STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company, )
) Docket No. 10-0467
)
Proposed general increase in electric rates )

REPLY BRIEF OF THE NATURAL RESOURCES DEFENSE COUNCIL

Pursuant to the schedule established in this proceeding, the Natural Resources Defense Council (“NRDC”), through its attorneys, Rowland & Moore LLP, files this Reply Brief in this Commonwealth Edison Company’s (“ComEd”) general rate increase proceeding.

INTRODUCTION

In its initial brief, NRDC showed the State of Illinois should remove the link between ComEd’s financial health and the amount of electricity consumed by its customers. “Decoupling” ComEd’s recovery of its revenue requirement from its customers’ electric consumption will remove the current disincentive that utilities have from investing in energy efficiency and becoming involved in activities that could lead to greater energy efficiency. NRDC also showed that its proposal was in this respect, far superior to ComEd’s proposed Rider SFV, which would raise fixed charges so high that customers would be discouraged from investing in energy efficiency. NRDC believes its Initial Brief adequately addressed this defect with Rider SFV and will not repeat those arguments here.
NRDC notes that ComEd does not provide any argument against NRDC’s decoupling proposal. On the contrary, the Company merely stated that it believes that its proposed Rider SFV “is a superior solution” but that if the Commission approved NRDC’s decoupling proposal, it could do so with the tariff ComEd had introduced into evidence during the proceeding. (ComEd Brief at 139). As NRDC indicated in its Initial Brief, subject to NRDC’s belief that there should be a cap on any refunds or surcharges and over- or under-collection should be refunded on a kWh basis, ComEd’s proposed tariff is an acceptable codification of its proposal. (NRDC Initial Brief at 7-8).

I. THE COMMISSION SHOULD NOT DEFER A DECISION ON DECOUPLING

The Commission Staff argued that the Commission should not consider decoupling in this proceeding because it has just started an experiment in decoupling with Peoples Gas Company and North Shore Gas Company. The Staff argues that the Commission should not consider another decoupling proposal until after the four year period of that experiment is completed and the Commission conducts a “complete assessment/evaluation” of that program. (Staff Brief at 128). NRDC already addressed this issue in its initial brief (NRDC Initial Brief at 16-17). Briefly, due to the numerous differences between gas and electric utilities, little will be gained by waiting until the completion of the assessment and evaluation of the Peoples’ experiment contemplated by the Staff; the Commission will merely be giving up the opportunity to gain experience with decoupling in the electric industry.

Along the same lines, ELPC argues that the experience to date under the People’s Gas decoupling pilot “raises questions that we should answer before allowing ComEd to decouple.” (ELPC Brief at 27). In reality, the experience to date under the People’s pilot shows two things
very clearly. First, the large refunds to customers made under the People’s decoupling pilot show very clearly that if sales are higher than projections due to weather factors, decoupling will protect consumers from paying more than the utility’s authorized revenue requirement, while current ratemaking policy would allow the utility to simply keep those earnings. Second, it shows that decoupling is one factor among many that affect utility energy efficiency spending. People’s Gas new three year energy efficiency plan was filed in response to a state law that set minimum savings goals for the first years at levels lower than were already being achieved by People’s. This factor, along with uncertainty about whether the decoupling pilot would be made permanent, could very well have resulted in a decision to reduce energy efficiency program budgets.

II. THE ARGUMENTS AGAINST DECOUPLING ARE ALMOST ENTIRELY A PRODUCT OF AN INCORRECT UNDERSTANDING OF THE PROPOSAL.

The balance of this reply brief will address the arguments set forth in the briefs of several parties that opposed decoupling. The Illinois Attorney General (“AG”), the Citizens Utility Board (“CUB”), the American Association of Retired Persons (“AARP”) and the Environmental Law and Policy Center (“ELPC”) all provide arguments why NRDC’s decoupling proposal should be rejected. Those arguments, to a large extent, reflect a misunderstanding of the proposal. This brief will attempt to clear up some of those misunderstandings.


