should be excluded from lease payments when evaluating lease classification and measuring the ROU asset and lease liability*. Furthermore, since the \$120 million of capital improvements are not expected to be paid to the City (i.e. the Lessor), but instead to other vendors, we do not consider these to be in-substance fixed lease payments.

While BGE expects that majority of the capital improvements commitment would qualify and be capitalized as a fixed asset, a portion of this amount will not be capitalizable and, therefore, expensed. The classification of these costs as capital versus expense is not determinable or estimable at this time because it is dependent upon the specific projects that are completed over the term of the lease and the specific projects to satisfy the capital improvement commitment have not been decided.

Conclusion:

The capital improvement commitment of up to \$120 million is excluded from lease payments and not included in the measurement of the lease liability and ROU asset at contract inception.

4. What expenditures related to the capital improvements commitment qualify as capital improvements?

Per ASC 360-10-05-3, *property, plant, and equipment typically consist of long-lived tangible assets used to create and distribute an entity's products and services*.

Per Concept Statement 8, Chapter 4, E16 - E17:

An asset is a present right of an entity to an economic benefit.

An asset has the following two essential characteristics:

a. It is a present right

b. The right is to an economic benefit

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled.

The conduit system is critical to BGE's electric distribution system infrastructure. BGE is the only entity that can use the electric conduit and access to BGE's equipment is restricted. While BGE does not own the conduit system, BGE has been granted perpetual access to rights of way by the State of Maryland in order to distribute safe and reliable electricity, which is a present right. BGE occupies space throughout the conduit system and any improvements it undertakes during the lease term will be essential to improve the safety, efficiency, and reliability of BGE's electric distribution system. Therefore, these expenditures provide a future economic benefit to BGE and its ratepayers. Additionally, because of the perpetual rights of way, BGE cannot be kicked out of the conduit system and will continue to benefit from any improvements over the economic life of the asset regardless of what agreement is in place with the City in the future.

There may be some expenditures that also benefit other tenants of the conduit system. However, to ensure the safe and reliable delivery of electricity, these improvements are necessary and primarily benefit BGE. Additionally, any capital improvements made to the conduit system that benefit BGE would have to be made whether another entity occupied it or not. Therefore, these expenditures also directly provide a future economic benefit to BGE and its ratepayers. However, if BGE makes capital improvements to the conduit system which are deemed to not benefit BGE (e.g. because BGE does not occupy any space in the related area), then this would not be capitalized (see further discussion in Issue 5 below).

BGE does not hold title to the additions and modifications to the conduit system under the terms of the 2023 Agreement. However, since the conduit system is critical to BGE's infrastructure, BGE expects to receive approval for the capital improvements spend in the 2023 Agreement in our next MYP filing that was submitted in February 2023.

BGE does not consider the capital improvements commitment to be leasehold improvements. Instead, these are fixed assets of BGE because they are required to be incurred to deliver safe and reliable electricity in the City and in the State of Maryland. Furthermore, BGE's perpetual right of way access and its ability to include these expenditures in rate base is what gives BGE the future economic benefit of these improvements.

In conjunction with assessing what could be capitalized, BGE also considered if a liability should be recorded up front for the \$120 million capital improvements. Concept Statement 8 states that *a liability is a present obligation of an entity to transfer an economic benefit.*

BGE expects that the entire \$120 million capital improvement commitment will either be paid to third party vendors or contractors (i.e. not to the City) and/or spent on internal BGE resources. Therefore, a present obligation does not exist until services have been rendered and/or assets have been acquired. Furthermore, BGE expects to capitalize most of the \$120 million, and therefore, is unable to determine how much will end up being expensed until the work is performed over the term of the agreement. Therefore, it is not appropriate to record an upfront liability for the \$120 million.

Conclusion:

Consistent with Exelon's Capitalization Policy, BGE will capitalize only the costs under the capital improvements commitment that provide future economic benefits to BGE. As discussed above, the capital improvements are necessary for BGE to safely, efficiently, and reliability distribute electricity, which provides BGE with a future economic benefit. BGE has a perpetual right of way access to the conduit system and has the ability to restrict access. The costs that are capitalized are not leasehold improvements and will therefore, be depreciated over the economic life of the asset and not the term of the lease.

5. How should expenditures be accounted for that aren't considered a capital improvement?

As noted above, BGE expects that the majority of the capital improvements commitment would qualify and be capitalized as a fixed asset. However, there will be a portion of the commitment that is not capitalizable and, therefore, expensed. These costs will either not meet the criteria for capital and/or will be a project that does not have any benefit to BGE.

The amount that is expensed will depend on the projects that are completed, which are not known at this time. Additionally, if BGE does not spend the full \$120 million capital commitment over the four-year term, BGE is required to pay the difference to the City as a maintenance payment and any such payments would be expensed. Since the amount that will be expensed is not determinable at contract inception, these costs are considered variable lease payments.

Conclusion:

Any capital improvement commitment cost that is not capitalized will be recorded as a variable lease payment.

Tax Implications:

For income tax purposes, BGE will depreciate the capital improvements and the operating lease / maintenance costs will be deducted when expensed for financial statement purposes. The accelerated tax depreciation will give rise to a deferred tax liability that is includible in rate base to the extent the underlying net plant basis is includible in rate base.

Financial Statement Presentation and Disclosure:

Balance sheet:

- The ROU asset is included in Other deferred debits and other assets and the lease liability is included in Other deferred credits and other liabilities
- Costs that are capitalized are included in PP&E

Income statement:

- Fixed and variable lease payments are included in Operating and maintenance expense

Statement of Cash Flows:

- Recording the ROU asset and lease liabilities represent a non-cash balance sheet adjustment
- Cash payments are classified in the Operating section of the cash flow statement

Required footnote disclosure:

- Lease Footnote
 - o Include annual fixed and variable lease expense
 - o Include future fixed payments for each of the next four years, undiscounted
- MD&A – Liquidity and Capital Resources
 - o Within the Cash Requirements for Other Financial Commitments table, include the future fixed lease payments in the Operating leases line and the remaining capital improvements commitment in the Other purchase obligations line

Form 8-K disclosure:

- There are no Form 8-K requirements stemming from this transaction.

Accounting Policy Impacts:

None of the conclusions reached within this memorandum represent changes to our existing accounting policies or require the establishment of a new policy.

FERC Implications:

Exelon does not include operating leases on the FERC balance sheet. FERC financial statements are manually adjusted monthly to exclude the ROU asset and lease liability and to include prepaid rent assets and deferred rent liabilities.

Attachments:



Amendment_to_Settlement_Agreement

Old Terracotta Pictures



New PVC Pictures