CUB, ELPC and the Attorney General\(^1\) all argue that the NRDC decoupling proposal violates the prohibition against single issue ratemaking and/or is an improper rider in violation of

\(^1\) CUB Brief at 78; ELPC Brief at 23-24; AG Brief at 142-144.
the Illinois Appellate Court decision in *Commonwealth Edison Co. v ICC.*² None of their arguments are valid. As NRDC explained in its Initial Brief, its decoupling proposal does not violate the prohibition against single issue ratemaking because it does not change any portion of a utility’s revenue requirement in isolation. Instead, it merely measures actual utility collection of fixed costs against the fixed cost revenue requirement *authorized by the* Commission, adjusted for the number of customers, eliminating the incentive for a utility to increase its sales between rate cases in the affected rate classes. This difference is key, because, as articulated in *Commonwealth Edison Co.*, “The rule against single issue ratemaking makes it improper to consider in isolation changes in a particular portion of a utility’s revenue requirement.”³ Under NRDC’s proposal, all components of ComEd’s revenue requirement are being considered in this docket and then the Commission would establish a revenue per customer figure against which refunds or charges would be made. ComEd is at risk for any of the components of its revenue requirement changing – expenses and construction costs, cost of capital, changes in number of customers under decoupling and changes in sales to customers not under decoupling – every one of these components of ComEd’s revenue requirement are outside of the decoupling proposal. Thus, regardless of how any of these items change, refunds or charges would remain the same. ComEd thus has incentive to act efficiently in every respect. The only incentive it would no longer have is to encourage customers in the affected rate classes to use more electricity.

Nor is the decoupling proposal a violation of the *Commonwealth Edison Co.*, decision in respect to the Court’s analysis of allowable riders. The Appellate Court determined in that case

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³ *Id.* 937 N.E.2d at 707; 344 Ill. Dec. 684, (emphasis added).
that there should be a two part test for riders: “(1) the cost is imposed upon the utility by an external circumstance over which the utility has no control and (2) the cost does not affect the utility's revenue requirement.” Here, NRDC is not proposing a rider to recover an isolated cost. Rather, it is proposing a rider that addresses over or under collection of Commission-authorized revenues per customer based on changes in sales compared to those projected in the rate case. As noted above, changes in ComEd’s costs will not impact the decoupling calculation, thus they not just out of ComEd’s control – they are completely irrelevant. Nor does the proposal affect ComEd’s revenue requirement. On the contrary, it takes away an incentive for ComEd to maintain sales volumes so as to over-collect its revenue requirement to the detriment of society by increasing its customer’s electric usage.

**B. Decoupling Does Not Shift Risk to Ratepayers.**

The Attorney General, CUB and AARP argue that the decoupling proposal shifts risk from ComEd to ratepayers. (AG Brief at 139; CUB Brief at 78; AARP Brief at 11). For example, according to the Attorney General,

> All business risks arising from changes in sales volumes are shifted from the utility to its customers under decoupling through the automatic rate adjustment mechanism that ensures the utility will fully recover its revenue requirement.

(AG Brief at139).

On the contrary ComEd is still subject to every risk of operations but one – the average use per customer. Even this one exception is just as likely to benefit ratepayers as it is to benefit ComEd. For example, if ComEd territory experiences hot weather that results in customers using more electricity than in the test year, then they would receive a refund. Thus, it is

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4 *Id.* 937 N.E.2d at 710; 344 Ill. Dec. 687.
completely inaccurate to claim that the proposal shifts risk to ratepayers. At most, it takes one risk – the risk of use per customer – and moderates it by allowing neither ComEd nor customers to receive benefit or harm from changes. Whether those changes are a reduction in use per customer caused by ComEd taking an active role in promoting energy efficiency or increases caused by hot weather, there is no risk being shifted. Nor is ComEd ensured of fully recovering its costs of providing reliable service: cost drivers other than sales in the affected rate classes will continue to change between rate cases. ComEd will be exposed to the same expense, revenue, construction cost and capital cost risks as every other utility.

Taking a slightly different approach, AARP argues that the decoupling proposal “would allow electric rates to be raised higher for all residential customers, on a piecemeal per customer basis.” (AARP Brief at 10). The Attorney General looks at the flip side of this coin and argues that ComEd does not need the revenues it would receive from decoupling:

NRDC has failed to provide any analysis to support the premise that ComEd has any financial need for the revenue that would be impacted by decoupling. . . Mr. Cavanagh’s testimony provides no evidence that ComEd has failed to recover its fixed costs under traditional, test-year regulation since initiating its statutory energy efficiency programs or that his concern for ComEd shareholders is even justified.

(AG Brief at 139-140).

The AARP and Attorney General’s statements represent a fundamental misunderstanding of the proposal because it is designed to be neutral, with refunds being as likely as surcharges. In fact, if the decoupling proposal had been in effect for the past two decades, customers would have received refunds rather than paid surcharges. More specifically, the average use per customer essentially doubled during that period, which would have resulted in huge refunds.
under the decoupling proposal. (NRDC Ex. 2.0, p. 20). In fact, the only decrease that the Attorney General could point to was for the period since 2005,\textsuperscript{5} which of course, coincides with the recent recession.

With the eventual economic recovery, there is no reason to believe that sales per customer will shrink absent aggressive energy efficiency measures. During the hearings in this proceeding, counsel for the People of the State of Illinois attempted to impeach Mr. Cavanagh with statements from a recent report from the Washington State Utilities and Transportation Commission issued on November 4th, 2010. One of those statements read into the record to impeach Mr. Cavanagh was as follows:

While customer use of natural gas has been declining in recent years, this does not appear to be the case for electric utilities. Our experience and understanding informs us that electric – electricity use per customer has been either steady or even increasing. . .

We attribute this trend generally to the addition of so-called plug load associated with increased consumer use of appliances and electronic devices. Such increased usage could become more pronounced in the future, should consumers shift away from automobiles powered by petroleum and toward electric vehicles.

Tr. 1469-70.

Rather than impeach the testimony of Mr. Cavanagh, this statement supports his position that customers may very well benefit from decoupling by receiving refunds for increases in energy consumption caused by the items mentioned by the Washington State Utilities and Transportation Commission.

Moreover, to the extent that surcharges are caused by ComEd successfully implementing energy efficiency measures for its customers, then customers’ bills will fall, even if there are

\textsuperscript{5} AG Brief at 144.
positive rider charges. As explained by Mr. Cavanagh, the savings from reduced consumption would far outweigh any increased charges, thus resulting in lower electric bills.

    Bills will go down. There will be a modest increase in rates, assuming a sustained reduction in per-customer electricity use. I think the most important point to make is that bills will be going down.

    Tr. 1447.

C. Decoupling Does Not Allow ComEd to Retain All Revenues From New Customers.

    One misunderstanding that is held by some of the parties in this proceeding is that NRDC’s decoupling proposal allows ComEd to retain all revenues from new customers. Thus, it would benefit from any growth that is likely as the country recovers from its recent downturn in the economy. The Attorney General’s Brief provides an example of this misconception:

    To the extent economic recovery results in adding new residential customers, the NRDC decoupling approach would simultaneously protect ComEd against declining usage “per-customer” while allowing ComEd to retain for its shareholders all new revenues associated with serving new customers.

    (AG at 140).

    Mr. Cavanagh addressed the misunderstanding of the treatment of new customers during his cross examination.

    Q . . isn't it correct that under your proposed form of revenue decoupling, those revenues gained from the new customers would be retained by the Company?

    A  I think this is a misunderstanding and that's turned up in several of the rebuttals. Our proposal is simply that not all of the revenues would be retained. There would be a revenue requirement per customer that the Company would adopt -- or that the Commission would adopt; and, yes, the Company would keep those revenues, but not all of the revenues from the new customers, only the revenue-per-customer limit adopted by the Commission.

    Tr. 1426-27.
The best way to understand the impact of ComEd experiencing a growth in customers due to a better economy is to examine the calculation underlying the refund/surcharge. Explaining that calculation, Mr. Cavanagh stated:

What you do is you count the customers every year. You count the electricity sales. So you know whether total fixed cost recovery was above or below the authorized level and you true-up. New customers are treated exactly like existing customers for this purpose.

Tr. 1428-29.

In summary, if ComEd sees an increase in customer base subsequent to the issuance of the Commission’s order in this proceeding, it will not retain every penny it earns from those customers. Instead, those customers and their electric use would become part of the calculation to determine refunds or surcharges.

D. Decoupling Will Not Affect Regulatory Lag.

AARP argues that adoption of decoupling would decrease the beneficial impact of regulatory lag: “However, NRDC’s per customer decoupling proposal would actually reduce regulatory lag, and thus weaken the incentive for cost efficiency.” (AARP Brief at 11). Again, this argument represents a misunderstanding of the proposal. NRDC’s decoupling proposal only affects ComEd’s revenues: strong financial performance (profits) will continue to be driven by ComEd’s revenues and its ability to control its costs. If ComEd forecasts sales declines, indeed the only hope for superior financial performance in the affected rate classes is cost control, as the Company under NRDC’s proposal no longer has the option of profiting from over-recovery of its costs when sales are above rate case expectations. The only item decoupling would address is electric use per customer. ComEd is at risk for changes in every other component of its revenues
and expenses and thus has an incentive to be as efficient as possible – efficiency that would flow through to ratepayers in the form of delay in new rate case filings.

E. Decoupling Does Not Necessitate a Reduction in ComEd’s Allowed Rate of Return.

The Attorney General argues that the decoupling proposal is deficient because it does not contemplate a reduction in ComEd’s allowed rate of return. (AG Brief at 145). The underlying assumption of this argument is that the proposal will reduce ComEd’s risk of earning its allowed return. Thus, the Attorney General argues: “The Commission should absolutely reject the notion that guaranteeing a utility’s last asserted revenue requirement is as an appropriate focus of regulation.” (AG Brief at 137). Along the same lines, the Attorney General argues: “Revenue decoupling is a regulatory mechanism that ensures that the utility collects its Commission-authorized revenue requirement.” (AG Brief at 139).

These statements are simply not true. The only impact of the decoupling proposal will be to moderate one element of ComEd’s revenue requirement – its per customer electric use. Every expense it incurs, every change in the markets affecting cost of capital, every change in construction costs and very simply EVERY other item impacting expenses and revenues, will affect ComEd’s ability to earn its allowed return. Nothing is guaranteed and nothing ensures that ComEd earns its allowed return.

NRDC recognizes that at some time in the future when there is more experience with decoupling, ComEd’s allowed return may be positively impacted by decoupling because it will moderate the impact of changes in sales per customer. In fact, in its next rate case, a standard analysis of allowed return on equity will capture its impact to the extent investors have reacted positively to decoupling in ComEd territory and/or for comparable companies used in a return on
equity analysis. But given the lack of data at this time, NRDC cannot recommend a specific adjustment to ComEd’s allowed return.

F. Decoupling Will Have a Positive Impact on Energy Efficiency in the ComEd Service Territory.

ELPC argues that decoupling cannot result in more efficiency in ComEd’s service territory because the company is already doing everything it can do under current law to maximize the potential for cost-effective energy savings. (ELPC Brief at 24-26). However, there is ample evidence before this Commission to conclude that there is much more ComEd could do to promote energy efficiency than is required of it under the current statutory framework in 220 ILCS 8-103.

As NRDC Witness Ralph Cavanagh testified, there exists an enormous gap between what is being achieved under these programs and what is cost-effectively possible. By 2016, ComEd could save more than 13,000 GWh of electricity at a cost of about four cents per kWh, while current programs are designed to achieve a fraction of this potential. (NRDC Ex. 2.0, p. 4). To be sure, under the current statute ComEd cannot simply increase the budgets of its current programs to capture all cost-effective potential to the benefit of its customers, but there are other ways to achieve some or all of this potential for savings. For example, ELPC and NRDC have supported allowing the Illinois Power Agency to procure energy savings instead of just supply side resources as part of its annual procurement event. Not surprisingly, ComEd has opposed this measure as it would add, potentially very significantly, to the revenue erosion it already faces. When one combines that potential savings with the savings that could result from advocacy at the state and federal level for better building codes and appliance standards or higher savings targets, assistance in implementing building codes or low-income assistance program,
and alternative financing mechanisms such as on-bill financing, it becomes evident that a
properly motivated utility in ComEd’s position could take actions that would substantially
increase the proportion of that cost effective savings potential being captured to the benefit of its
customers.

ELPC further argues that by “adjusting its test year” to incorporated projected sales
decline resulting from energy efficiency programs would eliminate the need for decoupling.
This argument entirely misses the point of decoupling. It should go without saying that in a rate
case the sales projections should incorporate existing knowledge about declining sales from all
causes, including energy efficiency programs, and the rates should be set to recover the revenue
requirement accordingly. Knowingly using unrealistic sales projections to set rates, and then
using a decoupling mechanism to recover or refund the gap between the revenue requirement and
the recovered revenue is a grave misuse of a decoupling true up. However, no matter how
accurate those projections are, the utility will benefit from higher sales than projected between
rate cases, and customers will benefit from lower sales than projected between rate cases. It
matters very little how frequently rate cases occur, what test year is used, or how accurate the
sales projections are, without decoupling the utility will have an incentive to resist doing
anything that might cause sales to be lower than projected. Decoupling makes a difference
between rate cases, not during rate cases when the test year adjustment is relevant.
CONCLUSION

For the reasons provided in NRDC’s Initial Brief and above, the Commission should reject ComEd’s proposed Rider SFV and instead approve Rider DA: Decoupling Adjustment (ComEd Ex. 46.2) with the modification of adding a 3% cap on refunds or charges, with any unrecovered balances carried forward and refunds or charges based on a per kWh basis.

Dated: February 23, 2011

Respectfully submitted,
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the Reply Brief of the Natural Resources Defense Council has been served upon the parties reported by the Clerk of the Commission as being on the service list of this docket, on the 23rd day of February, 2011, by electronic mail.

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